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

FORM 10-K

(Mark One)

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

For the fiscal year ended September 30, 2021

OR

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

Commission File Number: 001-39030

CERENCE INC.
(Exact name of Registrant as specified in its Charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**83-4177087** **(I.R.S. Employer Identification No.)**
1 Burlington Woods Drive, Suite 301A Burlington, Massachusetts **(Address of principal executive offices)**	**01803** **(Zip Code)**

Registrant's telephone number, including area code: (857) 362-7300

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common stock, par value $0.01 per share	CRNC	The Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act: **None**

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

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

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

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit such files). YES ☒ NO ☐

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

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
Emerging growth company	☐		

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

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). YES ☐ NO ☒

As of March 31, 2021, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately $3.4 billion based on the closing price of the common stock on the Nasdaq Global Select Market for such date.

The number of shares of Registrant's common stock outstanding as of November 9, 2021 was 38,538,050.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive Proxy Statement to be filed with the Securities and Exchange Commission in connection with the Registrant's 2022 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K. Such Proxy Statement will be filed within 120 days of the Registrant's fiscal year ended September 30, 2021.

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CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, or Form 10-K, filed by Cerence Inc. together with its consolidated subsidiaries, "Cerence", the "Company," "we," "us" or "our" unless the context indicates otherwise, contains "forward-looking statements" that involve risks and uncertainties. These statements can be identified by the fact that they do not relate strictly to historical or current facts, but rather are based on current expectations, estimates, assumptions and projections about our industry and our business and financial results. Forward-looking statements often include words such as "anticipates," "estimates," "expects," "projects," "forecasts," "intends," "plans," "continues," "believes," "may," "will," "goals" and words and terms of similar substance in connection with discussions of future operating or financial performance. As with any projection or forecast, forward-looking statements are inherently susceptible to uncertainty and changes in circumstances. Our actual results may vary materially from those expressed or implied in our forward-looking statements. Accordingly, undue reliance should not be placed on any forward-looking statement made by us or on our behalf. Although we believe that the forward-looking statements contained in this Form 10-K are based on reasonable assumptions, you should be aware that many factors could affect our actual financial results or results of operations and could cause actual results to differ materially from those in such forward-looking statements, including but not limited to:

- the duration and severity of the COVID-19 pandemic and its impact on our business and financial performance;
- adverse conditions in the automotive industry or the global economy more generally, including as a result of the COVID-19 pandemic;
- the continuation of the semiconductor shortage being experienced by the automotive industry;
- the highly competitive and rapidly changing market in which we operate;
- our employees are represented by workers councils or unions or are subject to local laws that are less favorable to employers than the laws of the U.S.;
- our fluctuations in our financial and operating results;
- escalating pricing pressures from our customers;
- our failure to win, renew or implement service contracts;
- the cancellation or postponement of service contracts after a design win;
- the loss of business from any of our largest customers;
- inability to recruit and retain qualified personnel;
- cybersecurity and data privacy incidents that damage client relations;
- interruption or delays in our services or services from data center hosting facilities or public clouds;
- economic, political, regulatory, foreign exchange and other risks of international operations;
- unforeseen U.S. and foreign tax liabilities;
- the failure to protect our intellectual property or allegations that we have infringed the intellectual property of others;
- defects in our software products that result in lost revenue, expensive correction or claims against us;
- our inability to quickly respond to changes in technology and to develop our intellectual property into commercially viable products;
- our strategy to increase cloud services and ability to successfully introduce new products, applications or services;
- a significant interruption in the supply or maintenance of our third-party hardware, software, services or data;
- restrictions on our current and future operations under the terms of our debt and the use of cash to service our debt; and
- certain factors discussed elsewhere in this Form 10-K.

These and other factors are more fully discussed in the "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" sections and elsewhere in this Form 10-K. These risks could cause actual results to differ materially from those implied by forward-looking statements in this Form 10-K. Even if our results of operations, financial condition and liquidity and the development of the industry in which we operate are consistent with the forward-looking statements contained in this Form 10-K, those results or developments may not be indicative of results or developments in subsequent periods.

Any forward-looking statements made by us in this Form 10-K speak only as of the date on which they are made. We are under no obligation to, and expressly disclaim any obligation to, update or alter our forward-looking statements, whether as a result of new information, subsequent events or otherwise, except as required by law.

PART I

Item 1. Business.

Overview

Cerence builds AI powered virtual assistants for the mobility/transportation market. Our primary target is the automobile market, but our solutions can apply to all forms of transportation including but not limited to two-wheel vehicles, planes, tractors, cruise ships and elevators. Our solutions power natural conversational and intuitive interactions between vehicles, drivers and passengers, and the broader digital world. We are a premier provider of AI-powered assistants and innovations for connected and autonomous vehicles, including one of the world's most popular software platforms for building automotive virtual assistants, such as "*Hey BMW*" and "*Ni hao Banma*". Our customers include all major automobile original equipment manufacturers, or OEMs, or their tier 1 suppliers worldwide, including BMW, Daimler, FCA Group, Ford, Geely, GM, Renault-Nissan, SAIC, Toyota, Volkswagen Group, Aptiv, Bosch, Continental, DENSO TEN, NIO, XPeng and Harman. We deliver our solutions on a white-label basis, enabling our customers to deliver customized virtual assistants with unique, branded personalities and ultimately strengthening the bond between their brands and end users. Our vision is to enable a more enjoyable, safer journey for everyone.

Our platform utilizes industry-leading speech recognition, natural language understanding, speech signal enhancement, text-to-speech, and acoustic modeling technology to provide a conversational AI-based solution. Virtual assistants built with our platform can enable a wide variety of modes of human-vehicle interaction, including speech, touch, handwriting, gaze tracking and gesture recognition, and can support the integration of third-party virtual assistants into the in-vehicle experience.

Our software platform is a market leader for building integrated, branded and differentiated virtual assistants for automobiles. As a unified platform and common interface for automotive cognitive assistance, our software platform provides OEMs and suppliers with an important control point with respect to the mobility experience and their brand value. Our platform is fully customizable and designed to support our customers in creating their own ecosystem in the automobile and transforming the vehicle into a hub for numerous connected devices and services. Virtual assistants built with our software platform can address user requests across a wide variety of categories, such as navigation, control, media, communication and tools. Our software platform is comprised of edge computing and cloud-connected software components and a software framework linking these components together under a common programming interface. We implement our software platform for our customers through our professional services organization, which works with OEMs and suppliers to optimize our software for the requirements, configurations and acoustic characteristics of specific vehicle models.

The market for automotive cognitive assistance is rapidly expanding. The proliferation of smartphones and smart speakers has encouraged consumers to rely on a growing number of virtual assistants and special-purpose bots for various tasks such as controlling entertainment systems and checking the news. Automobile drivers and passengers increasingly expect hands-free access to virtual assistants as part of the mobility experience, with common use cases in a variety of categories including mobility domains such as navigation, voice-activated texts, and telephone communication, automobile domains, such as automobile user guides, and ignition on-off, and generic domains, such as entertainment. To meet the increasing demand for automotive cognitive assistance and to offer differentiated mobility experiences, OEMs and suppliers are building proprietary virtual assistants into an increasing proportion of their vehicles. We believe that this trend will continue and that consumer appetite for automotive cognitive assistance will grow further as vehicles become more autonomous and drivers pursue new forms of human-vehicle engagement previously not feasible during vehicle operation.

We generate revenue primarily by selling software licenses and cloud-connected services. In addition, we generate professional services revenue from our work with OEMs and suppliers during the design, development and deployment phases of the vehicle model lifecycle and through maintenance and enhancement projects. Through our over 20 years in the automotive industry, we have developed longstanding industry relationships and benefit from incumbency. We have existing relationships with all major OEMs or their tier 1 suppliers, and while our customer contracts vary, they generally represent multi-year engagements, giving us visibility into future revenue. We have master agreements or similar commercial arrangements in place with many of our customers, supporting customer retention over the long term.

As of September 30, 2021, we had fixed backlog of $336.4 million, which includes $276.7 million of estimated future revenue related to remaining performance obligations and $59.7 million of contractual commitments which have not yet been invoiced. As of September 30, 2021, we had variable backlog of $1.7 billion, which includes estimated future revenue from variable forecasted royalties related to our embedded and connected businesses. Our estimation of forecasted royalties is based on our royalty rates for embedded and connected technologies from expected car shipments under our existing contracts over the term of the programs. Anticipated shipments are based on historical shipping experience and current customer projections that management believes are reasonable as of the date of this Form 10-K. Both our embedded and connected technologies are priced and sold on a per-vehicle or device basis, where we receive a single fee for either or both the embedded license and the connected service term. However, our fixed and variable backlog may not be indicative of our actual future revenue. The revenue we actually recognize is subject to several factors, including the number and timing of vehicles our customers ship, potential terminations or changes in scope of customer contracts, and currency fluctuations. As of September 30, 2021, we estimate our total backlog to be $2.0 billion, including $336.4 million of fixed backlog and $1.7 billion of variable backlog.

Our solutions have been installed in more than 400 million automobiles to date, including over 40 million new vehicles in fiscal 2021 alone. Based on royalty reports provided by our customers and third-party reports of total vehicle production worldwide, we estimate that approximately 53% of all shipped cars during the fiscal year ended September 30, 2021 included Cerence technologies. Cerence hybrid solutions shipped on approximately 8.9 million vehicles during the fiscal year ended September 30, 2021. In aggregate, over 65 automobile brands worldwide use our solutions, covering over 70 languages and dialects, including English, German, Spanish, French, Mandarin, Cantonese and Shanghainese.

In fiscal year 2021, we generated revenue of $387.2 million, an increase of 17.0% compared to $331.0 million for the fiscal year ended September 30, 2020. We recorded net income of $45.9 million for the fiscal year ended September 30, 2021, an increase of 350.8% compared to a net loss of $18.3 million recorded for the fiscal year ended September 30. 2020. For fiscal year 2019, our business was wholly-owned by Nuance Communications, Inc., ("Nuance"), and our results for that fiscal year may not reflect what our results would have been had we been an independent, publicly traded company during fiscal year 2019. In addition, the financial information included herein may not necessarily reflect our results of operations in the future.

History and Corporate Information

On October 1, 2019 ("Distribution Date"), Nuance, a leading provider of speech and language solutions for businesses and consumers around the world, completed the legal and structural separation and distribution to its stockholders of all of the outstanding shares of our common stock, and its consolidated subsidiaries, in a tax free spin-off ("Spin-Off"). The distribution was made in the amount of one share of our common stock for every eight shares of Nuance common stock ("Distribution") owned by Nuance's stockholders as of 5:00 p.m. Eastern Time on September 17, 2019, the record date of the Distribution.

In connection with the Distribution, on September 30, 2019, we filed an Amended and Restated Certificate of Incorporation, or the Charter, with the Secretary of State of the State of Delaware, which became effective on October 1, 2019. Our Amended and Restated By-laws also became effective on October 1, 2019. On October 2, 2019, our common stock began regular-way trading on the Nasdaq Global Select Market under the ticker symbol CRNC.

Our principal executive offices are located at 1 Burlington Woods Drive, Suite 301A, Burlington, Massachusetts 01803 and our telephone number at that address is (857) 362-7300. Our website is *www.cerence.com*. We are not including the information contained in our website as part of, or incorporating it by reference into, this Form 10-K. We make available free of charge through our website our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports, as soon as reasonably practicable after we electronically file these materials with, or otherwise furnish them to, the Securities and Exchange Commission, or the SEC. The SEC maintains a website (*www.sec.gov*) that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

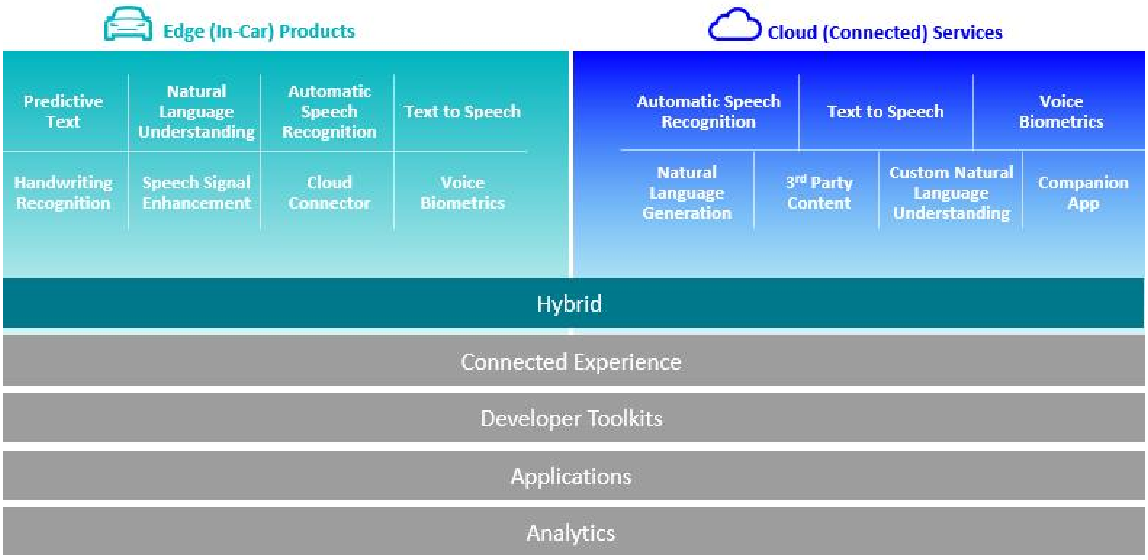
Our Capabilities

Our mission is to empower the transportation ecosystem with digital platform solutions for connected and autonomous vehicles. We deliver automotive cognitive assistance solutions that are conversational and intuitive and that enable OEMs to strengthen the emotional connection with their end users through a distinct, consistent, branded experience. We continue to extend these solutions to two-wheel vehicles and tractors and other transportation means. Our principal offering is our software platform, which our customers use to build virtual assistants that can communicate, find information and take action across an expanding variety of categories, including navigation, control, media, communication, information and tools. Our software, developed in deep partnership with the automotive industry, improves the mobility experience for drivers and passengers all over the world.

User engagement with virtual assistants built with our software platform typically begins with a voice request. Upon receiving such an input, our software platform determines what the user has said, infers user intent, and maps the request to the most applicable category and domain. Depending on the applicable domain, our software platform determines whether to respond directly or access an external data source or third-party virtual assistant, in all cases resulting in a response including spoken words or taking action. Depending on the complexity of the request and other factors, engagement may consist of multiple rapid voice interactions with the user and may combine assistance in multiple domains.

Our software platform offers a hybrid architecture combining edge software components, which are embedded in a vehicle's head unit and integrated with onboard systems, with cloud-connected components, which access data and content on external networks and support over-the-air updates. This hybrid architecture enables our software platform to combine the performance, reliability, efficiency, security and tight vehicular integration of embedded software with the flexibility that cloud connectivity provides. Response frameworks can generally be customized such that requests are processed first at the edge, controlling cloud transmission costs, or in parallel at the edge and in the cloud, to achieve higher confidence responses with low latency. Through edge computing capabilities, the platform is able to provide certain features, such as wake up words, while avoiding privacy and latency issues associated with always-listening cloud-connected technologies. Our software platform includes a common programming framework including toolkits and applications for its edge and cloud-connected components, and our customers can choose the software components that are necessary to power the experiences that they want to build and offer.

Cerence Platform Framework - Hybrid Architecture



We deliver our software platform through our professional services organization, which works with OEMs and suppliers to tailor it to the desired requirements, configurations and acoustic characteristics of specific vehicle models. For an initial implementation, our professional services engagements typically begin with the porting of our key technologies to the customer's specific hardware and software platforms and the development of specific dialogues and grammar libraries. Our professional services teams also work with OEMs on acoustic optimization of a system and application of our audio signal processing technologies. Following an initial implementation, our professional services organization may continue to provide services over the course of a head unit program and vehicle model lifecycle through maintenance and enhancement engagements.

Edge Software Components

Our software platform's edge software components are installed on a vehicle's head unit and can operate without access to external networks and information. We tailor our edge software components to a customer's desired use cases and a vehicle model's unique systems, sensors and data interfaces.

Capabilities of our edge software components include automatic speech recognition, natural language understanding, noise cancellation, driver and passenger voice isolation, voice biometrics, wake-up word and text-to-speech synthesis, as well as certain non-speech technologies such as gaze, gesture and touch input. Our software can support more than 70 languages and dialects. Edge deployment suits these technologies as it provides the following functionality and benefits:

- *Performance.* Processing at the edge is often necessary to meet the low latency requirements of natural conversation.
- *Vehicle Systems Integration.* Vehicle applications, sensors, and data interfaces can be integrated deeply with embedded systems.
- *Availability.* Edge-located systems are available regardless of cellular coverage and network connectivity.
- *Reduced cost.* Processing at the edge reduces or eliminates cellular data transmission costs.
- *Privacy.* Users' utterances and system outputs processed at the edge remain onboard and can immediately be purged.

Certain forms of assistant speech invocation can only be implemented using edge software. The use of wake-up words like "*Hey BMW*" and "*Ni hao Banma*" require constant listening and signal processing to identify instances when a virtual assistant should activate and respond. The same requirements apply to our JustTalk technology, which constantly listens to spoken conversation, determines speaker intent, and invokes assistance appropriately without requiring a specific invocation phase. The alternative of sending a constant stream of audio from the car interior to the cloud for processing would require enormous amounts of bandwidth and potentially create privacy concerns.

We typically sell our edge software components under a traditional per unit perpetual software license model, in which a per unit fee is charged for each software instance installed on an automotive head unit. Our customers generally provide estimates of the units to be shipped for a particular program, and we review third-party market studies and work with our customers to refine and understand these projections. While these projections provide us with some reasonable visibility into future revenue, the number of units to be shipped for a particular program is not committed upfront.

Cloud-Connected Components

Our software platform's cloud-connected components are comprised of certain speech and natural language understanding related technologies, AI-enabled personalization and context-based response frameworks, and content integration platforms. Our cloud-connected speech-related technologies perform many of the same tasks as our speech-related edge components while offering enhanced functionality through increased computational power and access to external content. Cloud-connected components also support the replication of personalized settings such as voice profiles and preferences across multiple vehicles.

We offer cloud-connected components in the form of a connected service to the vehicle end user. Initial subscriptions typically have multi-year terms from the time of a vehicle's sale and are paid in advance by the OEM or supplier. Renewal options vary and are managed by our customers on behalf of vehicle end users.

Virtual Assistant Coexistence

The wide variety of use cases encompassed by automotive cognitive assistance, in the context of evolving consumer preferences, necessitates the coexistence of multiple virtual assistants within the in-vehicle environment. For example, many vehicle-related categories such as navigation and control can best be addressed by a tightly integrated, vehicle-model-specific virtual assistant. At the same time, drivers and passengers often prefer to use familiar Internet-based virtual assistants for more general domains such as entertainment.

To enable drivers and passengers to extend their digital life from outside the vehicle to inside the vehicle, our software platform can support the integration of third-party virtual assistants, providing a uniform interface for virtual assistant engagement. We have invested in our platform to develop the technology and capabilities necessary to integrate third party virtual assistants with vehicles' systems.

To make integration as seamless as possible, we have built cognitive arbitration technology that is capable of inferring user intent, determining which within a set of virtual assistants would be best suited to address a request, and sending the request to the selected assistant thus enabling users to extend their digital life into the automobile. Depending on a system's configuration and the virtual assistants to which it is connected, output can be presented back to the user through a vehicle-specific personality or through the virtual assistant's own interface. Cognitive arbitration represents an important control point with respect to the mobility experience and an important brand differentiation opportunity for OEMs and suppliers. Like the rest of our software platform, cognitive arbitration is a white label product that can be customized and branded.

Along with providing OEMs control over their brand identity, our cognitive arbitration technology is an important element in letting an OEM design the overall driver and passenger experience. This technology allows an OEM to dictate interactions with third-party virtual assistants within the vehicle, strengthening its ability to differentiate and control the overall in-vehicle experience.

Professional Services

We have a large professional services team that works with our customers in the design, development and deployment phases of a vehicle head unit program and vehicle model lifecycle, as well as in maintenance and enhancement engagements. Our range of capabilities include personalization of grammar and natural language understanding development, localization, language selection and system coverage, navigation speech data generation, system prompt recordings, porting our platform's framework and our ability to deploy cognitive arbitration technologies, and user experience reviews and studies. Our professional services team is globally distributed to serve our customers in their primary design and production jurisdictions. We typically charge manufacturers for our design and consulting work, which are primarily project-based, in line with customary non-recurring engineering industry practices.

Our Competitive Strengths

Our key competitive strengths include:

- ***Industry-leading speech-related technology*****.** Our research shows that consumers see speech as an increasingly attractive medium for human-vehicle interaction. Nevertheless, they are often frustrated with speech recognition solutions that misunderstand spoken language or require users to speak rigid, pre-defined commands associated with a limited set of functions. Developing conversation-based automotive virtual assistants that users will perceive as natural is challenging as a matter of artificial intelligence technology, acoustic engineering and user interface design. We believe our software platform, as tailored for a specific vehicle model by our professional services organization, represents one of the most technologically advanced and highest-performing human-vehicle speech interaction systems available today. In tests performed by our customers to assess correct recognition of words, sentences, and domains, our solutions have achieved some of the highest marks relative to competitors and our offerings are backed by our portfolio of patents and associated rights.
- ***Hybrid edge-cloud system architecture.*** Our software platform's hybrid architecture combines the performance, reliability and tight integration that only edge software can provide with the flexibility of cloud connectivity. Cloud-reliant solutions with which our software platform competes cannot match edge software's low latency, its bandwidth efficiency or its availability in the absence of network connectivity. Moreover, emerging speech invocation paradigms such as wake up words and situationally aware invocation are most effectively implemented using edge technology.
- ***Bespoke vehicle integration and acoustic tuning*****.** Cognitive assistance for categories such as navigation, entertainment and control requires tight integration with onboard vehicle components, which vary widely among vehicle models. Separately, speech interaction systems can be significantly hampered by the noisy environment of a vehicle cabin and must be tuned for particular acoustics and audio system components. To achieve the tight vehicle integration necessary to address these concerns, our professional services team works closely with OEMs and suppliers to customize our offerings for the particular characteristics of specific vehicle models. Our expertise in acoustics enables us to implement systems that can isolate the voices of individual speakers and support simultaneous virtual assistance for speakers in multiple zones, representing a key point of differentiation.
- ***Interoperability with third-party Internet-based virtual assistants.*** Virtual assistants from large technology companies have become popular with consumers. We believe that consumers want to extend the use of these assistants while traveling in their vehicles and that a comprehensive automotive cognitive assistance system requires the coexistence of multiple virtual assistants. To accommodate their end user preferences while still providing a unique and brand-specific experience, OEMs seek to offer a common in-vehicle interface with seamless integration across various virtual assistants. To this end, our software platform can support the coexistence of multiple third-party virtual assistants and provide a uniform interface for virtual assistant engagement. Our market-leading position, our focus on the automotive market and the large size of our installed base create incentives for third party virtual assistant providers to work with us and support this integration.
- ***Independence from large technology companies and automobile industry players.*** As vehicles become more autonomous, mobility experiences are being increasingly defined by in-cabin features and alternative forms of human-vehicle engagement. Branded, differentiated automotive cognitive assistance is thus increasingly important to OEMs' brand value. As a neutral, independent, white-label software platform vendor, we empower our customers to build branded and differentiated experiences and retain ownership of, or rights to, their system design and data. The virtual assistant coexistence enabled by our cognitive arbitration functionality is designed to allow our customers to provide access to third-party virtual assistants without ceding overall control of the cognitive assistance experience.
- ***OEM alignment***. The design and development of the head unit within the vehicle ecosystem is a complex process requiring tight integration of the software and hardware components used in and with the vehicle. We believe our demonstrated long-standing capabilities in working closely with OEMs, understanding their needs, product roadmaps and global go-to-market strategies enables us to innovate our technologies to meet an OEM's specifications. Furthermore, our working relationships with OEMs uniquely allow us to market and sell our solutions on both a local and global basis in accordance with an OEM's particular requirements.
- ***Broad language coverage.*** Our software platform supports over 70 languages and dialects, far more than any of our competitors. As a result of our broad language support, our customers are already delivering cognitive assistance based on our software platform across the Americas, Europe and Asia, including China, the U.S. and all other large automotive markets. Our language support also enables multi-lingual capabilities for domains such as music selection, point-of-interest selection, and cross-border navigation among others, representing a critical feature for markets such as Continental Europe in which automobiles may routinely traverse multiple lingual zones. We believe that our portfolio of languages and multi-lingual capabilities represent an important competitive advantage, as the development of capabilities to support a new language is expensive and time-consuming.

- ***Broad, global network of deep relationships with OEMs and tier 1 suppliers.*** We have supplied speech recognition systems to OEMs and suppliers for over 20 years, working closely with our customers through our global professional services organization to design and integrate our solutions into their brands. Today, we work with all major OEMs or their tier 1 suppliers worldwide, leveraging the geographic breadth and industry experience of our professional services teams. Our long history in the automotive industry and the global reach and experience of our over 500 professional services employees across 12 countries gives us credibility with OEMs as we seek new business with OEMs, either directly or through their tier 1 suppliers. We believe that OEMs who sell globally will value our experience in servicing and deploying solutions on a global basis. We often have master agreements or similar commercial arrangements with our customers. These master agreements help us retain customer relationships over the long term.

Our Growth Strategies

We believe our growth opportunity has three key facets: continued investment in expending our core technology, development of new applications that extend our core technology into innovative applications, and expansion of our target market beyond automobiles. Successful execution of these key objectives could lead to the greater penetration of our offerings and key enabling technologies throughout our target markets, resulting in an increase in the revenue we are able to capture per vehicle and expansion of our market share relative to competitors.

Our primary strategies for pursuing our growth include the following:

- ***Maintain and extend product leadership.*** We intend to continue investing in developing our core product functionality and expanding the breadth of categories and domains our software platform is able to address, particularly with a view toward maintaining our market share in edge software components and growing our share in cloud-connected software functionalities. Our existing relationship with, and our proximity in the design process to, OEMs provides us with insight into the needs of the end-users and roadmaps for innovation. For instance, this insight has helped us identify and advance our technologies for autonomous driving systems, which technologies have been incorporated in solutions currently under development. Additionally, we intend to continue to invest in customizing and supporting our solutions for specific individual automobile vehicle models, resulting in tight integration of our solutions. We believe that increasing complexity of our edge software components, including with respect to multi-modal interaction, and growth in our cloud-connected product areas, including the enabling of third-party services, will enable us to increase the revenue per vehicle that we are able to generate. Additionally, these investments will help maintain our position with existing customers through new vehicle models and enable us to grow with the overall market for automotive cognitive assistance.

- ***Continue to invest in interoperability with third-party virtual assistants*.** We believe that the growing popularity of third-party virtual assistants is creating increasing demand for access to these assistants as part of the mobility experience. We also believe that complete automotive cognitive assistance requires the coexistence of multiple virtual assistants. We intend to continue to invest to develop our software platform's interoperability with third-party virtual assistants and its cognitive arbitration capabilities to maintain its position as a neutral automotive cognitive assistance platform. We believe a neutral automotive cognitive assistance platform will increasingly be valued by OEMs that prioritize maintaining their unique and branded in-car experience and the ability to control the mobility experience overall.
- ***Deliver new functionality to existing installed base.*** Our solutions have been installed in more than 400 million vehicles to date. Our large installed base represents an opportunity to deliver new features and software. Depending on system capabilities, we are able to deliver updated functionality to our users in the form of embedded software upgrades performed by dealers and over-the-air updates delivered from the cloud.
- ***Develop products that leverage our expertise in new applications.*** We have developed new products that leverage our expertise in voice-AI into new applications that will be distinct from our Edge or Cloud-connected product offerings. These new applications are expected to generate revenue using either a subscription or transaction-based model extending the company's market opportunity into new areas. New applications developed include Cerence Tour Guide, Cerence Pay and Car Life. Cerence Tour Guide is an AI-powered application for automotive assistants that brings guided tour content directly into the car via an ecosystem of partners. Cerence Pay offers a secure, contactless payment experience for drivers via voice and facial biometrics. Cerence Car Life is a suite of AI-powered, software-as-a-service (SaaS) offerings that provides drivers with up-to-date information about their cars via a companion application, voice output from the automotive assistant, and imagery displayed on the car's infotainment system.
- ***Expand into adjacent transportation markets.*** Today, we primarily target the automobile market. However, our products and technology also have application to other modes of transportation. Any type of vehicle that moves people are potential applications for our technology. We have integrated our technologies and solutions within the two-wheel vehicle market and have explored opportunities in the cruise line, public transit, fleet, and elevator markets. In total, we believe these adjacent markets represent an important growth opportunity.

Competition

The automobile cognitive assistance market is competitive. Today, we face two primary sets of competitors:

- ***Large technology companies*.** Many large technology companies, including Amazon, Apple, Google, Microsoft, Alibaba, Baidu and Tencent, offer Internet-based virtual assistants. Given the popularity in general of these virtual assistants, we believe that automobile drivers and riders increasingly desire the ability to use them as part of the mobility experience. To meet this demand, some of these companies have invested in technologies, such as Apple CarPlay, to make their virtual assistants more accessible within vehicle cabins.

  While these third-party virtual assistants directly compete with some of the functionality we provide as part of our software platform, they also increase the need for our software platform in two ways. First, given the fragmented and competitive nature of the virtual assistant market, it is important for OEMs and suppliers to enable their passengers to utilize a variety of virtual assistants. Our software platform's cognitive arbitration functionality can, dependent on appropriate third-party agreements, enable OEMs and suppliers to provide access to multiple third-party virtual assistants through a consistent, branded interface. Second, the noisy environment of a vehicle cabin presents significant speech processing challenges for smartphone-based third-party virtual assistants that are not designed for a specific vehicle model. Our software platform integrates with third-party virtual assistants and improves their functionality by improving the quality of speech input.
- ***Small, focused competitors*.** We compete for business directly with certain companies focused on voice-based virtual assistance, including SoundHound in the U.S., iFlyTek in China, and other regional and technology-focused competitors. These companies have had some success selling into our customer base. However, we believe that we have multiple meaningful competitive advantages, including our scale, our globally distributed team, our best-in-class portfolio of compatible languages, and our deep focus on the automotive market. We also believe that our technology, particularly our speech signal enhancement and acoustic tuning, is superior based on benchmarking results against our competitors. We believe we will continue to be able to compete successfully against these competitors as we continue to invest in our offerings.

  Our industry has attracted, and may continue to attract, new entrants. Although we find that OEMs often prefer to maintain relationships with suppliers that have a proven record of performance, they also rigorously reevaluate suppliers on the basis of product quality, price, reliability and timeliness of delivery, product design capability, technical expertise and development capability, new product innovation, financial viability, operational flexibility, customer service and overall management.

Technology

Our software platform's edge and cloud-connected software components are based on a number of proprietary technologies. We customize these technologies for specific vehicle models and continuously update and improve our features and functionality. Our key technologies include but are not limited to the following:

- ***Speech Signal Enhancement.*** A high-quality voice input signal is a precondition to reliable speech recognition and cognitive assistance. However, in a typical vehicle cabin, ambient interior sounds and noise from around the vehicle mix with infotainment system output and conversations between passengers, create a complex soundscape that can obscure virtual assistant requests. Audio signal processing technologies are therefore critical to the cognitive assistance experience. We have been developing and combining highly advanced audio signal enhancement technologies for over 20 years, and we tune our software in relation to the placement of microphones in a vehicle to create defined acoustic zones and support the isolation of individual speakers. Our technologies deliver best-in-class speech recognition results, as evidenced by tests performed by our customers to assess correct recognition of words, sentences, and domains, in which our solutions have achieved some of the highest marks relative to competitors.
- ***Automatic Speech Recognition.*** Our speech recognition technology, built using neural networks and specifically designed for automotive applications, is recognized as the automotive industry leader in automatic speech recognition. We support over 70 languages and dialects, representing the largest language portfolios in the speech industry. Key features of our speech recognition technology include free-form conversational interpretation, as opposed to a rigid system of predefined commands, and barge-in capabilities, enabling users to correct and modify their requests in the middle of stating them.
- ***Natural Language Understanding.*** Once speech has been captured and accurately converted into words, natural language understanding technology, or NLU, is necessary to match the request to the appropriate category and domain to interpret the user's intent. Our NLU system applies artificial intelligence reasoning, including predefined and learned preferences and real-time contextual information, to deliver informative responses consistent with what a user desires. NLU processing is performed by a hybrid of edge and cloud-connected software components to optimize performance, efficiency, reliability and security.
- ***Vocalizer: Text-to-Speech and Natural Language Generation.*** In many cases, the most useful result of a spoken query or command is a spoken response back to the user. To enable cognitive assistants to speak, we offer text-to-speech technology in more than 65 languages and dialects and over 145 distinct voices. We also have developed the technology to read text using human-like inflection and emotion, as well as, offer custom voices for customers who wish to differentiate themselves through an exclusive personality representing their brand.
- ***Voice Biometrics.*** Our software platform includes biometric functionality which can authenticate and personalize the automotive experience by recognizing users based on their voice and automatically load individual preferences and other automotive settings.
- ***Push-to-Talk, Wake-Up Words and Just Talk.*** Through our software platform, we are capable of offering three methods for invoking the virtual assistant, which can be implemented alone or in combination:
    - *Push-to-Talk* functionality, most commonly implemented as a button on the steering wheel or center console.
    - *Wake-Up Word* functionality, involving a spoken keyword or phrase, such as "*Hey BMW*."
    - *Just Talk*. Our active listening technology, filters out background noise and irrelevant conversation until it hears a keyword, phrase, or command that it understands as related to an applicable domain and which is intended as a virtual assistant request. False triggers are minimized through sophisticated syntax, cadence and intonation analysis performed in real-time and can be further reduced using automobile sensors such as head or body movement trackers.
- ***Cognitive Arbitration.*** Our cognitive arbitration technology can route arbitrary requests to the most appropriate virtual assistant or bot, including third-party virtual assistants.
- ***Non-Speech, Multimodal Input.*** Our technology seeks to mimic conversational human interaction by incorporating input methods beyond speech. Our multimodal capabilities allow vehicle systems to accept multiple forms of input such as voice, gestures, gaze, predictive text and handwriting.
- ***Multi-Seat Intelligence***. Due to its flexible design, our speech signal enhancement technology can be easily configured for complex multi-zone scenarios with various users and nearly arbitrary microphone configurations. Dedicated processing modes enable efficient and robust multi-user speech recognition in challenging acoustical environments. This allows for

passenger interaction in individual zones like sharing music or interacting simultaneously with the car or infotainment systems, where some passengers can enjoy browsing their music by speech, while others can send emails or other work-related activities.

Research and Development

We maintain technical engineering centers in major regions of the world that help develop our software platform and its underlying components and provide our customers with local engineering capabilities and design development.

We employ approximately 900 research and development personnel around the world, including scientists, engineers and technicians. Our total research and development expenses were approximately $112.1 million, $88.9 million and $93.1 million for fiscal years 2021, 2020 and 2019, respectively.

We believe that continued investment in research and development will be critical for us to continue to deliver market-leading solutions for automotive cognitive assistance. Accordingly, we intend to continue to invest in our product portfolio and allocate capital and resources to our growth opportunities.

Customers

Our customers include all major OEMs or their tier 1 suppliers worldwide. Our automobile manufacturer customers, commonly referred to as OEMs, include BMW, XPeng, FCA Group, Ford, Daimler, Geely, Renault-Nissan, SAIC, Toyota, Volkswagen Group and many others and represented approximately 46% of our sales in fiscal year 2021. Our largest customer, Toyota, represented approximately 19% of our revenue in fiscal year 2021. Our tier 1 supplier customers, who typically sell automobile components to the OEMs, include Aptiv, Bosch, Continental, DENSO TEN, NIO, Harman and many others and represented approximately 54% of our business in fiscal year 2021.

Our revenue base is geographically diverse. In fiscal 2021, approximately 35%, 37% and 28% of our revenue came from the Americas, Europe and Asia, respectively.

Sales and Marketing and Professional Services

We market our offerings using a high-touch OEM solutions model. We sell directly to our customers, which include OEMs and suppliers and as described above under “Customers”, and for each of our customers we assign a team comprising sales and marketing as well as professional services personnel. Our customer contracts are bespoke and vary widely, but generally represent multi-year agreements providing visibility into future revenue and helping to support retention of customer relationships over the long term.

Our sales and marketing team includes approximately 100 employees. This team includes sales representatives, account managers, sales engineers, product managers and marketing experts. As we sell our offerings to all major OEMs or their tier 1 suppliers today, our sales strategy is primarily focused on leveraging our existing customer relationships. Account managers typically have longstanding relationships with specific customers and are distributed worldwide to provide local customer coverage. We oftentimes utilize customer-specific demo days and proof-of-concepts (“POCs”) in which we showcase our technology and capabilities to OEMs and tier 1 suppliers on an individual basis. These events help maintain our market presence and awareness of our platform’s offerings while also providing opportunities to solicit feedback and input from our customers on our roadmap and future technologies.

Our professional services organization includes approximately 500 employees. These employees work with our customers in the design phase of the vehicle lifecycle to tailor our platform for specific requirements such as branding and also tune the software for the characteristics of a vehicle model. Our professional services team also provides post-design phase services through maintenance engagements, particular with respect to our cloud-connected solutions. The tight integration of our platform into our customers’ design process and their vehicles supports our ability to win future business with those customers. Like our sales representatives, our professional services employees often have longstanding relationships with specific customers and are distributed worldwide to provide local customer coverage.

Human Capital

Summary

As of September 30, 2021, we had approximately 1,700 full-time employees, including approximately 100 in sales and marketing, approximately 200 in administrative functions, approximately 500 in professional services, and approximately 900 in research and development. Approximately 90% of our employees are based outside of the United States. None of our employees in the United States are represented by a labor union, however many of our employees in Europe are represented by workers councils or labor unions. To date, we have experienced no work stoppages and believe that we have a good relationship with our employees.

Culture and Work Environment

We're a group of highly motivated collaborators who share a common passion for creating meaningful change in our industry and shaping the future of mobility. We are committed to attracting and retaining the best and brightest talent and building a culture of transparency, trust, and respect.

We are proactively nurturing our culture by investing in our people, processes and professional development. We understand our people are critical for our continued success and are focused on helping our employees grow at every stage of their career. We have education opportunities and training and development programs that help to enrich the knowledge and talents across the organization. From wellbeing programs and holiday celebrations to our virtual book club and LBGTQ alliance, we're focused on maintaining our connections regardless of our physical locations.

Compensation, Rewards and Benefits

In addition to competitive base salaries, we provide incentive-based compensation programs to reward performance relative to key metrics. We also provide compensation in the form of restricted stock unit grants as well as a competitive time-off policy. We offer comprehensive benefit options, including retirement savings plans, medical insurance, dental insurance, vision insurance, life and disability insurance, health savings accounts, flexible spending accounts, and an employee stock purchase plan, among others.

Diversity and Inclusion

We are a global team that seeks to build a diverse and inclusive workplace built upon the different perspectives, beliefs, and backgrounds of our people. We embrace what makes us each unique. Strengthening diversity enables us to bring our collective ideas together to make the best decisions for the global community we serve. We have successfully launched affinity groups for *Diversity and Inclusion, Women in Technology*, and *Working Parents*, as well as our *Book Club*. We celebrated important cultural observances such as *Black History Month, Women's History Month*, and *Pride Month*. It's extremely important that every employee feel welcome and valued as we strive to make our company a great place to work.

Intellectual Property

We own approximately 876 patents and patent applications and other intellectual property. Prior to our Spin-Off from Nuance, we entered into the Intellectual Property Agreement, which provides us with certain non-exclusive rights with respect to patents that will continue to be held by Nuance. While no individual patent or group of patents, taken alone, is considered material to our business, in the aggregate, these patents and rights provide meaningful protection for our products, technologies, and technical innovations.

Item 1A. Risk Factors.

You should carefully consider all of the information in this Form 10-K and each of the risks described below, which we believe are the material risks that we face. Some of the risks relate to our business, others to our intellectual property and technology, and the consequences of the Spin-Off. Some risks relate to the securities markets, our indebtedness and ownership of our common stock. Any of the following risks could materially and adversely affect our business, financial condition and results of operations and the actual outcome of matters as to which forward-looking statements are made in this Form 10-K.

Risk Factor Summary

Risks Relating to Our Business

- Pandemics or disease outbreaks, such as COVID-19, have disrupted, and may continue to disrupt, our business, which could adversely affect our financial performance.
- The market in which we operate is highly competitive and rapidly changing and we may be unable to compete successfully.
- Adverse conditions in the automotive industry or the global economy more generally could have adverse effects on our results of operations.
- Our strategy to increase cloud connected services may adversely affect our near-term revenue growth and results of operations.
- Pricing pressures from our customers may adversely affect our business.
- We invest effort and money seeking OEMs' validation of our technology, and there can be no assurance that we will win or be able to renew service contracts, which could adversely affect our future business, results of operations and financial condition.
- Our business could be materially and adversely affected if we lost any of our largest customers.
- Our operating results may fluctuate significantly from period to period, and this may cause our stock price to decline.
- We may not be successful with the adoption of new applications.
- Some of our employees represented by workers councils or unions or are subject to local laws that are less favorable to employers than the laws of the U.S.
- Cybersecurity and data privacy incidents or breaches may damage client relations and inhibit our growth.
- A significant portion of our revenues and research and development activities originate outside the United States. Our results could be harmed by economic, political, regulatory, foreign currency fluctuations and other risks associated with these international regions.
- Our business in China is subject to aggressive competition and is sensitive to economic, market and political conditions.
- Interruptions or delays in our services or services from data center hosting facilities or public clouds could impair the delivery of our services and harm our business.
- If our goodwill or other intangible assets become impaired, our operating results could be negatively impacted.

Risks Relating to our Intellectual Property and Technology

- Third parties have claimed and may claim in the future that we are infringing their intellectual property, and we could be exposed to significant litigation or licensing expenses or be prevented from selling our products if such claims are successful.
- Unauthorized use of our proprietary technology and intellectual property could adversely affect our business and results of operations.
- Our software products may have bugs, which could result in delayed or lost revenue, expensive correction, liability to our customers and claims against us.
- We may be unable to respond quickly enough to changes in technology and technological risks and to develop our intellectual property into commercially viable products.

- We utilize certain key technologies, content and services from, and integrate certain of our solutions with, third parties and may be unable to replace those technologies, content and services if they become obsolete, unavailable or incompatible with our solutions.

Risks Relating to the Spin-Off

- If the Spin-Off were determined not to qualify as tax-free for U.S. federal income tax purposes, we could have an indemnification obligation to Nuance, which could adversely affect our business, financial condition and results of operations.
- We have agreed to numerous restrictions to preserve the non-recognition treatment of the Spin-Off, which may reduce our strategic and operating flexibility.
- We may be unable to achieve some or all of the benefits that we expect to achieve from the Spin-Off.
- Our historical combined financial information is not necessarily representative of the results we would have achieved as an independent, publicly traded company.
- We may have potential business conflicts of interest with Nuance with respect to our past and ongoing relationships.
- A certain director may have actual or potential conflicts of interest because of their financial interests in Nuance.
- The allocation of intellectual property rights and data between Nuance and Cerence as part of the Spin-Off, could adversely impact our reputation, our ability to enforce certain intellectual property rights that are important to us and our competitive position.

Risks Relating to Our Securities and Indebtedness

- The terms of the Senior Credit Facilities restrict our current and future operations, particularly our ability to incur debt that we may need to fund initiatives in response to changes in our business, the industry in which we operate, the economy and governmental regulations.
- We may evaluate whether to pay cash dividends on our common stock in the future, and the terms of our Senior Credit Facilities limit our ability to pay dividends on our common stock.
- Servicing our debt may require a significant amount of cash. We may not have sufficient cash flow from our business to pay our indebtedness.
- The conditional conversion feature of the Notes, if triggered, may adversely affect our financial condition and results of operations and the value of our common stock.
- The accounting method for convertible debt securities that may be settled in cash, such as the Notes, could have a material effect on our reported financial results.
- Certain provisions in our Amended and Restated Certificate of Incorporation and Amended and Restated By-Laws and Delaware law may discourage takeovers.
- Our Amended and Restated Certificate of Incorporation designates the courts of the State of Delaware as the sole and exclusive forum for certain types of actions and proceedings, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes.

General Risk Factors

- Tax matters may cause significant variability in our financial results and may impact our overall financial condition.
- Our stock price may fluctuate significantly.
- The commercial and credit environment may adversely affect our access to capital.
- If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired and investors' views of us could be harmed.

Risks Relating to Our Business

Pandemics or disease outbreaks, such as COVID-19, have disrupted, and may continue to disrupt, our business, which could adversely affect our financial performance.

Our business depends on, and is directly affected by, the output and sales of the global automotive industry and the use of automobiles by consumers. Pandemics or disease outbreaks, such as COVID-19, have disrupted, and may continue to disrupt, global automotive industry customer sales and production volumes. Vehicle production initially decreased significantly in China, which was first affected by COVID-19, then Europe and also the United States. Subsequent events resulted in the shutdown of manufacturing operations in China, Europe and the United States, and even though manufacturing operations have resumed, the capacity of such global manufacturing operations remains uncertain. More recently, we have seen, and anticipate that we will continue to see, supply chain challenges in the automotive industry related to semiconductor devices that are used in automobiles. As a result, we have experienced, and may continue to experience, difficulties in entering into new contracts with our customers, a decline in revenues resulting from the decrease in the production and sale of automobiles by our customers, the use of automobiles, increased difficulties in collecting payment obligations from our customers and the possibility customers will stall or not continue existing projects. These all may be further exacerbated by the global economic downturn resulting from the pandemic which could further decrease consumer demand for vehicles or result in the financial distress of one or more of our customers.

As the COVID-19 pandemic continues, our business operations could be further disrupted or delayed. The pandemic has already resulted in, and may continue to result in, work stoppages, slowdowns and delays, travel restrictions, and other factors that cause a decrease in the production and sale of automobiles by our customers. The production of automobiles with our products has been and may continue to be adversely affected with production delays and our ability to provide engineering support and implement design changes for customers may be impacted by restrictions on travel and quarantine policies put in place by businesses and governments.

The full extent to which the ongoing COVID-19 pandemic adversely affects our financial performance will depend on future developments, many of which are outside of our control, are highly uncertain and cannot be predicted, including, but not limited to, the duration and spread of the pandemic, its severity, the effectiveness of actions to treat or contain the virus and its impact and how quickly and to what extent normal economic and operating conditions can resume. The COVID-19 pandemic could also result in additional governmental restrictions and regulations, which could adversely affect our business and financial results. In addition, a recession, depression or other sustained adverse market impact resulting from COVID-19 could materially and adversely affect our business, our access to needed capital and liquidity, and the value of our common stock. Even after the COVID-19 pandemic has lessened or subsided, we may continue to experience adverse impacts on our business and financial performance as a result of its global economic impact.

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

There are a number of companies that develop or may develop products that compete in the automotive voice assistance market. The market for our products and services is characterized by intense competition, evolving industry and regulatory standards, emerging business and distribution models, disruptive software technology developments, short product and service life cycles, price sensitivity on the part of customers, and frequent new product introductions, including alternatives for certain of our products that offer limited functionality at significantly lower costs or free of charge. In addition, some of our competitors have business objectives that may drive them to sell their alternative offerings at a significant discount to our offerings in the automotive voice assistant market. Current and potential competitors have established, or may establish, cooperative relationships among themselves or with third parties to increase the ability of their technologies to address the needs of our prospective customers. Furthermore, existing or prospective customers may decide to develop competing products or have established, or may in the future establish, strategic relationships with our competitors. We also face significant competition with respect to cloud-based solutions in the automotive cognitive assistance market where existing and new competitors may have or have already established significant market share and product offerings.

The competition in the automotive cognitive assistance market could adversely affect our operating results by reducing the volume of the products and solutions we license or sell or the prices we can charge. Some of our current or potential competitors are large technology companies that have significantly greater financial, technical and marketing resources than we do, and others are smaller specialized companies that possess automotive expertise or regional focus and may have greater price flexibility than we do. These competitors may be able to respond more rapidly than we can to new or emerging technologies or changes in customer requirements, or may decide to offer products at low or unsustainable cost to win new business. They may also devote greater resources to the development, promotion and sale of their products than we do, and in certain cases may be able to include or combine their competitive products or technologies with other of their products or technologies in a manner whereby the competitive functionality is available at lower cost or free of charge within the larger offering. To the extent they do so, penetration of our products, and therefore our revenue, may be adversely affected. Our large competitors may also have greater access to data, including customer data, which provides them with a competitive advantage in developing new products and technologies. Our success depends substantially upon our ability to enhance our products and technologies, to develop and introduce, on a timely and cost-effective basis, new products and features that meet changing customer requirements and incorporate technological enhancements, and to maintain our alignment with the OEMs, their technology and market strategies. If we are unable to develop new products and enhance functionalities or technologies to adapt to these changes and maintain our alignment with OEMs, our business will suffer.

Adverse conditions in the automotive industry or the global economy more generally could have adverse effects on our results of operations.

Our business depends on, and is directly affected by, the global automobile industry. Automotive production and sales are highly cyclical and depend on general economic conditions and other factors, including consumer spending and preferences, changes in interest rate levels and credit availability, consumer confidence, fuel costs, fuel availability, environmental impact, governmental incentives and regulatory requirements, and political volatility, especially in energy-producing countries and growth markets. Such factors may also negatively impact consumer demand for automobiles that include features such as our products. In addition, automotive production and sales can be affected by our customers' ability to continue operating in response to challenging economic conditions, and in response to labor relations issues, regulatory requirements, trade agreements and other factors. The volume of global automotive production has fluctuated, sometimes significantly, from year to year, and such fluctuations give rise to fluctuations in the demand for our products. Any significant adverse change in any of these factors, including, but not limited to, general economic conditions and the resulting bankruptcy of a customer, the closure of a customer manufacturing facility or the ability of manufacturing to obtain supplies to manufacture automobiles and to ship or receive shipments of parts, supplies or finished product, may result in a reduction in automotive sales and production by our customers, and could have a material adverse effect on our business, results of operations and financial condition.

Our strategy to increase cloud connected services may adversely affect our near-term revenue growth and results of operations.

Our leadership position has historically been derived from our products and services based on edge software technology. We have been and are continuing to develop new products and services that incorporate cloud-connected components. The design and development of new cloud-connected components will involve significant expense. Our research and development costs have greatly increased in recent years and, together with certain expenses associated with delivering our connected services, are projected to continue to escalate in the near future. We may encounter difficulties with designing, developing and releasing new cloud-connected components, as well as integrating these components with our existing hybrid technologies. These development issues may further increase costs and may affect our ability to innovate in a manner demanded by the market. As a result, our strategy to incorporate more cloud-connected components may adversely affect our revenue growth and results of operations.

Pricing pressures from our customers may adversely affect our business.

We may experience pricing pressure from our customers in the future, which could result from the strong purchasing power of major OEMs. As a developer of automotive cognitive assistance components, we may be expected to quote fixed prices or be forced to accept prices with annual price reduction commitments for long-term sales arrangements or discounted reimbursements for our work. We may encounter customers unwilling to accept the terms of our software license or non-recurring engineering agreements. Any price reductions could impact our sales and profit margins. Our future profitability will depend upon, among other things, our ability to continuously reduce the costs for our components and maintain our cost structure. Our profitability is also influenced by our success in designing and marketing technological improvements in automotive cognitive assistance systems. If we are unable to offset any price reductions in the future, our business, results of operations and financial condition would be adversely affected.

We invest effort and money seeking OEMs' validation of our technology, and there can be no assurance that we will win or be able to renew service contracts, which could adversely affect our future business, results of operations and financial condition.

We invest effort and money from the time an OEM or a tier 1 supplier begins designing for an upcoming program to the date on which the customer chooses our technology to be incorporated directly or indirectly into one or more specific vehicle models to be produced by the customer. This selection process is known as a "design win." We could expend our resources without success. After a design win, it is typically quite difficult for a product or technology that did not receive the design win to displace the winner until the customer begins a new selection process because it is very unlikely that a customer will change complex technology until a vehicle model is revamped. In addition, the company with the winning design may have an advantage with the customer going forward because of the established relationship between the winning company and such customer, which could make it more difficult for such company's competitors to win the designs for other service contracts. Even if we have an established relationship with a customer, any failure to perform under a service contract or innovate in response to their feedback may neutralize our advantage with that customer. If we fail to win a significant number of customer design competitions in the future or to renew a significant number of existing service contracts, our business, results of operations and financial condition would be adversely affected. Moreover, due to the evolution of our connected offerings and architecture, trending away from providing legacy infotainment and connected services and a change in our professional services pricing strategies, we expect our deferred revenue balances to decrease in the future, including due to a wind-down of a legacy connected service relationship with a major OEM, since the majority of the cash from the contract has been collected. To the extent we are unable to renew existing service contracts, such decrease could intensify. The period of time from winning a contract to implementation is long and we are subject to the risks of cancellation or postponement of the contract or unsuccessful implementation.

Our products are technologically complex and incorporate many technological innovations. Prospective customers generally must make significant commitments of resources to test and validate our products before including them in any particular vehicle model. The development cycles of our products with new customers are approximately six months to two years after a design win, depending on the customer and the complexity of the product. These development cycles result in us investing our resources prior to realizing any revenues from the customer contracts. Further, we are subject to the risk that a customer cancels or postpones implementation of our technology, as well as that we will not be able to implement our technology successfully. Further, our sales could be less than forecast if the vehicle model is unsuccessful, including reasons unrelated to our technology. Long development cycles and product cancellations or postponements may adversely affect our business, results of operations and financial condition.

Our business could be materially and adversely affected if we lost any of our largest customers.

The loss of business from any of our major customers, whether by lower overall demand for vehicles, cancellation of existing contracts or the failure to award us new business, could have a material adverse effect on our business, results of operations and financial condition. Alternatively, there is a risk that one or more of our major customers could be unable to pay our invoices as they become due or that a customer will simply refuse to make such payments given its financial difficulties. If a major customer becomes subject to bankruptcy or similar proceedings whereby contractual commitments are subject to stay of execution and the possibility of legal or other modification, or if a major customer otherwise successfully procures protection against us legally enforcing its obligations, it is likely that we will be forced to record a substantial loss. In addition, certain of our customers that are tier 1 suppliers exclusively sell to certain OEMs, including some of our other customers. A bankruptcy of, or other significant disruption to, any of these OEMs could intensify any adverse impact on our business and results of operations.

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

Our revenue and operating results may fluctuate materially in the future. These fluctuations may cause our results of operations to not meet the expectations of securities analysts or investors which would likely cause the price of our stock to decline. Factors that may contribute to fluctuations in operating results include:

- given our limited customer base, the volume, timing and fulfillment of large customer contracts;
- renewals of existing customer contracts and wins of new customer programs;
- increased expenditures incurred pursuing new product or market opportunities;
- the timing of the receipt of royalty reports;
- fluctuating sales by our customers to their end-users;
- contractual counterparties failing to meet their contractual commitments to us;
- introduction of new products by us or our competitors;
- cybersecurity or data breaches;
- reduction in the prices of our products in response to competition, market conditions or contractual obligations;
- impairment of goodwill or intangible assets;
- accounts receivable that are not collectible;
- higher than anticipated costs related to fixed-price contracts with our customers;
- change in costs due to regulatory or trade restrictions;
- expenses incurred in litigation matters, whether initiated by us or brought by third-parties against us, and settlements or judgments we are required to pay in connection with disputes;
- changes in our stock compensation practices, as relates to employee short term incentive payments; and
- general economic trends as they affect the customer bases into which we sell.

Due to the foregoing factors, among others, our finanical and operating results may fluctuate significantly from period to period. Our expense levels are based in significant part on our expectations of future revenue, and we may not be able to reduce our expenses quickly to respond to near-term shortfalls in projected revenue. Therefore, our failure to meet revenue expectations would seriously harm our operating results, financial condition and cash flows.

We may not be successful with the adoption of new applications.

Part of our growth strategy includes the successful introduction of new products that will rely on subscription or transactional-based revenue generation. These represent new applications and we cannot assure the introduction of these new products, the level of adoption of these new products, or how quickly they can ramp to generate meaningful revenue. The development and launch of new products will require maintaining adequate resources, such as the appropriate personnel and technology to develop such products. We may experience delays between the time we incur expenses associated with the development and launch of new products and the revenue generated from the products. In addition, anticipated demand for the new products could decrease after we have spent time and resources on the development of the new product, or our efforts may not lead to the successful introduction of new products that are competitive, which would harm our business, results of operations and financial condition.

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

If any of our key employees were to leave, we could face substantial difficulty in hiring qualified successors and could experience a loss in productivity while any successor obtains the necessary training and experience. Although we have arrangements with some of our executive officers designed to promote retention, our employment relationships are generally at-will and we have had key employees leave in the past. We cannot assure you that one or more key employees will not leave in the future. We intend to continue to hire additional highly qualified personnel, including research and development and operational personnel, but may not be able to attract, assimilate or retain qualified personnel in the future. Any failure to attract, integrate, motivate and retain these employees could harm our business.

We depend on skilled employees and could be impacted by a shortage of critical skills.

Much of our future success depends on the continued service and availability of skilled employees, particularly with respect to technical areas. Skilled and experienced personnel in the areas where we compete are in high demand, and competition for their talents is intense. We expect that many of our key employees will receive a total compensation package that includes equity awards. New regulations or volatility in the stock market could diminish our use, and the value, of our equity awards. This would place us at a competitive disadvantage in attracting qualified personnel or force us to offer more cash compensation.

Some of our employees are represented by workers councils or unions or are subject to local laws that are less favorable to employers than the laws of the U.S.

Most of our employees in Europe are represented by workers councils or unions. Although we believe we have a good working relationship with our employees and their legal representatives, they must approve any changes in terms which may impede efforts to restructure our workforce.

Cybersecurity and data privacy incidents or breaches may damage client relations and inhibit our growth.

The confidentiality and security of our information, and that of third parties, is critical to our business. Our services involve the transmission, use, and storage of customers' and their customers' information, which may be confidential or contain personally identifiable information. Any cybersecurity or data privacy incidents could have a material adverse effect on our results of operations and financial condition. While we maintain a broad array of information security and privacy measures, policies and practices, our networks may be breached through a variety of means, resulting in someone obtaining unauthorized access to our information, to information of our customers or their customers, or to our intellectual property; disabling or degrading service; or sabotaging systems or information. In addition, hardware, software, systems, or applications we develop or procure from third parties may contain defects in design or manufacture or other problems that could unexpectedly compromise information security. Unauthorized parties may also attempt to gain access to our systems or facilities, or those of third parties with whom we do business, through fraud or other forms of deceiving our employees, contractors, and vendors. Because the techniques used to obtain unauthorized access, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. We will continue to incur significant costs to continuously enhance our information security measures to defend against the threat of cybercrime. Any cybersecurity or data privacy incident or breach may result in:

- loss of revenue resulting from the operational disruption;

- loss of revenue or increased bad debt expense due to the inability to invoice properly or to customer dissatisfaction resulting in collection issues;
- loss of revenue due to loss of customers;
- material remediation costs to recreate or restore systems;
- material investments in new or enhanced systems in order to enhance our information security posture;
- cost of incentives offered to customers to restore confidence and maintain business relationships;
- reputational damage resulting in the failure to retain or attract customers;
- costs associated with potential litigation or governmental investigations;
- costs associated with any required notices of a data breach;
- costs associated with the potential loss of critical business data;
- difficulties enhancing or creating new products due to loss of data or data integrity issues; and
- other consequences of which we are not currently aware but will discover through the remediation process.

Our business is subject to a variety of domestic and international laws, rules, policies and other obligations.

We are subject to U.S. and international laws and regulations in multiple areas, including data protection, anticorruption, labor relations, tax, foreign currency, anti-competition, import, export and trade regulations, and we are subject to a complex array of federal, state and international laws relating to the collection, use, retention, disclosure, security and transfer of personally identifiable information. In many cases, these laws apply not only to transfers between unrelated third-parties but also to transfers between us and our subsidiaries. Many jurisdictions have passed laws in this area, and other jurisdictions are considering imposing additional restrictions. The European Commission adopted the European General Data Protection Regulation, or GDPR, which went into effect on May 25, 2018. China adopted a new cybersecurity law as of June 2017. In addition, California adopted significant new consumer privacy laws in June 2018 that went into effect in January 2020. Complying with the GDPR and other requirements may cause us to incur substantial costs and may require us to change our business practices.

Any failure by us, our customers or other parties with whom we do business to comply with our privacy policy or with federal, state or international privacy-related or data protection laws and regulations could result in proceedings against us by governmental entities or others. Any alleged or actual failure to comply with applicable privacy laws and regulations may:

- cause our customers to lose confidence in our solutions;
- harm our reputation;
- expose us to litigation, regulatory investigations and to resulting liabilities including reimbursement of customer costs, damages, penalties or fines imposed by regulatory agencies; and
- require us to incur significant expenses for remediation.

We are also subject to a variety of anticorruption laws in respect of our international operations, including the U.S. Foreign Corrupt Practices Act, the U.K. Bribery Act and the Canadian Corruption of Foreign Public Officials Act, and regulations issued by the U.S. Customs and Border Protection, the U.S. Bureau of Industry and Security, the U.S. Treasury Department's Office of Foreign Assets Control, and various other foreign governmental agencies. We cannot predict the nature, scope or effect of future regulatory requirements to which our international operations might be subject or the manner in which existing laws might be administered or interpreted. Actual or alleged violations of these laws and regulations could lead to enforcement actions and financial penalties that could result in substantial costs.

A significant portion of our revenues are derived, and a significant portion of our research and development activities are based, outside the United States. Our results could be harmed by economic, political, regulatory, foreign currency fluctuations and other risks associated with these international regions.

Because we operate worldwide, our business is subject to risks associated with doing business internationally. We generate most of our international revenue in Europe and Asia, and we anticipate that revenue from international operations could increase in the future. In addition, some of our products are developed outside the United States. We conduct a significant portion of the development of our voice recognition and natural language understanding solutions in Canada and Germany. We also have significant research and development resources in Belgium, China, India, Italy, and the United Kingdom. We are exposed to fluctuating exchange rates of foreign currencies including the euro, British pound, Canadian dollar, Chinese RMB, Japanese yen, Indian rupee and South Korean won. Accordingly, our future results could be harmed by a variety of factors associated with international sales and operations, including:

- adverse political and economic conditions, or changes to such conditions, in a specific region or country;
- trade protection measures, including tariffs and import/export controls, imposed by the United States and/or by other countries or regional authorities such as China, Canada or the European Union;
- the impact on local and global economies of the United Kingdom leaving the European Union;
- changes in foreign currency exchange rates or the lack of ability to hedge certain foreign currencies;
- compliance with laws and regulations in many countries and any subsequent changes in such laws and regulations;
- geopolitical turmoil, including terrorism and war;
- changing data privacy regulations and customer requirements to locate data centers in certain jurisdictions;
- evolving restrictions on cross-border investment, including recent enhancements to the oversight by the Committee on Foreign Investment in the United States pursuant to the Foreign Investment Risk Preview Modernization Act and substantial restrictions on investment from China;
- changes in applicable tax laws;
- difficulties in staffing and managing operations in multiple locations in many countries;
- longer payment cycles of foreign customers and timing of collections in foreign jurisdictions; and
- less effective protection of intellectual property than in the United States.

Our business in China is subject to aggressive competition and is sensitive to economic, market and political conditions.

We operate in the highly competitive automotive cognitive assistance market in China and face competition from both international and smaller domestic manufacturers. We anticipate that additional competitors, both domestic and international, may seek to enter the Chinese market resulting in increased competition. Increased competition may result in price reductions, reduced margins and our inability to gain or hold market share. There have been periods of increased market volatility and moderation in the levels of economic growth in China, which resulted in periods of lower automotive production growth rates in China than those previously experienced. In addition, political tensions between China and the United States may negatively impact our ability to conduct business in China. If we are unable to grow or maintain our position in the Chinese market, the pace of growth slows or vehicle sales in China decrease, our business, results of operations and financial condition could be materially adversely effected. Government regulations and business considerations may also require us to conduct business in China through joint ventures with Chinese companies. Our participation in joint ventures would limit our control over Chinese operations and may expose our proprietary technologies to misappropriation by joint venture partners. The above risks, if realized, could have a material adverse effect on our business, results of operations and financial condition.

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

Because our services are complex and incorporate a variety of third-party hardware and software, our services may have errors or defects that could result in unanticipated downtime for our customers and harm to our reputation and our business. We have from time to time, found defects in our services, and new errors in our services may be detected in the future. In addition, we currently serve our customers from data center hosting facilities or third-party public clouds we directly manage. Any damage to, or failure of, the systems and facilities that serve our customers in whole or in part could result in interruptions in our service. Interruptions in our service may reduce our revenue, cause us to issue credits or pay service level agreement penalties, cause customers to terminate their on-demand services, and adversely affect our renewal rates and our ability to attract new customers.

If our goodwill or other intangible assets become impaired, our operating results could be negatively impacted.

We have significant intangible assets, including goodwill and other intangible assets, which are susceptible to valuation adjustments as a result of changes in various factors or conditions. The most significant intangible assets are goodwill, customer relationships and patents and core technologies. Customer relationships are amortized over their estimated economic lives based on the pattern of economic benefits expected to be generated from the use of the asset. Technologies and patents are amortized on a straight-line basis over their estimated useful lives. We assess the potential impairment of goodwill on an annual basis. Whenever events or changes in circumstances indicate that the carrying value may not be recoverable, we will be required to assess the potential impairment of goodwill and other intangible assets. Factors that could trigger an impairment of such assets include the following:

- changes in our organization or management reporting structure that could result in additional reporting units, which may require alternative methods of estimating fair values or greater disaggregation or aggregation in our analysis by reporting unit;
- significant under performance relative to historical or projected future operating results;
- significant changes in the strategy for our overall business;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period; and
- our market capitalization declining to below net book value.

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

Risks Relating to our Intellectual Property and Technology

Third parties have claimed and may claim in the future that we are infringing their intellectual property, and we could be exposed to significant litigation or licensing expenses or be prevented from selling our products if such claims are successful.

From time to time, we are subject to claims and legal actions alleging that we or our customers may be infringing or contributing to the infringement of the intellectual property rights of others. We may be unaware of intellectual property rights of others that may cover some of our technologies and products. If it appears necessary or desirable, we may seek licenses for these intellectual property rights. However, we may not be able to obtain licenses from some or all claimants, the terms of any offered licenses may not be acceptable to us, and we may not be able to resolve disputes without litigation. Any litigation regarding intellectual property could be costly and time-consuming and could divert the attention of our management and key personnel from our business operations. Intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from licensing certain of our products, cause severe disruptions to our operations or the markets in which we compete, or require us to satisfy indemnification commitments with our customers including contractual provisions under various arrangements. Any of these could seriously harm our business, financial condition or operations.

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

Our success and competitive position depend in large part on our ability to obtain and maintain intellectual property rights protecting our products and services. We rely on a combination of patents, copyrights, trademarks, service marks, trade secrets, confidentiality provisions and licensing arrangements to establish and protect our intellectual property and proprietary rights. Unauthorized parties may attempt to copy or discover aspects of our products or to obtain, license, sell or otherwise use information that we regard as proprietary. Policing unauthorized use of our products is difficult and we may not be able to protect our technology from unauthorized use. Additionally, our competitors may independently develop technologies that are substantially the same or superior to our technologies and that do not infringe our rights. In these cases, we would be unable to prevent our competitors from selling or licensing these similar or superior technologies. In addition, the laws of some foreign countries do not protect our proprietary rights to the same extent as the laws of the United States. Although the source code for our proprietary software is protected both as a trade secret and as a copyrighted work, litigation may be necessary to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Litigation, regardless of the outcome, can be very expensive and can divert management’s efforts.

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

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

We may be unable to respond quickly enough to changes in technology and technological risks and to develop our intellectual property into commercially viable products.

Changes in legislative, regulatory or industry requirements or in competitive technologies may render certain of our products obsolete or less attractive to our customers, which could adversely affect our results of operations. Our ability to anticipate changes in technology and regulatory standards and to successfully develop and introduce new and enhanced products on a timely basis will be a significant factor in our ability to be competitive. There is a risk that we will not be able to achieve the technological advances that may be necessary for us to be competitive or that certain of our products will become obsolete. Moreover, restrictions on the use of our technology over the next three years under the Intellectual Property Agreement which we entered into with Nuance in connection with the Spin-Off may limit our ability to adapt to technology and regulatory developments and thereby compete effectively in the market. We are also subject to the risks generally associated with new product introductions and applications, including lack of market acceptance, delays in product development and failure of products to operate properly. These risks could have a material adverse effect on our business, results of operations and financial condition.

We utilize certain key technologies, content and services from, and integrate certain of our solutions with, third parties and may be unable to replace those technologies, content and services if they become obsolete, unavailable or incompatible with our solutions.

We utilize certain key technologies and content from, and/or integrate certain of our solutions with, hardware, software, services and content of third parties. Some of these vendors are also our competitors in various respects. These third-party vendors could, in the future, seek to charge us cost prohibitive fees for such use or integration or may design or utilize their solutions in a manner that makes it more difficult for us to continue to utilize their solutions, or integrate their technologies with our solutions, in the same manner or at all. Any significant interruption in the supply or maintenance of such third-party hardware, software, services or content could negatively impact our ability to offer our solutions unless and until we replace the functionality provided by this third-party hardware, software and/or content. In addition, we are dependent upon these third parties' ability to enhance their current products, develop new products on a timely and cost-effective basis and respond to emerging industry standards and other technological changes. There can be no assurance that we would be able to replace the functionality or content provided by third-party vendors in the event that such technologies become obsolete or incompatible with future versions of our solutions or are otherwise not adequately maintained or updated. Any delay in or inability to replace any such functionality could have a material adverse effect on our business, results of operations and financial condition. Furthermore, delays in the release of new and upgraded versions of third-party software applications could have a material adverse effect on our business, results of operations and financial condition.

Risks Relating to the Spin-Off

If the Spin-Off were determined not to qualify as tax-free for U.S. federal income tax purposes, we could have an indemnification obligation to Nuance, which could adversely affect our business, financial condition and results of operations.

On October 1, 2019, we were spun off from Nuance. Completion of the Spin-Off was conditioned on Nuance's receipt of a written opinion from its tax counsel to the effect that the Distribution will qualify for non-recognition of gain and loss under Section 355 and related provisions of the Internal Revenue Code of 1986, as amended, or the Code.

The opinion of counsel does not address any U.S. state or local or foreign tax consequences of the Spin-Off. The opinion assumed that the Spin-Off was completed according to the terms of the Separation and Distribution Agreement and relied on the facts as stated in the Separation and Distribution Agreement, the Tax Matters Agreement, the other ancillary agreements, Information Statement included as part of our registration statement on Form 10 and a number of other documents related to the Spin-Off. In addition, the opinion was based on certain assumptions as well as certain representations as to factual matters from, and certain covenants by, Nuance and us. The opinion cannot be relied on if any of the assumptions, representations or covenants are incorrect, incomplete or inaccurate or are violated in any material respect.

If, as a result of any of our representations being untrue or our covenants being breached, the Spin-Off, and certain related transactions or certain transactions, were determined not to qualify for non-recognition of gain or loss under Section 355 and related provisions of the Code, we could be required to indemnify Nuance for the resulting taxes and related expenses. Those amounts could be material. Any such indemnification obligation could adversely affect our business, financial condition and results of operations.

In addition, if we or our stockholders were to engage in transactions that resulted in a 50% or greater change by vote or value in the ownership of our stock during the four-year period beginning on the date that begins two years before the date of the Spin-Off, the Spin-Off would generally be taxable to Nuance, but not to stockholders, under Section 355(e) of the Code, unless it were established that such transactions and the Spin-Off were not part of a plan or series of related transactions. If the Spin-Off were taxable to Nuance due to such a 50% or greater change in ownership of our stock, Nuance would recognize gain equal to the excess of the fair market value on the Distribution Date of our common stock distributed to Nuance stockholders over Nuance's tax basis in our common stock and would also recognize gain in respect of certain reorganization transactions undertaken by Nuance to effect the separation, and we generally would be required to indemnify Nuance for the tax on such gain and related expenses. Those amounts could be material. Any such indemnification obligation could adversely affect our business, financial condition and results of operations.

We have agreed to numerous restrictions to preserve the non-recognition treatment of the Spin-Off, which may reduce our strategic and operating flexibility.

We have agreed in the Tax Matters Agreement to covenants and indemnification obligations that address compliance with Section 355 and related provisions of the Code and are intended to preserve the tax-free nature of the Spin-Off. These covenants include certain restrictions on our activity for a period of two years following the Spin-Off, unless we or Nuance obtain a private letter ruling from the U.S. Internal Revenue Service, or the IRS, or an opinion of counsel, in each case acceptable to Nuance in its reasonable discretion, that the restricted action would not impact the non-recognition treatment of the Spin-Off, or unless Nuance otherwise gives its consent for us to take a restricted action. These covenants and indemnification obligations limit our ability to pursue strategic transactions or engage in new businesses or other transactions that may maximize the value of our business, and might discourage or delay a strategic transaction that our stockholders may consider favorable.

We may be unable to achieve some or all of the benefits that we expect to achieve from the Spin-Off.

We believe that, as an independent, publicly traded company, we will be able to, among other things, design and implement corporate strategies and policies and develop partnerships that are better targeted to our business's areas of strength and differentiation, better focus our financial and operational resources on those specific strategies, create effective incentives for our management and employees that are more closely tied to our business performance, provide investors more flexibility and enable us to achieve alignment with a more natural stockholder base and implement and maintain a capital structure designed to meet our specific needs. We may be unable to achieve some or all of the benefits that we expect to achieve as an independent company in the time we expect, if at all, for a variety of reasons, including:

- as an independent, publicly traded company, we may be more susceptible to market fluctuations and other adverse events than if it were still a part of Nuance; and
- as an independent, publicly traded company, our businesses are less diversified than Nuance's businesses prior to the separation.

If we fail to achieve some or all of the benefits that we expect to achieve as an independent company, or do not achieve them in the time we expect, our business, financial condition and results of operations could be adversely affected.

Our historical combined financial information is not necessarily representative of the results we would have achieved as an independent, publicly traded company.

For fiscal year 2019, we derived the historical combined financial information included in this Form 10-K from Nuance's consolidated financial statements, and this information does not necessarily reflect the results of operations and financial position we would have achieved as an independent, publicly traded company during the periods presented. This is primarily because of the following factors:

- Prior to the Spin-Off, we operated as part of Nuance's broader organization, and Nuance performed various corporate functions for us. Our historical combined financial information for fiscal year 2019 reflects allocations of corporate expenses from Nuance for these and similar functions. These allocations may not reflect the costs we would have incurred for similar services as an independent publicly traded company.

- We have entered into transactions with Nuance that did not exist prior to the Spin-Off, such as Nuance's provision of transition and other services, and undertaken indemnification obligations, which have caused us to incur new costs after the Spin-Off.
- Our historical combined financial information for fiscal year 2019 does not reflect changes that we experienced as a result of our separation from Nuance, including changes in the financing, cash management, operations, cost structure and personnel needs of our business. As part of Nuance, we enjoyed certain benefits from Nuance's operating diversity, size, purchasing power, borrowing leverage and available capital for investments that we can no longer enjoy after the Spin-Off. As an independent entity, we may be unable to purchase goods, services and technologies, such as insurance and health care benefits and computer software licenses, or access capital markets, on terms as favorable to us as those we obtained as part of Nuance prior to the Spin-Off, and our results of operations may be adversely affected. In addition, our historical combined financial data for fiscal year 2019 does not include an allocation of interest expense comparable to the interest expenses we incurred as a result of the Spin-Off and related transactions.

We may have potential business conflicts of interest with Nuance with respect to our past and ongoing relationships.

Conflicts of interest may arise between Nuance and us in a number of areas relating to our past and ongoing relationships, including:

- labor, tax, employee benefit, indemnification and other matters arising from our separation from Nuance;
- intellectual property matters;
- employee recruiting and retention; and
- business combinations involving our company.

We may not be able to resolve any potential conflicts, and, even if we do so, the resolution may be less favorable to us than if we were dealing with an unaffiliated party.

A certain director may have actual or potential conflicts of interest because of their financial interests in Nuance.

A certain director owns equity interests in Nuance. Continuing ownership of Nuance shares and equity awards could create, or appear to create, potential conflicts of interest if we and Nuance face decisions that could have implications for both of us.

The allocation of intellectual property rights and data between Nuance and Cerence as part of the Spin-Off, the shared use of certain intellectual property rights and data following the Spin-Off and restrictions on the use of intellectual property rights, could adversely impact our reputation, our ability to enforce certain intellectual property rights that are important to us and our competitive position.

In connection with the Spin-Off, we are entered into agreements with Nuance governing the allocation of intellectual property rights and data related to our business. These agreements include restrictions on our use of Nuance's intellectual property rights and data licensed to us, including limitations on the field of use in which we can exercise our license rights. As a result, we may not be able to pursue opportunities that require use of these license rights in industries other than the automotive industry and certain ancillary fields. Moreover, the licenses granted to us under Nuance's intellectual property rights and data are non-exclusive, so Nuance may be able to license the rights and data to third parties that may compete with us. These agreements could adversely affect our position and options relating to intellectual property enforcement, licensing negotiations and monetization and access to data used in our business. We also may not have sufficient rights to grant sublicenses of intellectual property or data used in our business, and we may be subject to third party rights pertaining to the underlying intellectual property or data. These circumstances could adversely affect our ability to protect our competitive position in the industry and otherwise adversely affect our business, financial condition and results of operations.

Risks Relating to Our Securities and Indebtedness

The terms of the Senior Credit Facilities restrict our current and future operations, particularly our ability to incur debt that we may need to fund initiatives in response to changes in our business, the industry in which we operate, the economy and governmental regulations.

The terms of the Senior Credit Facilities include a number of restrictive covenants that impose significant operating and financial restrictions on us and our subsidiaries and limit our ability to engage in actions that may be in our long-term best interests. These restrict our and our subsidiaries' ability to take some or all of the following actions:

- incur or guarantee additional indebtedness or sell disqualified or preferred stock;
- pay dividends on, make distributions in respect of, repurchase or redeem capital stock;
- make investments or acquisitions;
- create liens;
- enter into sale/leaseback transactions;
- enter into agreements restricting the ability to pay dividends or make other intercompany transfers;
- enter into transactions with affiliates;
- prepay, repurchase or redeem certain kinds of indebtedness;
- consolidate, merge, sell or otherwise dispose of assets or sell stock of our subsidiaries; and/or
- significantly change the nature of our business.

Furthermore, the lenders under the Senior Credit Facilities have required that we pledge our assets as collateral as security for our repayment obligations and that we abide by certain financial or operational covenants. Our ability to comply with such covenants and restrictions may be affected by events beyond our control, including prevailing economic, financial and industry conditions. If market or other economic conditions deteriorate, our ability to comply with these covenants may be impaired. A breach of any of these covenants, if applicable, could result in an event of default under the terms of the Senior Credit Facilities. If an event of default occurred, the lenders would have the right to accelerate the repayment of such debt, and the event of default or acceleration could result in the acceleration of the repayment of any other debt to which a cross-default or cross-acceleration provision applies. We might not have, or be able to obtain, sufficient funds to make these accelerated payments, and lenders could then proceed against any collateral. Any subsequent replacement of the agreements governing the Senior Credit Facilities or any new indebtedness could have similar or greater restrictions. The occurrence and ramifications of an event of default could adversely affect our business, financial condition and results of operations. Moreover, as a result of all of these restrictions, we may be limited in how we conduct our business and pursue our strategy, unable to raise additional debt financing to operate during general economic or business downturns or unable to compete effectively or to take advantage of new business opportunities.

We may evaluate whether to pay cash dividends on our common stock in the future, and the terms of our Senior Credit Facilities limit our ability to pay dividends on our common stock.

Our Board of Directors', or our Board, decisions regarding the payment of dividends depends on consideration of many factors, such as our financial condition, earnings, sufficiency of distributable reserves, opportunities to retain future earnings for use in the operation of our business and to fund future growth, capital requirements, debt service obligations, legal requirements, regulatory constraints and other factors that our Board deems relevant. Additionally, the terms of the Senior Credit Facilities limit our ability to pay cash dividends. There can be no assurance that we will pay a dividend in the future or continue to pay any dividend if we do commence paying dividends.

Servicing our debt may require a significant amount of cash. We may not have sufficient cash flow from our business to pay our indebtedness, and we may not have the ability to raise the funds necessary to settle for cash conversions of the Notes or to repurchase the Notes for cash upon a fundamental change, which could adversely affect our business and results of operations.

In June 2020, we issued an aggregate principal amount of $175 million 3.00% convertible senior notes due 2025, or the Notes. The interest rate is fixed at 3.00% per annum and is payable semi-annually in arrears on June 1 and December 1 of each year, beginning on December 1, 2020. We may also incur additional indebtedness to meet future financing needs. Our indebtedness could have significant negative consequences for our stockholders and our business, results of operations and financial condition by, among other things: (a) increasing our vulnerability to adverse economic and industry conditions; (b) limiting our ability to obtain additional financing; (c) requiring the dedication of a substantial portion of our cash flow from operations to service our indebtedness, which will reduce the amount of cash available for other purposes; (d) limiting our flexibility to plan for, or react to, changes in our business; (e) diluting the interests of our existing stockholders as a result of issuing our common stock upon conversion of the Notes; and (f) placing us at a possible competitive disadvantage with competitors that are less leveraged than us or have better access to capital.

Our ability to make scheduled payments of the principal of, to pay interest on, or to refinance our indebtedness, including the Notes, depends on our future performance, which is subject to economic, financial, competitive, and other factors beyond our control. Our business may not generate cash flows from operations in the future that are sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flows, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt, or obtaining additional debt financing or equity capital on terms that may be onerous or highly dilutive. Our ability to refinance any future indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations. In addition, any of our future debt agreements may contain restrictive covenants that may prohibit us from adopting any of these alternatives.

Holders of the Notes have the right to require us to repurchase their Notes upon the occurrence of a fundamental change (as defined in the indenture governing the Notes) at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus accrued and unpaid interest, if any. Upon conversion, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the Notes being converted. We may not have enough available cash or be able to obtain financing at the time we are required to make repurchases in connection with such conversion and our ability to pay may additionally be limited by law, by regulatory authority, or by agreements governing our existing and future indebtedness. Our failure to repurchase the Notes at a time when the repurchase is required by the indenture governing the Notes or to pay any cash payable on future conversions as required by such indenture would constitute a default under such indenture. A default under the indenture or the fundamental change itself could also lead to a default under agreements governing our existing and future indebtedness. If the repayment of the related indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay the indebtedness and repurchase the Notes or make cash payments upon conversions thereof.

In addition, our indebtedness, combined with our other financial obligations and contractual commitments, could have other important consequences. For example, it could:

- make us more vulnerable to adverse changes in general U.S. and worldwide economic, industry, and competitive conditions and adverse changes in government regulations;
- limit our flexibility in planning for, or reacting to, changes in our business and our industry;
- place us at a disadvantage compared to our competitors who have less debt;
- limit our ability to borrow additional amounts for funding acquisitions, for working capital, and for other general corporate purposes; and
- make an acquisition of our company less attractive or more difficult.

Any of these factors could harm our business, results of operations, and financial condition. In addition, if we incur additional indebtedness, the risks related to our business and our ability to service or repay our indebtedness would increase.

The conditional conversion feature of the Notes, if triggered, may adversely affect our financial condition and results of operations and the value of our common stock.

In the event the conditional conversion feature of the Notes is triggered, holders of Notes will be entitled to convert the Notes at any time during specified periods at their option. If one or more holders elect to convert their Notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

The conversion of some or all of the Notes would dilute the ownership interests of existing stockholders to the extent we satisfy our conversion obligation by delivering shares of our common stock upon any conversion of such Notes. Our Notes may become in the future convertible at the option of their holders under certain circumstances. If holders of our Notes elect to convert their Notes, we may settle our conversion obligation by delivering to them a significant number of shares of our common stock, which would cause dilution to our existing stockholders.

The accounting method for convertible debt securities that may be settled in cash, such as the Notes, could have a material effect on our reported financial results.

Under FASB ASC Subtopic 470-20, *Debt with Conversion and Other Options*, or ASC 470-20, an entity must separately account for the liability and equity components of convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer’s economic interest cost. ASC 470-20 requires the value of the conversion options of the Notes, representing the equity component, to be recorded as additional paid-in capital within stockholders’ equity in our consolidated balance sheet and as a discount to the Notes, which reduces their initial carrying value. The carrying value of the Notes, net of the applicable discount recorded, will be accreted up to the principal amount of the Notes, as the case may be, from the issuance date until maturity, which will result in non-cash charges to interest expense in our consolidated statement of operations. Accordingly, we will report lower net income or higher net loss in our financial results because ASC 470-20 requires interest to include both the current period’s accretion of the debt discount and the instrument’s coupon interest, which could adversely affect our reported or future financial results, the trading price of our common stock, and the respective trading price of the Notes.

In August 2020, the FASB issued Accounting Standards Update ASU 2020-06, or ASU 2020-06, with the intent to simplify ASC 470-20 and ASC subtopic 815-40, *Contracts in Entity’s Own Equity*, or ASC 815-40. Among the changes, ASU 2020-06 removed the requirement to bifurcate the liability and equity components of convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion. The removal of the bifurcation of liability and equity components would eliminate non-cash interest expense corresponding to the amounts recorded within equity. In addition, ASU 2020-06 precludes the use of the treasury stock method, when calculating diluted earnings per share, for convertible debt instruments that may be settled entirely or partially in cash upon conversion. The FASB has specified that public companies should adopt ASU 2020-06 as of the beginning of its annual fiscal year, for fiscal years beginning after December 15, 2021. Early adoption is permitted for fiscal years beginning after December 15, 2020, including interim periods.

We currently apply the “if-converted” method for calculating any potential dilutive effect of the conversion options embedded in the Notes on diluted net income per share, which assumes that all of the Notes were converted solely into shares of common stock at the beginning of the reporting period, unless the result would be anti-dilutive.

Certain provisions in our Amended and Restated Certificate of Incorporation and Amended and Restated By-Laws and Delaware law may discourage takeovers.

Several provisions of our Amended and Restated Certificate of Incorporation, Amended and Restated By-Laws and Delaware law may discourage, delay or prevent a merger or acquisition. These include, among others, provisions that:

- provide for staggered terms for directors on our Board for a period following the Spin-Off;
- do not permit our stockholders to act by written consent and require that stockholder action must take place at an annual or special meeting of our stockholders, in each case except as such rights may otherwise be provided to holders of preferred stock;
- provide for the removal of directors only for cause for a period following the Spin-Off;
- establish advance notice requirements for stockholder nominations and proposals;

- provide that a special meeting of our stockholders may only be called by our Board, the Chairman of our Board or our Chief Executive Officer, or at the request of holders of not less than 20% of the outstanding shares of the common stock of Cerence; and
- limit our ability to enter into business combination transactions.

These and other provisions of our Amended and Restated Certificate of Incorporation, Amended and Restated By-Laws and Delaware law may discourage, delay or prevent certain types of transactions involving an actual or a threatened acquisition or change in control of Cerence, including unsolicited takeover attempts, even though the transaction may offer our stockholders the opportunity to sell their shares of our common stock at a price above the prevailing market price.

Our Amended and Restated Certificate of Incorporation designates the courts of the State of Delaware as the sole and exclusive forum for certain types of actions and proceedings that may be initiated by our stockholders, which could limit our stockholders' ability to obtain a favorable judicial forum for disputes with us or our directors, officers or other employees.

Our Amended and Restated Certificate of Incorporation provides, in all cases to the fullest extent permitted by law, unless we consent in writing to the selection of an alternative forum, the Court of Chancery located within the State of Delaware is the sole and exclusive forum for any derivative action or proceeding brought on behalf of Cerence, any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee or stockholder of Cerence to Cerence or Cerence's stockholders, any action asserting a claim arising pursuant to the Delaware General Corporate Law, or DGCL, or as to which the DGCL confers jurisdiction on the Court of Chancery located in the State of Delaware or any action asserting a claim governed by the internal affairs doctrine or any other action asserting an "internal corporate claim" as that term is defined in Section 115 of the DGCL. However, if the Court of Chancery within the State of Delaware does not have jurisdiction, the action may be brought in any other state or federal court located within the State of Delaware. Further, this exclusive forum provision would not apply to suits brought to enforce a duty or liability created by the Exchange Act or the Securities Act of 1933, as amended, or the Securities Act, except that it may apply to such suits if brought derivatively on behalf of Cerence. There is, however, uncertainty as to whether a court would enforce such provision in connection with suits to enforce a duty or liability created by the Exchange Act or the Securities Act if brought derivatively on behalf of Cerence, and our stockholders will not be deemed to have waived our compliance with the federal securities laws and the rules and regulations thereunder.

Any person or entity purchasing or otherwise acquiring or holding any interest in shares of our capital stock will be deemed to have notice of and to have consented to these provisions. This provision may limit a stockholder's ability to bring a claim in a judicial forum that it finds favorable for disputes with us or our directors, officers or other employees, which may discourage such lawsuits. Alternatively, if a court were to find this provision of our Amended and Restated Certificate of Incorporation inapplicable to, or unenforceable in respect of, one or more of the specified types of actions or proceedings, we may incur additional costs associated with resolving such matters in other jurisdictions.

General Risk Factors

Tax matters may cause significant variability in our financial results and may impact our overall financial condition.

Our businesses are subject to income taxation in the United States, as well as in many tax jurisdictions throughout the world. Tax rates in these jurisdictions may be subject to significant change. If our effective tax rate increases, our operating results and cash flow could be adversely affected. Our effective income tax rate can vary significantly between periods due to a number of complex factors including:

- projected levels of taxable income;
- pre-tax income being lower than anticipated in countries with lower statutory rates or higher than anticipated in countries with higher statutory rates;
- increases or decreases to valuation allowances recorded against deferred tax assets;
- tax audits conducted and settled by various tax authorities;
- adjustments to income taxes upon finalization of income tax returns;
- the ability to claim foreign tax credits;
- the repatriation of non-U.S. earnings for which we have not previously provided for income taxes;
- changes in tax laws and their interpretations in countries in which we are subject to taxation; and
- changes to assessments of uncertain tax positions.

We regularly evaluate the need for a valuation allowance on deferred tax assets, considering historical profitability, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. This analysis is heavily dependent upon our current and projected operating results. A decline in future operating results could provide substantial evidence that a full or partial valuation allowance for deferred tax assets is necessary, which could have a material adverse effect on our results of operations and financial condition.

The commercial and credit environment may adversely affect our access to capital.

Our ability to issue debt or enter into other financing arrangements on acceptable terms could be adversely affected if there is a material decline in the demand for our products or in the solvency of our customers or suppliers or if there are other significantly unfavorable changes in economic conditions. Volatility in the world financial markets could increase borrowing costs or affect our ability to access the capital markets. These conditions may adversely affect our ability to obtain targeted credit ratings.

Our stock price may fluctuate significantly.

The market price of our common stock may fluctuate widely, depending on many factors, some of which may be beyond our control, including:

- actual or anticipated fluctuations in our results of operations due to factors related to our business;
- success or failure of our business strategies;
- competition and industry capacity;
- changes in interest rates and other factors that affect earnings and cash flow;
- our level of indebtedness, our ability to make payments on or service our indebtedness and our ability to obtain financing as needed;
- our ability to retain and recruit qualified personnel;
- our quarterly or annual earnings, or those of other companies in our industry;
- announcements by us or our competitors of significant acquisitions or dispositions;
- changes in accounting standards, policies, guidance, interpretations or principles;
- the failure of securities analysts to cover, or positively cover, our common stock;
- changes in earnings estimates by securities analysts or our ability to meet those estimates;
- the operating and stock price performance of other comparable companies;
- investor perception of our company and our industry;
- overall market fluctuations unrelated to our operating performance;
- results from any material litigation or government investigation;
- changes in laws and regulations (including tax laws and regulations) affecting our business;
- changes in capital gains taxes and taxes on dividends affecting stockholders; and
- general economic conditions and other external factors.

Low trading volume for our stock would amplify the effect of the above factors on our stock price volatility.

Should the market price of our shares drop significantly, stockholders may institute securities class action lawsuits against us. A lawsuit against us could cause us to incur substantial costs and could divert the time and attention of our management and other resources.

Your percentage ownership in Cerence may be diluted in the future.

Your percentage ownership in Cerence may be diluted in the future because of equity issuances for acquisitions, capital market transactions or otherwise, including equity awards that we grant to our directors, officers, employees and other service providers and shares of our common stock issuable upon the future vesting of certain Nuance equity awards held by our employees as a result of the Spin-Off. In addition, our Board has adopted the Cerence 2019 Equity Incentive Plan, or the Equity Plan, for the benefit of certain of our current and future employees, service providers and non-employee directors. Such awards will have a dilutive effect on our earnings per share, which could adversely affect the market price of our common stock.

In addition, our Amended and Restated Certificate of Incorporation authorizes us to issue, without the approval of our stockholders, one or more classes or series of preferred stock having such designation, powers, preferences and relative, participating, optional and other special rights, including preferences over our common stock with respect to dividends and distributions, as our Board may generally determine. The terms of one or more classes or series of preferred stock could dilute the voting power or reduce the value of our common stock. For example, we could grant the holders of preferred stock the right to elect some number of the members of our Board in all events or upon the happening of specified events, or the right to veto specified transactions. Similarly, the repurchase or redemption rights or liquidation preferences that we could assign to holders of preferred stock could affect the residual value of our common stock.

From time-to-time, we may opportunistically evaluate and pursue acquisition opportunities, including acquisitions for which the consideration thereof may consist partially or entirely of newly-issued shares of our common stock and, therefore, such transactions, if consummated, would dilute the voting power and/or reduce the value of our common stock.

If we fail to maintain proper and effective internal controls, our ability to produce accurate and timely financial statements could be impaired and investors' views of us could be harmed.

The Sarbanes-Oxley Act requires, among other things, that we maintain effective internal control over financial reporting and disclosure controls and procedures. In particular, we must perform system and process evaluation and testing of our internal control over financial reporting to allow management and our independent registered public accounting firm to report on the effectiveness of our internal control over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act, with auditor attestation of the effectiveness of our internal controls. If we are not able to comply with the requirements of Section 404 in a timely manner, or if we or our independent registered public accounting firm identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses, the market price of shares of our common stock could decline and we could be subject to sanctions or investigations by the SEC or other regulatory authorities, which would require additional financial and management resources.

Our ability to successfully implement our business plan and comply with Section 404 of the Sarbanes-Oxley Act requires us to be able to prepare timely and accurate financial statements. Any delay in the implementation of, or disruption in the transition to, new or enhanced systems, procedures or controls may cause our operations to suffer, and we may be unable to conclude that our internal control over financial reporting is effective and to obtain an unqualified report on internal controls from our auditors as required under Section 404 of the Sarbanes-Oxley Act. Moreover, we cannot be certain that these measures would ensure that we implement and maintain adequate controls over our financial processes and reporting in the future. Even if we were to conclude, and our auditors were to concur, that our internal control over financial reporting provided reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with United States Generally Accepted Accounting Principles, or GAAP, because of its inherent limitations, internal control over financial reporting might not prevent or detect fraud or misstatements. This, in turn, could have an adverse impact on trading prices for shares of our common stock, and could adversely affect our ability to access the capital markets.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our corporate headquarters is located in Burlington, Massachusetts, and our international headquarters is located in Heerlen, Netherlands. Other large, leased sites include properties located in: Montreal, Canada; Aachen and Ulm, Germany; Shanghai and Chengdu, China; Merelbeke, Belgium; Turin, Italy; Tokyo, Japan and Pune, India.

We believe our existing facilities and equipment are in good operating condition and are suitable for the conduct of our business.

Item 3. Legal Proceedings.

Similar to many companies in the software industry, we are involved in a variety of claims, demands, suits, investigations and proceedings that arise from time to time relating to matters incidental to the ordinary course of our business, including actions with respect to contracts, intellectual property, employment, benefits and securities matters. We evaluate the probability of adverse outcomes and, as applicable, estimate the amount of probable losses that may result from pending matters. Probable losses that can be reasonably estimated are reflected in our combined financial statements. These recorded amounts are not material to our combined financial statements for any of the periods presented in the accompanying combined financial statements. While it is not possible to predict the outcome of these matters with certainty, we do not expect the results of any of these actions to have a material adverse effect on our results of operations or financial position. However, each of these matters is subject to uncertainties, the actual losses may prove to be larger or smaller than the accruals reflected in our combined financial statements, and we could incur judgments or enter into settlements of claims that could adversely affect our financial position, results of operations or cash flows.

Item 4. Mine Safety Disclosures.

Not Applicable.

PART II

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

Our common stock has been listed on the Nasdaq Global Select Market under the symbol "CRNC" since October 2, 2019. Prior to that date, there was no public trading market for our common stock. A "when-issued" trading market for our common stock existed between September 17, 2019 and October 1, 2019 under the symbol "CRNCV".

Holders of Common Stock

As of November 9, 2021, there were 505 holders of record of our common stock. This number does not reflect beneficial owners whose shares are held in street name.

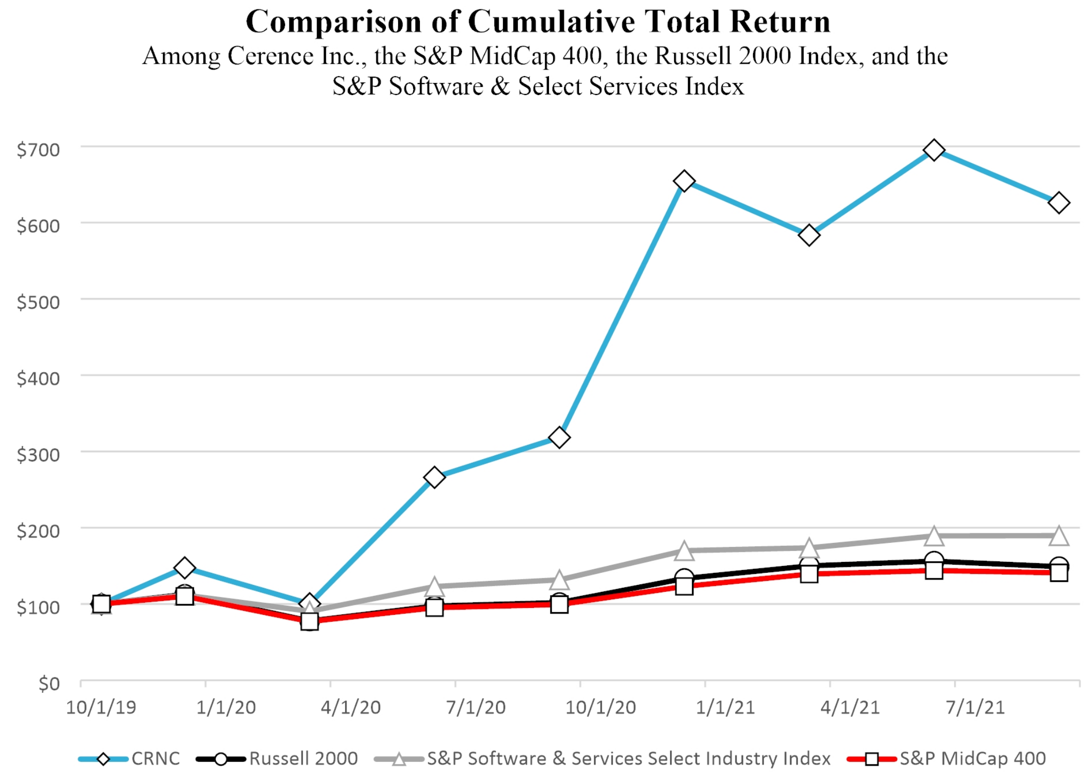
Dividend Policy

We have not paid any dividends since our formation. We may evaluate whether to pay cash dividends to our stockholders. The timing, declaration, amount and payment of future dividends to stockholders, if any, will fall within the discretion of our Board. Among the items we would consider in establishing a dividend policy are the capital needs of our business and opportunities to retain future earnings for use in the operation of our business and to fund future growth. Additionally, the terms of the Senior Credit Facilities limit our ability to pay cash dividends. There can be no assurance that we will pay a dividend in the future or continue to pay any dividend if we do commence the payment of dividends.

Performance Graph

The graph below compares the cumulative total shareholder return of our common stock for the last two years with the S&P MidCap 400, Russell 2000 and the S&P Software & Services Select indices. The information presented assumes an initial investment of $100 on October 2, 2019, the date our common stock began regular-way trading on the Nasdaq Global Select Market. The graph shows the value that each of these investments would have had at the end of each quarter.

The comparisons shown in the graph below are based upon historical data. We caution that the stock price performance shown in the graph below is not necessarily indicative of, nor is it intended to forecast, the potential future performance of our common stock.



	10/2/2019	12/31/2019	3/31/2020	6/30/2020	9/30/2020	12/31/2020	3/31/2021	6/30/2021	9/30/2021
Cerence Inc.	$ 100.00	$ 147.43	$ 100.33	$ 266.06	$ 318.37	$ 654.59	$ 583.58	$ 695.18	$ 626.12
S&P MidCap 400 (1)	$ 100.00	$ 110.10	$ 77.03	$ 95.16	$ 99.33	$ 123.10	$ 139.25	$ 143.88	$ 140.92
Russell 2000 (1)	$ 100.00	$ 112.76	$ 77.93	$ 97.41	$ 101.90	$ 133.47	$ 150.07	$ 156.16	$ 148.98
S&P Software & Services Select	$ 100.00	$ 111.69	$ 90.53	$ 122.93	$ 131.74	$ 169.98	$ 173.65	$ 189.31	$ 189.66

(1) During fiscal year 2021, our common stock was added to the S&P MidCap 400 Index. As such, we have included the S&P MidCap 400 Index as our broad market equity index comparative and will no longer include the Russell 2000 Index. We believe the S&P MidCap 400 Index generally includes companies with more comparable market capitalization to us. The stock performance line graph and table includes a comparison of our cumulative total return to the selected indices ((i) the S&P MidCap 400 Index and (ii) the S&P Software and Select Services) and the discontinued index ((iii) the Russell 2000 Index).

Recent Sales of Unregistered Securities and Use of Proceeds

None.

Issuer Purchases of Equity Securities

Not applicable.

Item 6. Reserved.

Not applicable.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations, (the "MD&A"), describes the principal factors, based on management's assessment, which have a material impact on our results of operations, financial condition and liquidity, as well as our critical accounting policies and estimates. Our MD&A generally includes a discussion of results of operations, financial condition, liquidity and capital resources related to year-over-year comparisons between fiscal years ended September 30, 2021, and 2020, as well as fiscal years ended September 30, 2020, and 2019.

The following discussion and analysis presented below should be read in conjunction with the Consolidated and Combined Financial Statements and the corresponding notes, and included elsewhere in this Form 10-K. The information presented in this section includes forward-looking statements, which are described in detail in the section titled "Cautionary Statement Concerning Forward-Looking Statements." The matters discussed in these forward-looking statements are subject to risks, uncertainties, and other factors that could cause actual results to differ materially from those made, projected, or implied in the forward-looking statements. See the section titled "Risk Factors" for a discussion of the risks, uncertainties, and assumptions associated with these statements.

Overview

Cerence builds AI powered virtual assistants for the mobility/transportation market. Our primary target is the automobile market, but our solutions can apply to all forms of transportation including but not limited to two-wheel vehicles, planes, tractors, cruise ships and elevators. Our solutions power natural conversational and intuitive interactions between automobiles, drivers and passengers, and the broader digital world. We possess one of the world's most popular software platforms for building automotive virtual assistants. Our customers include all major OEMs or their tier 1 suppliers worldwide. We deliver our solutions on a white-label basis, enabling our customers to deliver customized virtual assistants with unique, branded personalities and ultimately strengthening the bond between automobile brands and end users. Our vision is to enable a more enjoyable, safer journey for everyone.

Our principal offering is our software platform, which our customers use to build virtual assistants that can communicate, find information and take action across an expanding variety of categories. Our software platform has a hybrid architecture combining edge software components with cloud-connected components. Edge software components are installed on a vehicle's head unit and can operate without access to external networks and information. Cloud-connected components are comprised of certain speech and natural language understanding related technologies, AI-enabled personalization and context-based response frameworks, and content integration platform.

We generate revenue primarily by selling software licenses and cloud-connected services. Our edge software components are typically sold under a traditional per unit perpetual software license model, in which a per unit fee is charged for each software instance installed on an automotive head unit. We typically license cloud-connected software components in the form of a service to the vehicle end user, which is paid for in advance. In addition, we generate professional services revenue from our work with our customers during the design, development and deployment phases of the vehicle model lifecycle and through maintenance and enhancement projects. We have existing relationships with all major OEMs or their tier 1 suppliers, and while our customer contracts vary, they generally represent multi-year engagements, giving us visibility into future revenue.

Impact of COVID-19 on our Business

As the full impact of the COVID-19 pandemic on our business continues to develop, we are closely monitoring the global situation. We are unable to predict the full impact that COVID-19 will have on our operations, liquidity and financial results, and, depending on the magnitude and duration of the COVID-19 pandemic, such impact may be material. Accordingly, current results and financial condition discussed herein may not be indicative of future operating results and trends. For further discussion of the business risks associated with COVID-19, see Item 1A, Risk Factors, within this Form 10-K report.

Business Trends

We experienced total revenue growth of 17.0% and 9.1%, during fiscal year 2021 and fiscal year 2020, respectively, primarily driven by our connected and professional services revenues due to increased market penetration of our connected and professional services solutions. License revenues increased during fiscal 2021 due to higher volume of licensing royalties as the global auto industry recovered from the COVID-19 pandemic and OEMs increased production.

During fiscal year 2021, total cost of revenues decreased by 6.3%, primarily driven by our cost savings initiatives. Total operating expenses grew by 12.4% during fiscal year 2021, primarily driven by innovation initiatives in order to increase our competitive position in the market. Our R&D expenses increased 26.1%, as our R&D and engineering workforces refocused on developing new products and advancing our core technologies. Restructuring and other costs, net decreased $11.4 million as expenditures to establish the Cerence business as a standalone public company were not repeated in fiscal 2021. We anticipate that our R&D expenses will continue to represent a majority of our operating expenses as we focus on innovation and serving our customers.

Basis of Presentation

Fiscal years 2021 and 2020

The accompanying consolidated financial statements of the Company have been prepared in accordance with GAAP, and the rules and regulations of the SEC. The consolidated financial statements reflect all adjustments considered necessary for a fair presentation of the consolidated results of operations and financial position for the fiscal years presented. All such adjustments are of a normal recurring nature.

The consolidated financial statements include the accounts of the Company, as well as those of its wholly owned subsidiaries. All significant intercompany transactions and balances are eliminated in consolidation.

During the second quarter of fiscal 2021, we identified and corrected immaterial errors related to previously issued consolidated financial statements. In order to present the impact of the resulting adjustments, previously issued financial statements have been revised. See *Note 19 – Impact on Previously Issued Financial Statements for Immaterial Adjustments* in the Notes to the Consolidated and Combined Financial Statements included in Item 8, Financial Statements and Supplementary Data, within this Form 10-K for additional details. Accordingly, the tables presented in the MD&A reflect the impact of those revisions. The errors had no impact on the discussions related to year-over-year comparisons between fiscal years 2020 and 2019.

Fiscal year 2019

Standalone financial statements had not been historically prepared for the Cerence business. The accompanying combined financial statements have been prepared from Nuance Communications, Inc. (“Nuance” or “Parent”)’s historical accounting records and are presented on a “carve out” basis to include the historical financial position, results of operations and cash flows applicable to the Cerence business. As a direct ownership relationship did not exist among all the various business units comprising the Cerence business, Nuance’s investment in the Cerence business was shown in lieu of stockholders’ equity in the combined financial statements.

The Combined Statement of Operations included all revenues and costs directly attributable to Cerence as well as an allocation of expenses related to functions and services performed by centralized Parent organizations. These corporate expenses have been allocated to the Cerence business based on direct usage or benefit, where identifiable, with the remainder allocated on a pro rata basis of revenues, headcount, number of transactions or other measures as determined appropriate. The Combined Statement of Cash Flows presented these corporate expenses that are cash in nature as cash flows from operating activities, as this was the nature of these costs at the Parent. Non-cash expenses allocated from the Parent included corporate depreciation and amortization and stock-based compensation included as add-back adjustments to reconcile net income to net cash provided by operations.

The combined financial statements included the allocation of certain assets and liabilities that have historically been held at the Nuance corporate level or by shared entities, but which are specifically identifiable or allocable to the Cerence business. These shared assets and liabilities have been allocated to the Cerence business on the basis of direct usage when identifiable, or allocated on a pro rata basis of revenue, headcount or other systematic measures that reflect utilization of the services provided to or benefits received by Cerence. The Parent used a centralized approach to cash management and financing its operations. Accordingly, none of the cash, cash equivalents, marketable securities, foreign currency hedges or debt and related interest expense had been allocated to the Cerence business in the combined financial statements. The Parent’s short and long-term debt had not been pushed down to the Cerence business’s combined financial statements because the Cerence business was not the legal obligor of the debt and the Parent’s borrowings were not directly attributable to the Cerence business.

Transactions between the Parent and the Cerence business are considered to be effectively settled in the combined financial statements at the time the transaction was recorded. The total net effect of the settlement of these intercompany transactions was reflected in the Combined Statement of Cash Flows as a financing activity and in the Combined Balance Sheet as net parent investment.

All of the allocations and estimates in the combined financial statements are based on assumptions which management believed are reasonable. However, the combined financial statements included herein may not be indicative of the financial position, results of operations and cash flows if the Cerence business had been a separate, standalone entity during the period presented.

Key Metrics

In evaluating our financial condition and operating performance, we focus on revenue, operating margins, and cash flow from operations.

For the fiscal year 2021 as compared to fiscal year 2020:

- Total revenue increased by $56.2 million, or 17.0%, from $331.0 million to $387.2 million.
- Operating margin increased 8.9 percentage points from 6.8% to 15.7%.
- Cash provided by operating activities increased by $29.6 million, or 66.1%, from $44.8 million to $74.4 million.

For fiscal year 2020 as compared to fiscal year 2019:

- Total revenue increased by $27.7 million, or 9.1%, from $303.3 million to $331.0 million.
- Operating margin increased by 3.2 percentage points from 3.6% to 6.8%.
- Cash provided by operating activities decreased by $43.3 million, or 49.1%, from $88.1 million to $44.8 million.

Operating Results

The following table shows the Consolidated Statements of Operations for the fiscal years 2021 and 2020 and the Combined Statement of Operations for the fiscal year 2019 (dollars in thousands):

	Year Ended September 30,		
	2021	**2020**	**2019**
Revenues:			
License	$ 202,183	$ 164,268	$ 172,379
Connected services	109,534	97,469	78,690
Professional services	75,465	69,230	52,246
Total revenues	387,182	330,967	303,315
Cost of revenues:			
License	3,544	2,783	2,069
Connected services	25,727	31,768	37,562
Professional services	64,287	64,963	51,214
Amortization of intangibles	7,516	8,337	8,498
Total cost of revenues	101,074	107,851	99,343
Gross profit	286,108	223,116	203,972
Operating expenses:			
Research and development	112,070	88,899	93,061
Sales and marketing	38,683	33,398	36,261
General and administrative	56,979	49,386	25,926
Amortization of intangible assets	12,690	12,544	12,524
Restructuring and other costs, net	5,092	16,458	24,404
Acquisition-related costs	—	—	944
Total operating expenses	225,514	200,685	193,120
Income from operations	60,594	22,431	10,852
Interest income	109	585	—
Interest expense	(13,997)	(22,737)	—
Other income (expense), net	1,563	(23,319)	332
Income (loss) before income taxes	48,269	(23,040)	11,184
Provision for (benefit from) income taxes	2,376	(4,724)	(89,084)
Net income (loss)	$ 45,893	$ (18,316)	$ 100,268

Our revenue consists primarily of license revenue, connected services revenue and revenue from professional services. License revenue primarily consists of license royalties associated with our edge software components, with costs of license revenue primarily consisting of third-party royalty expenses for certain external technologies we leverage. Connected services revenue represents the subscription fee that provides access to our connected services components, including the customization and construction of our connected services solutions. Cost of connected service revenue primarily consists of labor costs of software delivery services, infrastructure, and communications fees that support our connected services solutions. Professional services revenue is primarily comprised of porting, integrating, and customizing our embedded solutions, with costs primarily consisting of compensation for services personnel, contractors and overhead.

Our operating expenses include R&D, sales and marketing and general and administrative expenses. R&D expenses primarily consist of salaries, benefits, and overhead relating to research and engineering staff. Sales and marketing expenses includes salaries, benefits, and commissions related to our sales, product marketing, product management, and business unit management teams. General and administrative expenses primarily consist of personnel costs for administration, finance, human resources, general management, fees for external professional advisers including accountants and attorneys, and provisions for credit losses.

Amortization of acquired patents and core technology are included within cost of revenues whereas the amortization of other intangible assets, such as acquired customer relationships, trade names and trademarks, are included within operating expenses. Customer relationships are amortized over their estimated economic lives based on the pattern of economic benefits expected to be generated from the use of the asset. Other identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives.

Restructuring and other costs, net include restructuring expenses as well as other charges that are unusual in nature, are the result of unplanned events, and arise outside the ordinary course of our business.

Acquisition-related costs include transition and integration costs, professional service fees, and fair value adjustments related to business and asset acquisitions, including potential acquisitions.

Total other expense, net consists primarily of foreign exchange gains (losses), losses on the extinguishment of debt and interest expense related to Existing Facilities, Notes, and Senior Credit Facilities.

Fiscal Year 2021 Compared with Fiscal Year 2020 and Fiscal Year 2020 Compared with Fiscal Year 2019

Total Revenues

The following table shows total revenues by product type, including the corresponding percentage change (dollars in thousands):

	Year Ended September 30,						% Change	% Change
	2021	% of Total	2020	% of Total	2019	% of Total	2021 vs. 2020	2020 vs. 2019
License	$ 202,183	52.2%	$ 164,268	49.6%	$ 172,379	56.8%	23.1%	(4.7)%
Connected services	109,534	28.3%	97,469	29.5%	78,690	26.0%	12.4%	23.9%
Professional services	75,465	19.5%	69,230	20.9%	52,246	17.2%	9.0%	32.5%
Total revenues	$ 387,182		$ 330,967		$ 303,315		17.0%	9.1%

Fiscal Year 2021 Compared with Fiscal Year 2020

Total revenues fiscal year 2021 were $387.2 million, an increase of $56.2 million, or 17.0%, from $331.0 million from fiscal year 2020. The increase in revenues occurred across all product types.

License Revenue

License revenue for fiscal year 2021 was $202.2 million, an increase of $37.9 million, or 23.1%, from $164.3 million for fiscal year 2020. The increase in license revenue was primarily due to higher volume of licensing royalties as the global auto industry recovered from the COVID-19 pandemic and OEMs increased production. As a percentage of total revenue, license revenue increased by 2.6 percentage points from 49.6% for fiscal year 2020 to 52.2% for fiscal year 2021. Currently, the global automotive industry is experiencing a semiconductor shortage. We are unable to predict the full extent this will have on our business, including our license revenue.

Connected Services Revenue

Connected services revenue for fiscal year 2021 was $109.5 million, an increase of $12.0 million, or 12.4%, from $97.5 million for fiscal year 2020. This increase was primarily driven by continued market penetration from our connected services solutions as our customers increasingly deploy hybrid solutions. As a percentage of total revenue, connected services revenue decreased by 1.2 percentage points from 29.5% for fiscal year 2020 to 28.3% for fiscal year 2021.

Professional Services Revenue

Professional services revenue for fiscal year 2021 was $75.5 million, an increase of $6.3 million, or 9.0%, from $69.2 million for fiscal year 2020. This increase was primarily driven by demand for the integration and customization services related to our edge software and the timing of services rendered. As a percentage of total revenue, professional services revenue decreased by 1.4 percentage points from 20.9% for fiscal year 2020 to 19.5% for fiscal year 2021.

Fiscal Year 2020 Compared with Fiscal Year 2019

Our total revenues for fiscal year 2020 were $331.0 million, an increase of $27.7 million, or 9.1%, from $303.3 million from fiscal year 2019. This growth was primarily driven by increased demand for our connected and professional solutions.

License Revenue

License revenue for fiscal year 2020 was $164.3 million, a decrease of $8.1 million, or 4.7%, from $172.4 million for fiscal year 2019. The decrease in license revenue was driven by the COVID-19 pandemic, which resulted in declining reported royalties from ongoing agreements. As a percentage of total revenue, license revenue decreased by 7.2 percentage points from 56.8% for fiscal year 2019 to 49.6% for fiscal year 2020.

Connected Services Revenue

Connected services revenue for fiscal year 2020 was $97.5 million, an increase of $18.8 million, or 23.9%, from $78.7 million for fiscal year 2019. This increase was primarily driven by continued market penetration from our connected services solutions as our customers increasingly deploy hybrid solutions. As a percentage of total revenue, connected services revenue increased by 3.5 percentage points from 26.0% for fiscal year 2019 to 29.5% for fiscal year 2020.

Professional Services Revenue

Professional services revenue for fiscal year 2020 was $69.2 million, an increase of $17.0 million, or 32.5%, from $52.2 million for fiscal year 2019. This increase was primarily driven by demand for the integration and customization services related to our edge software and the timing of services rendered. As a percentage of total revenue, professional services revenue increased by 3.7 percentage points from 17.2% for fiscal year 2019 to 20.9% for fiscal year 2020.

Total Cost of Revenues and Gross Profits

The following table shows total cost of revenues by product type and the corresponding percentage change (dollars in thousands):

	Year Ended September 30,			% Change	% Change
	2021	2020	2019	2021 vs. 2020	2020 vs. 2019
License	$ 3,544	$ 2,783	$ 2,069	27.3%	34.5%
Connected services	25,727	31,768	37,562	(19.0)%	(15.4)%
Professional services	64,287	64,963	51,214	(1.0)%	26.8%
Amortization of intangibles	7,516	8,337	8,498	(9.8)%	(1.9)%
Total cost of revenues	$ 101,074	$ 107,851	$ 99,343	(6.3)%	8.6%

The following table shows total gross profit by product type and the corresponding percentage change (dollars in thousands):

	Year Ended September 30,			% Change	% Change
	2021	2020	2019	2021 vs. 2020	2020 vs. 2019
License	$ 198,639	$ 161,485	$ 170,310	23.0%	(5.2)%
Connected services	83,807	65,701	41,128	27.6%	59.7%
Professional services	11,178	4,267	1,032	162.0%	313.5%
Amortization of intangibles	(7,516)	(8,337)	(8,498)	(9.8)%	(1.9)%
Total gross profit	$ 286,108	$ 223,116	$ 203,972	28.2%	9.4%

Fiscal Year 2021 Compared with Fiscal Year 2020

Total cost of revenues for fiscal year 2021 were $101.1 million, a decrease of $6.8 million, or 6.3%, from $107.9 million for fiscal year 2020. The decrease in cost of revenues resulted primarily from our cost savings initiatives implemented in the second half of fiscal 2020.

We experienced an increase in total gross profit of $63.0 million, or 28.2%, from $223.1 million to $286.1 million. The increase was primarily driven by our license and connected services solutions.

Cost of License Revenue

Cost of license revenue for fiscal year 2021 was $3.5 million, an increase of $0.7 million, or 27.3%, from $2.8 million for fiscal year 2020. Cost of license revenues increased due to third-party royalty expenses associated with external technologies we leverage in our edge software components. As a percentage of total cost of revenue, cost of license revenue increased by 0.9 percentage points from 2.6% for fiscal year 2020 to 3.5% for fiscal year 2021.

License gross profit increased by $37.2 million, or 23.0%, primarily due to license revenue growth during fiscal year 2021.

Cost of Connected Services Revenue

Cost of connected services revenue for fiscal year 2021 was $25.7 million, a decrease of $6.1 million, or 19.0%, from $31.8 million for fiscal year 2020. Cost of connected services revenue decreased primarily due to a $1.8 million decrease in salary-related expenditures, $1.8 million decrease in third-party contractor costs, $1.7 million decrease from lower internal allocated labor, $1.7 million decrease in depreciation costs, $0.7 million decrease in cloud infrastructure costs and $0.5 million decrease in stock-based compensation. These decreases were partly offset by a $3.2 million increase in amortization of costs previously deferred. As a percentage of total cost of revenue, cost of connected service revenue decreased by 4.0 percentage points from 29.5% for fiscal year 2020 to 25.5% for fiscal year 2021.

Connected services gross profit increased $18.1 million, or 27.6%, from $65.7 million to $83.8 million which was primarily due to connected services revenue growth and cost savings initiatives.

Cost of Professional Services Revenue

Cost of professional services revenue for fiscal year 2021 was $64.3 million, a decrease of $0.7 million, or 1.0%, from $65.0 million for fiscal year 2020. Cost of professional services revenue decreased primarily due to $5.1 million in lower internal allocated labor, and a $1.9 million decrease in third-party contractor cost. The decrease was partly offset by a $3.2 million increase in salary-related expenditures and $2.3 million increase in amortization of costs previously deferred. As a percentage of total cost of revenue, cost of professional services revenue increased by 3.4 percentage points from 60.2% for fiscal year 2020 to 63.6% for fiscal year 2021.

Professional services gross profit increased $6.9 million, or 162.0%, from $4.3 million to $11.2 million which was primarily due to increases in professional services revenue recognized and continued cost reduction measures.

Fiscal Year 2020 Compared with Fiscal Year 2019

Our total cost of revenues for fiscal year 2020 were $107.9 million, an increase of $8.6 million, or 8.6%, from $99.3 million for fiscal year 2019. The increase in cost of revenues resulted primarily from our investments in professional services staff to meet customer program demands.

We experienced an increase in gross profit of $19.1 million, or 9.4%, from $204.0 million to $223.1 million which was primarily driven by increased demand for our connected services solutions and professional services.

Cost of License Revenue

Cost of license revenue for fiscal year 2020 were $2.8 million, an increase of $0.7 million, or 34.5%, from $2.1 million for fiscal year 2019. Cost of license revenues increased due to third-party royalty expenses associated with external technologies we leverage in our edge software components. As a percentage of total cost of revenue, cost of license revenue increased by 0.5 percentage points from 2.1% for fiscal year 2019 to 2.6% for fiscal year 2020.

License gross profit decreased $8.8 million, or 5.2%, from $170.3 million to $161.5 million, which was primarily due to declines in license revenue recognized during the year.

Cost of Connected Services Revenue

Cost of connected services revenue for fiscal year 2020 were $31.8 million, a decrease of $5.8 million, or 15.4%, from $37.6 million for fiscal year 2019. Cost of connected services revenue decreased primarily as a result of lower internal allocated costs. As a percentage of total cost of revenue, cost of connected service revenue decreased by 8.3 percentage points from 37.8% for fiscal year 2019 to 29.5% for fiscal year 2020.

Connected services gross profit increased $24.6 million, or 59.7%, from $41.1 million to $65.7 million, which was primarily due to connected services revenue growth on relatively fixed cloud infrastructure costs.

Cost of Professional Services Revenue

Cost of professional services revenue for fiscal year 2020 were $65.0 million, an increase of $13.8 million, or 26.8%, from $51.2 million for fiscal year 2019. Cost of professional services revenue increased primarily due to our investments in professional services staff to meet customer program demands. Investments included increases in internally allocated labor costs of $4.3 million, compensation-related expenses of $3.3 million, and stock-based compensation expenses of $3.1 million. As a percentage of total cost of revenue, cost of professional services revenue increased by 8.6 percentage points from 51.6% for fiscal year 2019 to 60.2% for fiscal year 2020.

Professional services gross profit increased $3.3 million, or 313.5%, from $1.0 million to $4.3 million, which was primarily due to increases in professional services revenue recognized and continued cost reduction measures.

Operating Expenses

The tables below show each component of operating expense. Other income (expense), net and provision for income taxes are non-operating expenses and presented in a similar format (dollars in thousands).

R&D Expenses

	Year Ended September 30,			% Change	% Change
	2021	2020	2019	2021 vs. 2020	2020 vs. 2019
Research and development	$ 112,070	$ 88,899	$ 93,061	26.1%	(4.5)%

Fiscal Year 2021 Compared with Fiscal Year 2020

Historically, R&D expenses are our largest operating expense as we continue to build on our existing software platforms and develop new technologies. R&D expenses for fiscal year 2021 were $112.1 million, an increase of $23.2 million, or 26.1%, from $88.9 million for fiscal year 2020. The increase in R&D expenses was primarily attributable to a $11.5 million increase in salary-related expenditures driven by headcount growth, as well as a $5.4 million increase in third-party contractor costs, a $2.6 million increase in stock-based compensation and a $6.5 million reduction in labor allocated to support our customer projects partially offset by a $5.1 million increase of capitalized cost associated with internally developed software. As a percentage of total operating expenses, R&D expenses increased by 5.4 percentage points from 44.3% for fiscal year 2020 to 49.7% for fiscal year 2021.

Fiscal Year 2020 Compared with Fiscal Year 2019

R&D expenses for fiscal year 2020 were $88.9 million, a decrease of $4.2 million, or 4.5%, from $93.1 million for fiscal year 2019. In response to the COVID-19 pandemic, we shifted a portion of our R&D workforce to support our professional service teams, which led to a decline in R&D expenses as a result of internal labor cost allocations. R&D costs also declined due to capitalization of costs associated with internally developed software of $2.7 million and reduction of stock-based compensation of $2.0 million. The decline in R&D expenses were partially offset by a $0.8 million increase in contractor costs. As a percentage of total operating expenses, R&D expenses decreased by 3.9 percentage points from 48.2% for fiscal year 2019 to 44.3% for fiscal year 2020.

Sales & Marketing Expenses

	Year Ended September 30,			% Change	% Change
	2021	2020	2019	2021 vs. 2020	2020 vs. 2019
Sales and marketing	$ 38,683	$ 33,398	$ 36,261	15.8%	(7.9)%

Fiscal Year 2021 Compared with Fiscal Year 2020

Sales and marketing expenses for fiscal year 2021 were $38.7 million, an increase of $5.3 million, or 15.8%, from $33.4 million for fiscal year 2020. The increase in sales and marketing expenses was primarily attributable to $3.1 million increase in salary related expenses, $3.0 million increase related to stock-based compensation, and $0.4 million related to commission expenses. The increase was partly offset by a reduction of $0.9 million in travel-related expenditures as a result of COVID-19 and $0.7 million in marketing spending. As a percentage of total operating expenses, sales and marketing expenses increased by 0.6 percentage points from 16.6% for fiscal year 2020 to 17.2% for fiscal year 2021.

Fiscal Year 2020 Compared with Fiscal Year 2019

Sales and marketing expenses for fiscal year 2020 were $33.4 million, a decrease of $2.9 million, or 7.9%, from $36.3 million for fiscal year 2019. Sales and marketing expenses decreased primarily due lower compensation related expenses, including $1.9 million attributed to salary-related expenses and $2.7 million related to commission expenses. We also experienced a reduction of $1.1 million in travel-related expenditures as a result of COVID-19. The decrease was partly offset by stock-based compensation expenses, which increased $3.4 million. As a percentage of total operating expenses, sales and marketing expenses decreased by 2.2 percentage points from 18.8% for fiscal year 2019 to 16.6% for fiscal year 2020.

General & Administrative Expenses

	Year Ended September 30,			% Change	% Change
	2021	2020	2019	2021 vs. 2020	2020 vs. 2019
General and administrative	$ 56,979	$ 49,386	$ 25,926	15.4%	90.5%

Fiscal Year 2021 Compared with Fiscal Year 2020

General and administrative expenses for fiscal year 2021 were $57.0 million, an increase of $7.6 million, or 15.4%, from $49.4 million for fiscal year 2020. The increase in general and administrative expenses was primarily attributable to $7.5 million increase in stock-based compensation, a $2.1 million increase in depreciation, a $1.8 million increase in professional service fees and a $1.4 million increase in salary-related expenses. The increases were partly offset by a $1.2 million decrease in third-party contractor costs, a $1.1 million decreases in bad debt expenses and $0.6 million decrease in travel-related expenditures as a result of COVID-19. As a percentage of total operating expenses, general and administrative expenses increased by 0.7 percentage points from 24.6% for fiscal year 2020 to 25.3% for fiscal year 2021.

Fiscal Year 2020 Compared with Fiscal Year 2019

General and administrative expenses for fiscal year 2020 were $49.4 million, an increase of $23.5 million, or 90.5%, from $25.9 million for fiscal year 2019. General and administrative expenses increased primarily due to our operation as a standalone public company during fiscal year 2020. We incurred higher compensation related expenses, including $8.5 million attributed to salary-related expenses and $12.5 attributed to stock-based compensation expenses. In addition, professional service expenses increased $3.0 million. As a percentage of total operating expenses, general and administrative expenses increased by 11.2 percentage points from 13.4% for fiscal year 2019 to 24.6% for fiscal year 2020.

Amortization of Intangible Assets

	Year Ended September 30,			% Change	% Change
	2021	**2020**	**2019**	**2021 vs. 2020**	**2020 vs. 2019**
Cost of revenues	$ 7,516	$ 8,337	$ 8,498	(9.8)%	(1.9)%
Operating expense	12,690	12,544	12,524	1.2%	0.2%
Total amortization	$ 20,206	$ 20,881	$ 21,022	(3.2)%	(0.7)%

Fiscal Year 2021 Compared with Fiscal Year 2020

Intangible asset amortization for fiscal year 2021 was $20.2 million, a decrease of $0.7 million, or 3.2%, from $20.9 million for fiscal year 2020. The decrease primarily relates to certain intangible assets having been fully amortized during fiscal year 2020.

As a percentage of total cost of revenues, intangible asset amortization within cost of revenues decreased by 0.3 percentage points from 7.7% for fiscal year 2020 to 7.4% for fiscal year 2021. As a percentage of total operating expenses, intangible asset amortization expenses within operating expenses decreased by 0.7 percentage points from 6.3% for fiscal year 2020 to 5.6% for fiscal year 2021.

Fiscal Year 2020 Compared with Fiscal Year 2019

Intangible asset amortization for fiscal year 2020 was $20.9 million, a decrease of $0.1 million, or 0.7%, from $21.0 million for fiscal year 2019. The decrease primarily relates to the composition of intangible assets allocated to the Cerence business prior to Spin-Off.

As a percentage of total cost of revenues, intangible asset amortization within cost of revenues decreased by 0.9 percentage points from 8.6% for fiscal year 2019 to 7.7% for fiscal year 2020. As a percentage of total operating expenses, intangible asset amortization expenses within operating expenses decreased by 0.2 percentage points from 6.5% for fiscal year 2019 to 6.3% for fiscal year 2020.

Restructuring and Other Costs, Net

	Year Ended September 30,			% Change	% Change
	2021	2020	2019	2021 vs. 2020	2020 vs. 2019
Restructuring and other costs, net	$ 5,092	$ 16,458	$ 24,404	(69.1)%	(32.6)%

Fiscal Year 2021 Compared with Fiscal Year 2020

Restructuring and other costs, net for fiscal year 2021 were $5.1 million, a decrease of $11.4 million, from $16.5 million for fiscal year 2020. The decrease in restructuring and other costs, net was primarily driven by a $10.6 million decrease in expenditures to establish the Cerence business as a standalone public company. As a percentage of total operating expense, restructuring and other costs, net decreased by 5.9 percentage points from 8.2% for fiscal year 2020 to 2.3% for fiscal year 2021.

Fiscal Year 2020 Compared with Fiscal Year 2019

Restructuring and other costs, net for fiscal year 2020 were $16.5 million, a decrease of $7.9 million, from $24.4 million for fiscal year 2019. Restructuring and other costs, net decreased primarily due to the winding down of separation costs to establish the Cerence business as a standalone public company, which decreased $10.8 million. The decrease was partly offset by the $3.6 million increase in severance charges related to the elimination of personnel across multiple functions and the $1.1 million increase in facilities related charges. As a percentage of total operating expense, restructuring and other costs, net decreased by 4.4 percentage points from 12.6% for fiscal year 2019 to 8.2% for fiscal year 2020.

Acquisition-related Costs

	Year Ended September 30,			% Change	% Change
	2021	2020	2019	2021 vs. 2020	2020 vs. 2019
Acquisition-related costs	$ -	$ -	$ 944	—	(100.0)%

Fiscal Year 2020 Compared with Fiscal Year 2019

There were no acquisition-related costs for fiscal year 2020, which resulted in a decrease of $0.9 million, from $0.9 million for fiscal year 2019. Acquisition costs decreased as a direct result of integration, legal, and other professional fees incurred resulting from the acquisition of Voicebox on April 2, 2018. As a percentage of total operating expense, acquisition-related costs decreased by 0.5 percentage points from 0.5% for fiscal year 2019 to 0.0% for fiscal year 2020.

Total Other Expense, Net

	Year Ended September 30,			% Change	% Change
	2021	2020	2019	2021 vs. 2020	2020 vs. 2019
Interest income	$ 109	$ 585	$ -	(81.4)%	—
Interest expense	(13,997)	(22,737)	-	(38.4)%	—
Other income (expense), net	1,563	(23,319)	332	(106.7)%	(7123.8)%
Total other income (expense), net	$ (12,325)	$ (45,471)	$ 332	(72.9)%	(13796.1)%

Fiscal Year 2021 Compared with Fiscal Year 2020

Total other expense, net for fiscal year 2021 was $12.3 million, a decrease of $33.2 million from $45.5 million of expense for fiscal year 2020. The decrease in interest expense and other income (expense), net is primarily attributed to our debt refinancing in June 2020. During fiscal year 2020, we recognized a $19.3 million loss on the extinguishment of debt.

Fiscal Year 2020 Compared with Fiscal Year 2019

Total other expense, net for fiscal year 2020 was $45.5 million, an increase of $45.8 million from total other income, net of $0.3 million for fiscal year 2019. The increase was primarily attributable to $22.7 million in interest expense related to our debt financings during fiscal year 2020, a $19.3 million loss on the extinguishment of debt related to our Existing Facilities and $1.2 million of expense related to a decrease in an asset corresponding with the release of indemnified pre-Spin-Off liabilities for uncertain tax positions.

Provision for (Benefit from) Income Taxes

	Year Ended September 30,			% Change	% Change
	2021	2020	2019	2021 vs. 2020	2020 vs. 2019
Provision for (benefit from) income taxes	$ 2,376	$ (4,724)	$ (89,084)	(150.3)%	(94.7)%
Effective income tax rate%	4.9%	20.5%	(796.5)%		

Fiscal Year 2021 Compared with Fiscal Year 2020

Our effective income tax rate for fiscal year 2021 was 4.9%, compared to 20.5% for fiscal year 2020. Consequently, our provision for income taxes for fiscal year 2021 was $2.4 million, a net change of $7.1 million, or 150.3%, from a benefit from income taxes of $4.7 million for fiscal year 2020. The effective tax rate for the fiscal year 2021 differed from the U.S. federal statutory rate of 21.0%, primarily due to our composition of jurisdictional earnings, U.S. inclusions of foreign taxable income as a result of changes in applicable tax laws in 2017, and an income tax benefit of approximately $15.9 million related to an increase in tax rates in the Netherlands enacted in the first quarter of fiscal year 2021.

Fiscal Year 2020 Compared with Fiscal Year 2019

Our effective income tax rate for fiscal year 2020 was 20.5%, compared to negative 796.5% for fiscal year 2019. Consequently, our benefit from income taxes for fiscal year 2020 was $4.7 million, a net change of $84.4 million, or 94.7%, from $89.1 million for fiscal year 2019. The effective income tax rate for fiscal year 2020 differed from the U.S. statutory rate of 21.0% primarily due to our composition of jurisdictional earnings, U.S. inclusions of foreign taxable income as a result of changes in applicable tax laws in 2017, and an income tax benefit of approximately $5.0 million related to an increase in tax rates in the Netherlands enacted in the first quarter of fiscal year 2020.

Liquidity and Capital Resources

Financial Condition

As of September 30, 2021, we had $166.2 million in cash, cash equivalents, and marketable securities. Cash equivalents include highly liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less. Marketable securities include commercial paper and corporate bonds. As of September 30, 2021, our net working capital, excluding deferred revenue and deferred costs, was $194.0 million. This balance is representative of the short-term net cash inflows based on the working capital at that date.

Sources and Material Cash Requirements

Our principal sources of liquidity are our cash, cash equivalents, and marketable securities, as well as the cash flows we generated from our operations. The primary uses of cash include costs of revenues, funding of R&D activities, capital expenditures and debt obligations.

Our ability to fund future operating needs will depend on our ability to generate positive cash flows from operations and finance additional funding in the capital markets as needed. Based on our history of generating positive cash flows and the $166.2 million of cash, cash equivalents and marketable securities as of September 30, 2021, we believe we will be able to meet our liquidity needs over the next 12 months. We believe we will meet longer-term expected future cash requirements and obligations, through a combination of cash flows from operating activities, available cash balances, and available credit via our Revolving Facility.

The following table presents our material cash requirements for future periods:

	Material Cash Requirements Due by the Year Ended September 30,				
	2022	2023 - 2024	2025 - 2026	Thereafter	Total
Notes	$ -	$ -	$ 175,000	$ -	$ 175,000
Interest payable on the Notes (a)	5,246	10,507	3,507	-	19,260
Senior Credit Facilities	6,250	23,438	87,500	-	117,188
Interest payable on Senior Credit Facilities (b)	2,708	4,762	839	-	8,309
Operating leases	5,289	7,835	3,844	1,521	18,489
Operating leases under restructuring (c)	100	24	396	198	718
Finance leases	480	885	415	-	1,780
Total material cash requirements	$ 20,073	$ 47,451	$ 271,501	$ 1,719	$ 340,744

(a) Interest per annum is due and payable semiannually and is determined based on the outstanding principal as of September 30, 2021.

(b) Interest per annum is due and payable monthly and is determined based on the outstanding principal as of September 30, 2021.

(c) Contractual lease commitments are shown net of sublease income related to certain facilities. As of September 30, 2021, we anticipate sublease income of $2.3 million through fiscal year 2024.

We sponsor certain defined benefit plans that are offered primarily by certain of our foreign subsidiaries. Many of these plans were assumed as part of the Spin-Off or are required by local regulatory requirements. We may deposit funds for these plans with insurance companies, third-party trustees, or into government-managed accounts consistent with local regulatory requirements, as applicable. The aggregate net liability of our defined benefit plans as of September 30, 2021 was $8.7 million.

As the impact of the COVID-19 pandemic on the economy and our operations evolves, we will continue to assess our liquidity needs. Should we need to secure additional sources of liquidity, we believe that we could finance our needs through the issuance of equity securities or debt offerings. However, we cannot guarantee that we will be able to obtain financing through the issuance of equity securities or debt offerings on reasonable terms. The COVID-19 pandemic has negatively impacted the global economy and created significant volatility and disruption of financial markets. An extended period of economic disruption could materially affect our business, results of operations, ability to meet debt covenants, access to sources of liquidity and financial condition.

3.00% Senior Convertible Notes due 2025

On June 2, 2020, in an effort to refinance our debt structure, we issued $175.0 million in aggregate principal amount of 3.00% Convertible Senior Notes due 2025 (the “Notes”), including the initial purchasers’ exercise in full of their option to purchase an additional $25.0 million principal amount of the Notes, between us and U.S. Bank National Association, as trustee (the “Trustee”), in a private offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended (the “Securities Act”). The net proceeds from the issuance of the Notes were $169.8 million after deducting transaction costs. We used net proceeds from the issuance of the Notes to repay a portion of our indebtedness under the Credit Agreement, dated October 1, 2019, by and among us, the lenders and issuing banks party thereto and Barclays Bank PLC, as administrative agent (the “Existing Facility”).

The Notes are senior, unsecured obligations and will accrue interest payable semiannually in arrears on June 1 and December 1 of each year, beginning on December 1, 2020, at a rate of 3.00% per year. The Notes will mature on June 1, 2025, unless earlier converted, redeemed, or repurchased. The Notes are convertible into cash, shares of our common stock or a combination of cash and shares of our common stock, at our election. As of September 30, 2021, the if-converted value of the Notes exceeds its principal amount by $274.5 million.

A holder of Notes may convert all or any portion of its Notes at its option at any time prior to the close of business on the business day immediately preceding March 1, 2025 only under the following circumstances: (1) during any fiscal quarter commencing after the fiscal quarter ending on September 30, 2020 (and only during such fiscal quarter), if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price on each applicable trading day; (2) during the five business day period after any ten consecutive trading day period (the “measurement period”) in which the “trading price” per $1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; (3) if we call such Notes for redemption, at any time prior to the close of business on the business day immediately preceding the redemption date; or (4) upon the occurrence of specified corporate events. On or after March 1, 2025 until the close of business on the second scheduled trading day immediately preceding the maturity date, a holder may convert all or any portion of its Notes at any time, regardless of the foregoing.

The conversion rate will initially be 26.7271 shares of our common stock per $1,000 principal amount of Notes (equivalent to an initial conversion price of approximately $37.42 per share of our common stock). The conversion rate is subject to adjustment in some events but will not be adjusted for any accrued and unpaid interest. In addition, following certain corporate events that occur prior to the maturity date or if we deliver a notice of redemption, we will, in certain circumstances, increase the conversion rate for a holder who elects to convert its Notes in connection with such a corporate event or convert its Notes called for redemption in connection with such notice of redemption, as the case may be.

We may not redeem the Notes prior to June 5, 2023. We may redeem for cash all or any portion of the Notes, at our option, on a redemption date occurring on or after June 5, 2023 and on or before the 31st scheduled trading day immediately before the maturity date, if the last reported sale price of our common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive), including the trading day immediately preceding the date on which we provide notice of redemption, during any 30 consecutive trading day period ending on, and including, the trading day immediately preceding the date on which we provide notice of redemption at a redemption price equal to 100% of the principal amount of the notes to be redeemed, plus accrued and unpaid interest to, but excluding, the redemption date. No sinking fund is provided for the Notes.

If we undergo a “fundamental change”, subject to certain conditions, holders may require us to repurchase for cash all or any portion of their Notes at a fundamental change repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

The indenture governing the Notes contains customary terms and covenants, including that upon certain events of default occurring and continuing, either the Trustee or the holders of not less than 25% in aggregate principal amount of the Notes then outstanding may declare the entire principal amount of all the Notes plus accrued special interest, if any, to be immediately due and payable.

At issuance, we accounted for the Notes by allocating proceeds from the Notes into debt and equity components according to the accounting standards for convertible debt instruments that may be fully or partially settled in cash upon conversion. The initial carrying amount of the debt component, which approximates its fair value, was estimated by using an interest rate for nonconvertible debt, with terms similar to the Notes. The excess of the principal amount of the Notes over the fair value of the debt component was recorded as a debt discount and a corresponding increase in additional paid-in capital. The debt discount is accreted to the carrying value of the Notes over their expected term as interest expense using the interest method. Upon issuance of the Notes, we recorded $155.3 million as debt and $19.7 million as additional paid-in capital in stockholders’ equity.

We incurred transaction costs of $5.6 million relating to the issuance of the Notes. In accounting for these costs, we allocated the costs of the offering between debt and equity in proportion to the fair value of the debt and equity recognized. The transaction costs allocated to the debt component of approximately $5.0 million were recorded as a direct deduction from the face amount of the Notes and are being amortized as interest expense over the term of the Notes using the interest method. The transaction costs allocated to the equity component of approximately $0.6 million were recorded as a decrease in additional paid-in capital.

The interest expense recognized related to the Notes for the fiscal years ended September 30, 2021 and 2020 was as follows (dollars in thousands):

	Year Ended September 30,	
	2021	**2020**
Contractual interest expense	$ 5,246	$ 1,753
Amortization of debt discount	3,527	1,131
Amortization of issuance costs	887	285
Total interest expense related to the Notes	$ 9,660	$ 3,169

The conditional conversion feature of the Notes was triggered during the fiscal year ended September 30, 2021, and the Notes were convertible as of September 30, 2021, with no Notes being converted. Whether any of the Notes will be converted in future quarters will depend on the satisfaction of one or more of the conversion conditions in the future. If one or more holders elect to convert their Notes at a time when any such Notes are convertible, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional shares), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity.

Senior Credit Facilities

On June 12, 2020 (the “Financing Closing Date”), in connection with our effort to refinance our existing indebtedness, we entered into a Credit Agreement, by and among the Borrower, the lenders and issuing banks party thereto and Wells Fargo Bank, N.A., as administrative agent (the “Credit Agreement”), consisting of a four-year senior secured term loan facility in the aggregate principal amount of $125.0 million (the “Term Loan Facility”). The net proceeds from the issuance of the Term Loan Facility were $123.0 million, which together with proceeds from the Notes was intended to pay in full all indebtedness under the Existing Facility, and paid fees and expenses in connection with the Senior Credit Facilities. We also entered into a senior secured first-lien revolving credit facility in an aggregate principal amount of $50.0 million (the “Revolving Facility” and, together with the Term Loan Facility, the “Senior Credit Facilities”), which shall be drawn on in the event that our working capital and other cash needs are not supported by our operating cash flow. As of September 30, 2021, there were no amounts outstanding under the Revolving Facility.

Our obligations under the Credit Agreement are jointly and severally guaranteed by certain of our existing and future direct and indirect wholly owned domestic subsidiaries, subject to certain exceptions customary for financings of this type. All obligations are secured by substantially all of our tangible and intangible personal property and material real property, including a perfected first-priority pledge of all (or, in the case of foreign subsidiaries or subsidiaries (“FSHCO”) that own no material assets other than equity interests in foreign subsidiaries that are “controlled foreign corporations” or other FSHCOs, 65%) of the equity securities of our subsidiaries held by any loan party, subject to certain customary exceptions and limitations.

On December 17, 2020 (the “Amendment No. 1 Effective Date”), we entered into Amendment No. 1 to the Credit Agreement (the “Amendment”). The Amendment extended the scheduled maturity date of the revolving credit and term facilities from June 12, 2024 to April 1, 2025.

The Amendment revised certain interest rates in the Credit Agreement. Following delivery of a compliance certificate for the first full fiscal quarter after the Amendment No. 1 Effective Date, the applicable margins for the revolving credit and term facilities is subject to a pricing grid based upon the net total leverage ratio as follows (i) if the net total leverage ratio is greater than 3.00 to 1.00, the applicable margin is LIBOR plus 3.00% or ABR plus 2.00%; (ii) if the net total leverage ratio is less than or equal to 3.00 to 1.00 but greater than 2.50 to 1.00, the applicable margin is LIBOR plus 2.75% or ABR plus 1.75%; (iii) if the net total leverage ratio is less than or equal to 2.50 to 1.00 but greater than 2.00 to 1.00, the applicable margin is LIBOR plus 2.50% or ABR plus 1.50%; (iv) if the net total leverage ratio is less than or equal to 2.00 to 1.00 but greater than 1.50 to 1.00, the applicable margin is LIBOR plus 2.25% or ABR plus 1.25%; and (v) if the net total leverage ratio is less than or equal to 1.50 to 1.00, the applicable margin is LIBOR plus 2.20% or ABR plus 1.00%. As a result of the Amendment, the applicable LIBOR floor was reduced from 0.50% to 0.00%. From the Amendment No. 1 Effective Date until the fiscal quarter ended December 31, 2020, the interest rate was LIBOR plus 2.50%. For the three months ended March 31, 2021, the interest rate was LIBOR plus 2.25%. For the three months ended June 30, 2021, the interest rate was LIBOR plus 2.25%. For the three months ended September 30, 2021, the interest rate was LIBOR plus 2.25%. Total interest expense relating to the Senior Credit Facilities for the fiscal year ended September 30, 2021 and 2020 was $4.1 million and $1.5 million, respectively, reflecting the coupon and accretion of the discount.

In addition, the quarterly commitment fee required to be paid based on the unused portion of the Revolving Facility is subject to a pricing grid based upon the net total leverage ratio as follows (i) if the net total leverage ratio is greater than 3.00 to 1.00, the unused line fee is 0.500%; (ii) if the net total leverage ratio is less than or equal to 3.00 to 1.00 but greater than 2.50 to 1.00, the unused line fee is 0.450%; (iii) if the net total leverage ratio is less than or equal to 2.50 to 1.00 but greater than 2.00 to 1.00, the unused line fee is 0.400%; (iv) if the net total leverage ratio is less than or equal to 2.00 to 1.00 but greater than 1.50 to 1.00, the unused line fee is 0.350%; and (v) if the net total leverage ratio is less than or equal to 1.50 to 1.00, the unused line fee is 0.300%.

The Amendment revised the amount by which we are obligated to make quarterly principal payments. Through the fiscal quarter ending December 31, 2022, we are obligated to make quarterly principal payments in an aggregate amount equal to 1.25% of the original principal amount of the Term Loan Facility. From the fiscal quarter ending March 31, 2023 and for each fiscal quarter thereafter, we are obligated to make quarterly principal payments in an aggregate amount equal to 2.50% of the original principal amount of the Term Loan Facility, with the balance payable at the maturity date thereof.

Borrowings under the Credit Agreement are prepayable at our option without premium or penalty. We may request, and each lender may agree in its sole discretion, to extend the maturity date of all or a portion of the Senior Credit Facilities subject to certain conditions customary for financings of this type. The Credit Agreement also contains certain mandatory prepayment provisions in the event that we incur certain types of indebtedness or receives net cash proceeds from certain non-ordinary course asset sales or other dispositions of property, in each case subject to terms and conditions customary for financings of this type.

The Credit Agreement contains certain affirmative and negative covenants customary for financings of this type that, among other things, limit our and our subsidiaries' ability to incur additional indebtedness or liens, to dispose of assets, to make certain fundamental changes, to designate subsidiaries as unrestricted, to make certain investments, to prepay certain indebtedness and to pay dividends, or to make other distributions or redemptions/repurchases, in respect of our and our subsidiaries' equity interests. In addition, the Credit Agreement contains financial covenants, each tested quarterly, (1) a net secured leveraged ratio of not greater than 3.25 to 1.00; (2) a net total leverage ratio of not greater than 4.25 to 1.00; and (3) minimum liquidity of at least $75 million. The Credit Agreement also contains events of default customary for financings of this type, including certain customary change of control events. As of September 30, 2021, we were in compliance with all Credit Agreement covenants.

Cash Flows

Cash flows from operating, investing and financing activities for the fiscal years ended September 30, 2021, 2020, and 2019, as reflected in the audited Consolidated and Combined Statements of Cash Flows included in Item 8 of this Form 10-K, are summarized in the following table (dollars in thousands):

	Year Ended September 30,			% Change	% Change
	2021	2020	2019	2021 vs. 2020	2020 vs. 2019
Net cash provided by operating activities	$ 74,389	$ 44,789	$ 88,071	66.1%	(49.1)%
Net cash used in investing activities	(41,631)	(30,675)	(4,517)	35.7%	579.1%
Net cash (used in) provided by financing activities	(41,505)	121,553	(83,554)	(134.1)%	(245.5)%
Effect of foreign currency exchange rates on cash and cash equivalents	1,108	400	—	177.0%	100.0%
Net changes in cash and cash equivalents	$ (7,639)	$ 136,067	$ —	(105.6)%	100.0%

Net Cash Provided by Operating Activities

Fiscal Year 2021 Compared with Fiscal Year 2020

Net cash provided by operating activities for fiscal year 2021 was $74.4 million, a net increase of $29.6 million, or 66.1%, from net cash provided by operating activities of $44.8 million for fiscal year 2020. The change in cash flows were primarily due to:

- An increase of $62.0 million from income before non-cash charges
- A decrease of $22.7 million due to unfavorable changes in working capital primarily related to cash outflows from accrued expenses and other liabilities; and
- A decrease of $9.7 million from changes in deferred revenue.

Deferred revenue represents a significant portion of our net cash provided by operating activities and, depending on the nature of our contracts with customers, this balance can fluctuate significantly from period to period. We expect our deferred revenue balances to decrease in the future, including due to a wind-down of a legacy connected service relationship with a major OEM, since the majority of cash from the contract has been collected. We do not expect any changes in deferred revenue to affect our ability to meet our obligations.

Fiscal Year 2020 Compared with Fiscal Year 2019

Net cash provided by operating activities for fiscal year 2020 was $44.8 million, a decrease of $43.3 million, or 49.1%, from $88.1 million for fiscal year 2019. The net decrease in cash provided by operating activities stems from unfavorable changes in working capital. Outflows in prepaids and other assets and accounts payable increased by $21.5 million and $12.6 million, respectively. The timing of billings and collections resulted in $14.3 million additional cash inflows from accounts receivable compared to prior year.

Net Cash Used in Investing Activities

Fiscal Year 2021 Compared with Fiscal Year 2020

Net cash used in investing activities for the fiscal year 2021 was $41.6 million, an increase of $10.9 million, or 35.7%, from $30.7 million for fiscal year 2020. The change in cash flows were driven by:

- $26.1 million net purchase of marketable securities for fiscal year 2021

- $2.6 million paid in connection with equity investments during the fiscal year 2021
- $2.0 million paid related to debt securities; and
- A decrease of $7.0 million in capital expenditures.

Fiscal Year 2020 Compared with Fiscal Year 2019

Net cash used in investing activities for fiscal year 2020 was $30.7 million, an increase of $26.2 million, or 579.1%, from $4.5 million for fiscal year 2019. The increase in cash outflows is due to the purchase of property and equipment to support the standalone operations of the Company and the purchase of marketable securities, in the amount of $11.7 million.

Net Cash (Used in) Provided by Financing Activities

Fiscal Year 2021 Compared with Fiscal Year 2020

Net cash used in financing activities for the fiscal year 2021 was $41.5 million, a net change of $163.1 million, from cash provided by financing activities of $121.6 million for fiscal year 2020. The change in cash flows were primarily due to:

- $249.7 million proceeds from the issuance of the Existing Facilities during the first quarter of fiscal year 2020;
- $169.8 million proceeds from the issuance of the Notes during the quarter ended June 30, 2020;
- $123.0 million proceeds from the issuance of the Senior Credit Facilities during the quarter ended June 30, 2020;
- $271.6 million principal payments of long-term debt during the fiscal year 2020;
- $153.0 million distribution paid to Nuance related to our Spin-Off during the first quarter of fiscal year 2020; and
- $45.8 million payment of tax related withholdings due to the net settlement of equity awards during the fiscal year 2021.

Fiscal Year 2020 Compared with Fiscal Year 2019

Net cash provided by financing activities for fiscal year 2020 was $121.6 million, an increase of $205.1 million, or 245.5%, from net cash used in financing activities of $83.6 million for fiscal year 2019. The increase in cashflows were the result of $169.8 million net proceeds from the issuance of the Notes, $123.0 million net proceeds from the issuance of the Senior Credit Facilities, and $249.7 million net proceeds from the issuance of the Existing Facilities. The increase in cashflows were partly offset by $271.6 million in principal payments of long-term debt, $6.4 million payments of debt issuance costs, and the $153.0 million distribution paid to Nuance.

Issued Accounting Standards Not Yet Adopted

Refer to Note 3 to the accompanying audited Consolidated and Combined Financial Statements included elsewhere in this Form 10-K for a description of certain issued accounting standards that have not been adopted by us and may impact our results of operations in future reporting periods.

Critical Accounting Policies, Judgments and Estimates

The preparation of financial statements in conformity with GAAP, requires management to make estimates and assumptions that have a material impact on the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. On an ongoing basis, we evaluate our estimates, assumptions and judgments, including those related to revenue recognition; allowance for credit losses and doubtful accounts; accounting for deferred costs; accounting for internally developed software; the valuation of goodwill and intangible assets; accounting for business combinations; accounting for stock-based compensation; accounting for income taxes; accounting for leases; accounting for convertible debt; and loss contingencies. Our management bases its estimates on historical experience, market participant fair value considerations, projected future cash flows, and various other factors that are believed to be reasonable under the circumstances. Actual results could differ from these estimates.

We believe the following critical accounting policies most significantly affect the portrayal of our financial condition and the results of our operations. These policies require our most difficult and subjective judgements.

Revenue Recognition

We primarily derive revenue from the following sources: (1) royalty-based software license arrangements, (2) connected services, and (3) professional services. Revenue is reported net of applicable sales and use tax, value-added tax and other transaction taxes imposed on the related transaction including mandatory government charges that are passed through to our customers. We account for a contract when both parties have approved and committed to the contract, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

Our arrangements with customers may contain multiple products and services. We account for individual products and services separately if they are distinct—that is, if a product or service is separately identifiable from other items in the contract and if a customer can benefit from it on its own or with other resources that are readily available to the customer.

We recognize revenue after applying the following five steps:

- identification of the contract, or contracts, with a customer;
- identification of the performance obligations in the contract, including whether they are distinct within the context of the contract;
- determination of the transaction price, including the constraint on variable consideration;
- allocation of the transaction price to the performance obligations in the contract; and
- recognition of revenue when, or as, the performance obligations are satisfied.

We allocate the transaction price of the arrangement based on the relative estimated standalone selling price, or SSP, of each distinct performance obligation. In determining SSP, we maximize observable inputs and consider a number of data points, including:

- the pricing of standalone sales (in the instances where available);
- the pricing established by management when setting prices for deliverables that are intended to be sold on a standalone basis;
- contractually stated prices for deliverables that are intended to be sold on a standalone basis; and
- other pricing factors, such as the geographical region in which the products or services are sold and expected discounts based on the customer size and type.

We only include estimated amounts in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. We reduce transaction prices for estimated returns that represent variable consideration under ASC 606, which we estimate based on historical return experience and other relevant factors, and record a corresponding refund liability as a component of accrued expenses and other current liabilities. Other forms of contingent revenue or variable consideration are infrequent.

Revenue is recognized when control of these products or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those products or services.

We assess the timing of the transfer of products or services to the customer as compared to the timing of payments to determine whether a significant financing component exists. In accordance with the practical expedient in ASC 606-10-32-18, we do not assess the existence of a significant financing component when the difference between payment and transfer of deliverables is a year or less. If the difference in timing arises for reasons other than the provision of finance to either the customer or us, no financing component is deemed to exist. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our services, not to receive or provide financing from or to customers. We do not consider set-up fees nor other upfront fees paid by our customers to represent a financing component.

Reimbursements for out-of-pocket costs generally include, but are not limited to, costs related to transportation, lodging and meals. Revenue from reimbursed out-of-pocket costs is accounted for as variable consideration.

Performance Obligations

License

Embedded software and technology licenses operate without access to the external networks and information. Embedded licenses sold with non-distinct professional services to customize and/or integrate the underlying software and technology are accounted for as a combined performance obligation. Revenue from the combined performance obligation is recognized over time based upon the progress towards completion of the project, which is measured based on the labor hours already incurred to date as compared to the total estimated labor hours.

Revenue from distinct embedded software and technology licenses, which do not require professional services to customize and/or integrate the software license, is recognized at the point in time when the software and technology is made available to the customer and control is transferred. For income statement presentation purposes, we separate distinct embedded license revenue from professional services revenue based on their relative SSPs.

Revenue from embedded software and technology licenses sold on a royalty basis, where the license of non-exclusive intellectual property is the predominant item to which the royalty relates, is recognized in the period the usage occurs in accordance with ASC 606-10-55-65(A).

For usage-based royalty arrangements, which include fixed consideration related to a minimum usage guarantees, the fixed consideration is recognized when the software is made available to the customer.

Connected Services

Connected services, which allow our customers to use the hosted software over the contract period without taking possession of the software, are provided on a usage basis as consumed or on a fixed fee subscription basis. Subscription basis revenue represents a single promise to stand-ready to provide access to our connected services. Our connected services contract terms generally range from one to five years.

As each day of providing services is substantially the same and the customer simultaneously receives and consumes the benefits as access is provided, we have determined that our connected services arrangements are a single performance obligation comprised of a series of distinct services. These services include variable consideration, typically a function of usage. We recognize revenue as each distinct service period is performed (i.e., recognized as incurred).

Our connected service arrangements generally include services to develop, customize, and stand-up applications for each customer. In determining whether these services are distinct, we consider dependence of the cloud service on the up-front development and stand-up, as well as availability of the services from other vendors. We have concluded that the up-front development, stand-up and customization services are not distinct performance obligations, and as such, revenue for these activities is recognized over the period during which the cloud-connected services are provided, and is included within connected services revenue. There can be instances where the customer purchases a software license that allows them to take possession of the software to enable hosting by the customer or a third-party. For such arrangements, the performance obligation of the license is completed at a point in time once the customer takes possession of the software.

Professional Services

Revenue from distinct professional services, including training, is recognized over time based upon the progress towards completion of the project, which is measured based on the labor hours already incurred to date as compared to the total estimated labor hours.

Significant Judgements

Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. Our license contracts often include professional services to customize and/or integrate the licenses into the customer’s environment. Judgment is required to determine whether the license is considered distinct and accounted for separately, or not distinct and accounted for together with professional services. Furthermore, hybrid contracts that contain both embedded and connected license and professional services are analyzed to determine if the products and services are distinct or have stand=alone functionality to determine the revenue treatment.

Judgments are required to determine the SSP for each distinct performance obligation. When the SSP is directly observable, we estimate the SSP based upon the historical transaction prices, adjusted for geographic considerations, customer classes, and customer relationship profiles. In instances where the SSP is not directly observable, we determine the SSP using information that may include market conditions and other observable inputs. We may have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP. Determining the SSP for performance obligations which we never sell separately also requires significant judgment. In estimating the SSP, we consider the likely price that would have resulted from established pricing practices had the deliverable been offered separately and the prices a customer would likely be willing to pay. For contracts that contain future royalties, the allocation of SSP is determined using any fixed payments as well as the forecasted volume usage associated with royalties.

Contract Acquisition Costs

In conjunction with the adoption of ASC 606, we are required to capitalize certain contract acquisition costs. The capitalized costs primarily relate to paid commissions. In accordance with the practical expedient in ASC 606-10-10-4, we apply a portfolio approach to estimate contract acquisition costs for groups of customer contracts. We elect to apply the practical expedient in ASC 340-40-25-4 and will expense contract acquisition costs as incurred where the expected period of benefit is one year or less. Contract acquisition costs are deferred and amortized on a straight-line basis over the period of benefit, which we have estimated to be between one and eight years. The period of benefit was determined based on an average customer contract term, expected contract renewals, changes in technology and our ability to retain customers, including canceled contracts. We assess the amortization term for all major transactions based on specific facts and circumstances. Contract acquisition costs are classified as current or noncurrent assets based on when the expense will be recognized. The current and noncurrent portions of contract acquisition costs are included in prepaid expenses and other current assets and in other assets, respectively. As of September 30, 2021 and 2020, we had $6.9 million and $5.6 million of contract acquisition costs. We had amortization expense of $1.9 million, $1.5 million, and $0.7 million related to these costs during the fiscal years ended September 30, 2021, 2020, and 2019. There was no impairment related to contract acquisition costs.

Capitalized Contract Costs

We capitalize incremental costs incurred to fulfill our contracts that (i) relate directly to the contract, (ii) are expected to generate resources that will be used to satisfy our performance obligation under the contract, and (iii) are expected to be recovered through revenue generated under the contract. Our capitalized costs consist primarily of setup costs, such as costs to standup, customize and develop applications for each customer, which are incurred to satisfy our stand-ready obligation to provide access to our connected offerings. These contract costs are expensed to cost of revenue as we satisfy our stand-ready obligation over the contract term which we estimate to be between one and eight years, on average. The contract term was determined based on an average customer contract term, expected contract renewals, changes in technology, and our ability to retain customers, including canceled contracts. We classify these costs as current or noncurrent based on the timing of when we expect to recognize the expense. The current and noncurrent portions of capitalized contract fulfillment costs are presented as deferred costs. As of September 30, 2021 and 2020, we had $37.8 million and $45.4 million of capitalized contract costs.

We had amortization expense of $15.4 million, $12.0 million and $10.6 million related to these costs during the fiscal years ended September 30, 2021, 2020 and 2019, respectively. There was no impairment related to contract fulfillment costs capitalized.

Trade Accounts Receivable and Contract Balances

We classify our right to consideration in exchange for deliverables as either a receivable or a contract asset. A receivable is a right to consideration that is unconditional (i.e., only the passage of time is required before payment is due). We present such receivables in Accounts receivable, net in our Consolidated Balance Sheets at their net estimated realizable value. We maintain an allowance for credit losses to provide for the estimated amount of receivables that may not be collected. The allowance is based upon an assessment of customer creditworthiness, historical payment experience, the age of outstanding receivables and other applicable factors.

Our contract assets and liabilities are reported in a net position on a contract-by-contract basis at the end of each reporting period. Contract assets include unbilled amounts from long-term contracts when revenue recognized exceeds the amount billed to the customer, and right to payment is not solely subject to the passage of time. Contract assets are included in Prepaid expenses and other current assets. As of September 30, 2021, we had $59.1 million of contract assets.

Our contract liabilities, or deferred revenue, consist of advance payments and billings in excess of revenues recognized. We classify deferred revenue as current or noncurrent based on when we expect to recognize the revenues. As of September 30, 2021, we had $276.7 million of deferred revenue.

Business Combinations

We determine and allocate the purchase price of an acquired company to the tangible and intangible assets acquired and liabilities assumed as of the business combination date. Results of operations and cash flows of acquired companies are included in our operating results from the date of acquisition. The purchase price allocation process requires us to use significant estimates and assumptions as of the date of the business acquisition, including fair value estimates such as:

- estimated fair values of intangible assets;
- estimated fair values of legal performance commitments to customers, assumed from the acquiree under existing contractual obligations (classified as deferred revenue) at the date of acquisition;
- estimated income tax assets and liabilities assumed from the acquiree; and
- estimated fair value of pre-acquisition contingencies from the acquiree.

While we use our best estimates and assumptions to determine the fair values of assets acquired and liabilities assumed at the date of acquisition, our estimates and assumptions are inherently uncertain and subject to refinement. As a result, within the measurement period, which is generally one year from the date of acquisition, we record adjustments to the assets acquired and liabilities assumed against goodwill in the period the amounts are determined. Adjustments identified subsequent to the measurement period are recorded within Acquisition-related costs, net.

Although we believe the assumptions and estimates we have made in the past have been reasonable and appropriate, they are based in part on historical experience and information obtained from the management of the acquired companies and are inherently uncertain. Examples of critical estimates in valuing certain of the intangible assets we have acquired or may acquire in the future include but are not limited to:

- future expected cash flows from software license sales, support agreements, consulting contracts, connected services, other customer contracts and acquired developed technologies and patents;
- expected costs to develop in-process R&D projects into commercially viable products and the estimated cash flows from the projects when completed;
- the acquired company’s brand and competitive position, as well as assumptions about the period during which the acquired brand will continue to be used in the combined company’s product portfolio; and
- discount rates.

Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results.

In connection with the purchase price allocations for our acquisitions, we estimate the fair market value of legal performance commitments to customers, which are classified as deferred revenue. The estimated fair market value of these obligations is determined and recorded as of the acquisition date.

We may identify certain pre-acquisition contingencies. If, during the purchase price allocation period, we are able to determine the fair values of a pre-acquisition contingencies, we will include that amount in the purchase price allocation. If we are unable to determine the fair value of a pre-acquisition contingency at the end of the measurement period, we will evaluate whether to include an amount in the purchase price allocation based on whether it is probable a liability had been incurred and whether an amount can be reasonably estimated. Subsequent to the end of the measurement period, any adjustment to amounts recorded for a pre-acquisition contingency will be included within acquisition-related cost, net in the period in which the adjustment is determined.

Goodwill Impairment Analysis

Goodwill represents the excess of the purchase price in a business combination over the fair value of net tangible and intangible assets acquired. Goodwill is not amortized but tested annually for impairment or when indicators of impairment are present. The test for goodwill impairment involves a qualitative assessment of impairment indicators. If indicators are present, a quantitative test of impairment is performed. Goodwill impairment, if any, is determined by comparing the reporting unit’s fair value to its carrying value. An impairment loss is recognized in an amount equal to the excess of the reporting unit’s carrying value over its fair value, up to the amount of goodwill allocated to the reporting unit. Goodwill is tested for impairment annually on July 1, the first day of the fourth quarter of the fiscal year. There was no goodwill impairment in any of the periods presented.

For the purpose of testing goodwill for impairment, all goodwill acquired in a business combination is assigned to one or more reporting units. A reporting unit represents an operating segment or a component within an operating segment for which discrete financial information is available and is regularly reviewed by segment management for performance assessment and resource allocation. Components of similar economic characteristics are aggregated into one reporting unit for the purpose of goodwill impairment assessment. Reporting units are identified annually and re-assessed periodically for recent acquisitions or any changes in segment reporting structure. Upon consideration of our components, we have concluded that our goodwill is associated with one reporting unit.

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

Long-Lived Assets with Definite Lives

Our long-lived assets consist principally of technology, customer relationships, internally developed software, land, building, and equipment. Customer relationships are amortized over their estimated economic lives based on the pattern of economic benefits expected to be generated from the use of the asset. Other definite-lived assets are amortized over their estimated economic lives using the straight-line method. The remaining useful lives of long-lived assets are re-assessed periodically at the asset group level for any events and circumstances that may change the future cash flows expected to be generated from the long-lived asset or asset group.

Internally developed software consists of capitalized costs incurred during the application development stage, which include costs related design of the software configuration and interfaces, coding, installation and testing. Costs incurred during the preliminary project stage and post-implementation stage are expensed as incurred. Internally developed software is amortized over the estimated useful life, commencing on the date when the asset is ready for its intended use. Land, building and equipment are stated at cost and depreciated over their estimated useful lives. Leasehold improvements are depreciated over the shorter of the related lease term or the estimated useful life. Depreciation is computed using the straight-line method. Repair and maintenance costs are expensed as incurred. The cost and related accumulated depreciation of sold or retired assets are removed from the accounts and any gain or loss is included in the results of operations for the period.

Long-lived assets with definite lives are tested for impairment whenever events or changes in circumstances indicate the carrying value of a specific asset or asset group may not be recoverable. We assess the recoverability of long-lived assets with definite lives at the asset group level. Asset groups are determined based upon the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. When the asset group is also a reporting unit, goodwill assigned to the reporting unit is also included in the carrying amount of the asset group. For the purpose of the recoverability test, we compare the total undiscounted future cash flows from the use and disposition of the assets with its net carrying amount. When the carrying value of the asset group exceeds the undiscounted future cash flows, the asset group is deemed to be impaired. The amount of the impairment loss represents the excess of the asset or asset group’s carrying value over its estimated fair value, which is generally determined based upon the present value of estimated future pre-tax cash flows that a market participant would expect from use and disposition of the long-lived asset or asset group. There were no long-lived asset impairments in any of the periods presented.

Stock-Based Compensation

We grant equity awards to certain employees which include stock options and restricted awards in accordance with provisions of the Cerence 2019 Equity Incentive Plan (“Equity Incentive Plan”).

We account for stock-based compensation through recognition of the fair value of the stock-based compensation as a charge against earnings. The fair value for time-based restricted stock units and performance-based restricted stock units is based on the closing share price of our common stock on the date of grant. For performance-based restricted stock units, the compensation cost is recognized based on the number of units expected to vest upon the achievement of the performance conditions. We recognize stock-based compensation as an expense on a straight-line basis, over the requisite service period. We account for forfeitures as they occur, rather than applying an estimated forfeiture rate.

Income Taxes

Fiscal years 2021 and 2020

We account for income taxes using the assets and liabilities method, as prescribed by ASC No. 740, *Income Taxes*, or ASC 740.

Deferred Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carry amount of assets and liabilities and their respective tax bases. The method also requires the recognition of future tax benefits such as net operating loss carryforwards, to the extent that realization of such benefits is more likely than not after consideration of all available evidence. As the income tax returns are not due and filed until after the completion of our annual financial reporting requirements, the amounts recorded for the current period reflect estimates for the tax-based activity for the period. In addition, estimates are often required with respect to, among other things, the appropriate state and foreign income tax rates to use, the potential utilization of operating loss carry-forwards and valuation allowance required, if any, for tax assets that may not be realizable in the future. Tax laws and tax rates vary substantially in these jurisdictions and are subject to change given the political and economic climate. We report and pay income tax based on operational results and applicable law. Our tax provision contemplates tax rates currently in effect to determine both our currency and deferred tax positions.

Any significant fluctuations in rates or changes in tax laws could cause our estimates of taxes we anticipate either paying or recovering in the future to change. Such changes could lead to either increases or decreases in our effective tax rates.

We have historically estimated the future tax consequences of certain items, including bad debts and accruals that cannot be deducted for income tax purposes until such expenses are paid or the related assets are disposed. We believe the procedures and estimates used in our accounting for income taxes are reasonable and in accordance with established tax law. The income tax estimates used have not resulted in material adjustments to income tax expense in subsequent period when the estimates are adjusted to the actual filed tax return amounts.

Deferred tax assets and liabilities are measured used enacted tax rates expected to apply to taxable income in the fiscal years in which those temporary differences are expected to be recovered or settled. With respect to earnings expected to be indefinitely reinvested offshore, we do not accrue tax for the repatriations of such foreign earnings.

Valuation Allowance

We regularly review our deferred tax assets for recoverability considering historically profitability, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. In assessing the need for a valuation allowance, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets. The weight given to the positive and negative evidence is commensurate with the extent to which the evidence may be objectively verified. If positive evidence regarding projected future taxable income, exclusive of reversing taxable temporary differences, existed it would be difficult for it to outweigh objective negative evidence of recent financial reporting losses.

Uncertain Tax Positions

We operate in multiple jurisdictions through wholly owned subsidiaries and our global structure is complex. The estimates of our uncertain tax positions involve judgements and assessment of the potential tax implications related to legal entity restructuring, intercompany transfer and acquisition or divestures. We recognize tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. Our tax positions are subject to audit by taxing authorities across multiple global jurisdictions and the resolution of such audits may span multiple years. Tax laws is complex and often subject to varied interpretations, accordingly, the ultimate outcome with respect to taxes we may own may differ from the amounts recognized.

Fiscal year 2019

Income taxes as presented herein attribute current and deferred income taxes of Nuance to the Cerence business's standalone financial statements in a manner that is systematic, rational, and consistent with the asset and liability method prescribed by ASC 740. Accordingly, the Cerence business's income tax provision was prepared following the "Separate Return Method." The Separate Return Method applies ASC 740 to the standalone financial statements of each member of the consolidated group as if the group member were a separate taxpayer and a standalone enterprise. As a result, actual tax transactions included in the consolidated financial statements of Nuance may not be included in the combined financial statements of the Cerence business. Similarly, the tax treatment of certain items reflected in the combined financial statements of Cerence may not be reflected in the consolidated financial statements and tax returns of Nuance; therefore, such items as net operating losses, credit carryforwards and valuation allowances may exist in the standalone financial statements that may or may not exist in Nuance's consolidated financial statements.

The breadth of the Cerence business's operations and the global complexity of tax regulations require assessments of uncertainties and judgments in estimating taxes that the Cerence business would have paid if it had been a separate taxpayer. The final taxes that would have been paid are dependent upon many factors, including negotiations with taxing authorities in various jurisdictions, outcomes of tax litigation and resolution of disputes arising from federal, state and international tax audits in the normal course of business. The provision for income taxes was determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. This method also requires the recognition of future tax benefits relating to net operating loss carryforwards and tax credits, to the extent that realization of such benefits is more likely than not after consideration of all available evidence. The provision for income taxes represented income taxes paid by Nuance or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax basis of the Cerence business's assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted.

Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized. In assessing the need for a valuation allowance, we considered both positive and negative evidence related to the likelihood of realization of the deferred tax assets. The weights assigned to the positive and negative evidence are commensurate with the extent to which the evidence may be objectively verified. If positive evidence regarding projected future taxable income, exclusive of reversing taxable temporary differences, existed, it would be difficult for it to outweigh objective negative evidence of recent financial reporting losses.

In general, the taxable income (loss) of the various Cerence business entities was included in Nuance's consolidated tax returns, where applicable in jurisdictions around the world. As such, separate income tax returns were not prepared for any Cerence business entities. Consequently, income taxes currently payable are deemed to have been remitted to Nuance, in cash, in the period the liability arose and income taxes currently receivable are deemed to have been received from Nuance in the period that a refund could have been recognized by the Cerence business had the Cerence business been a separate taxpayer.

Leases

We have entered into a number of facility and equipment leases which qualify as operating leases under GAAP. We also have a limited number of equipment leases that also qualify as finance leases. We determine if contracts with vendors represent a lease or have a lease component under GAAP at contract inception. Our leases have remaining terms ranging from less than one year to seven years. Some of our leases include options to extend or terminate the lease prior to the end of the agreed upon lease term. For purposes of calculating lease liabilities, lease terms include options to extend or terminate the lease when it is reasonably certain that we will exercise such options.

Operating leases are included in Operating lease right of use assets, Short-term operating lease liabilities, and Long-term operating lease liabilities on our Consolidated Balance Sheets as of September 30, 2021 and 2020. Finance leases are included in Property and equipment, net, Accrued expenses and other current liabilities, and Other liabilities on our Consolidated Balance Sheets as of September 30, 2021 and 2020.

Lease costs for minimum lease payments is recognized on a straight-line basis over the lease term. For operating leases, costs are included within Cost of revenues, Research and development, Sales and marketing, and General and administrative lines on the Consolidated and Combined Statements of Operations. For financing leases, amortization of the finance right of use assets is included within Research and development, Sales and marketing, and General and administrative lines on the Consolidated and Combined Statements of Operations, and interest expense is included within Interest expense.

For operating leases, the related cash payments are included in the operating cash flows on the Consolidated and Combined Statements of Cash Flows. For financing leases, the related cash payments for the principal portion of the lease liability are included in the financing cash flows on the Consolidated and Combined Statement of Cash Flows and the related cash payments for the interest portion of the lease liability are included in the operating cash flows on the Consolidated and Combined Statement of Cash Flows.

Convertible Debt

We bifurcate the debt and equity (the contingently convertible feature) components of our convertible debt instruments in a manner that reflects our nonconvertible debt borrowing rate at the time of issuance. The equity components of our convertible debt instruments are recorded within stockholders' equity with an allocated issuance premium or discount. The debt issuance premium or discount is amortized to Interest expense in our Consolidated and Combined Statement of Operations using the effective interest method over the expected term of the convertible debt.

We assess the short-term and long-term classification of our convertible debt on each balance sheet date. Whenever the holders have a contractual right to convert, the carrying amount of the convertible debt is reclassified to current liabilities, with the corresponding equity components classified from additional paid-in-capital to mezzanine equity, as needed.

Loss Contingencies

We may be subject to legal proceedings, lawsuits and other claims relating to labor, service, intellectual property, and other matters that arise from time to time in the ordinary course of business. On a quarterly basis, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. Significant judgments are required for the determination of probability and the range of the outcomes. Due to the inherent uncertainties, estimates are based only on the best information available at the time. Actual outcomes may differ from our estimates. As additional information becomes available, we reassess the potential liability related to our pending claims and litigation and may revise our estimates. Such revisions may have a material impact on our results of operations and financial position.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

We are exposed to market risk from changes in foreign currency exchange rates and interest rates which could affect operating results, financial position and cash flows. We manage our exposure to these market risks through our regular operating and financing activities, and through the use of derivative financial information.

Exchange Rate Sensitivity

We are exposed to changes in foreign currency exchange rates. Any foreign currency transaction, defined as a transaction denominated in a currency other than the local functional currency, will be reported in the functional currency at the applicable exchange rate in effect at the time of the transaction. A change in the value of the functional currency compared to the foreign currency of the transaction will have either a positive or negative impact on our financial position and results of operations.

Assets and liabilities of our foreign entities are translated into U.S. dollars at exchange rates in effect at the balance sheet date and income and expense items are translated at average rates for the applicable period. Therefore, the change in the value of the U.S. dollar compared to foreign currencies will have either a positive or negative effect on our financial position and results of operations. Historically, our primary exposure has been related to transactions denominated in the Canadian dollar, Chinese yuan, Euro, and Japanese yen.

We use foreign currency forward contracts to hedge the foreign currency exchange risk associated with forecasted foreign denominated payments related to our ongoing business. The aggregate notional amount of our outstanding foreign currency forward contracts was $61.0 million at September 30, 2021. Foreign currency forward contracts are sensitive to changes in foreign currency exchange rates. A 10% unfavorable exchange rate movement in our portfolio of foreign currency contracts would have resulted in unrealized losses of $5.3 million at September 30, 2021. Such losses would be offset by corresponding gains in the remeasurement of the underlying transactions being hedged. We believe these foreign currency forward exchange contracts and the offsetting underlying commitments, when taken together, do not create material market risk.

Interest Rate Sensitivity

We are exposed to interest rate risk as a result of our cash and cash equivalents and indebtedness related to the Senior Credit Facilities.

At September 30, 2021, we held approximately $128.4 million of cash and cash equivalents consisting of cash and highly liquid investments, including money-market funds. Assuming a 1% increase in interest rates, our interest income on our money-market funds and time deposits classified as cash and cash equivalents would increase by $0.8 million per annum, based on September 30, 2021 reported balances.

The borrowings under our Senior Credit Facilities are subject to interest rates based on LIBOR. As of September 30, 2021, assuming a 1% increase in interest rates and our Revolving Facility is fully drawn, our interest expense on our Senior Credit Facilities would increase by approximately $1.7 million per annum.

Item 8. Financial Statements and Supplementary Data.

INDEX TO CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Cerence Inc.
Burlington, Massachusetts

Opinion on the Consolidated and Combined Financial Statements

We have audited the accompanying consolidated balance sheets of Cerence Inc. (the “Company”) as of September 30, 2021 and 2020, the related consolidated and combined statements of operations and comprehensive income (loss), consolidated statements of equity and combined statement of changes in parent company equity, and cash flows for each of the three years in the period ended September 30, 2021, and the related notes (collectively referred to as the “consolidated and combined financial statements”). In our opinion, the consolidated and combined financial statements present fairly, in all material respects, the financial position of the Company at September 30, 2021 and 2020, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2021, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company's internal control over financial reporting as of September 30, 2021, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) and our report dated November 22, 2021 expressed an unqualified opinion thereon.

Basis for Opinion

These consolidated and combined financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated and combined financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated and combined financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated and combined financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated and combined financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated and combined financial statements. We believe that our audits provide a reasonable basis for our opinion.

Change in Accounting Principle

As discussed in Note 3 to the consolidated and combined financial statements, effective October 1, 2019, the Company adopted Accounting Standards Codification Topic 842, *Leases* (Topic 842).

Emphasis of a Matter

As discussed in Note 2, the financial statements of the Company prior to October 1, 2019 (the “Cerence business”) are not those of a standalone entity. The combined financial statements of the Cerence business for the year ended September 30, 2019 reflects the assets, liabilities, revenues and expenses directly attributable to the Cerence business, as well as allocations deemed reasonable by management, to present the financial position, results of operations, changes in parent company equity, and cash flows of the Cerence business on a standalone basis and do not necessarily reflect the financial position, results of operations, changes in parent company equity, and cash flows of the Cerence business in the future or what they would have been had the Cerence business been a separate, standalone entity during the year presented.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated and combined financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated and combined financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the consolidated and combined financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinions on the critical audit matter or on the accounts or disclosures to which it relates.

Identification of Performance Obligations

As described in Note 4 to the Company's consolidated and combined financial statements, certain of the Company's revenue contracts contain multiple products and services primarily relating to the sale of connected or embedded licenses and professional services. For these revenue contracts, the Company accounts for the individual products and services separately if they are distinct. The transaction price is allocated to the performance obligations based on their relative standalone selling prices. The Company determines the standalone selling prices by maximizing observable inputs when available, including pricing of standalone sales, pricing as established by management, geographical region in which products are sold and expected discounts based on customer size and type.

We associate the identification of performance obligations and the recognition of revenue related to contracts that contain multiple performance obligations as a critical audit matter. The determination of whether multiple services within a contract are distinct performance obligations that should be accounted for separately requires management to exercise significant judgment that includes a high degree of subjectivity. Auditing these elements involved especially challenging auditor judgment due to the nature and extent of audit effort required to address these matters.

The primary procedures we performed to address this critical audit matter included:

- Evaluating management's technical accounting conclusions and assessing the reasonableness of management's judgments and assumptions in the determination of whether the products and services represent distinct performance obligations.
- Testing the reasonableness of the identification of distinct performance obligations through inspection of a sample of certain customer contracts and other source documents.

/s/ BDO USA, LLP

We have served as the Company's auditor since 2017.

Boston, Massachusetts

November 22, 2021

Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Cerence Inc.
Burlington, Massachusetts

Opinion on Internal Control over Financial Reporting

We have audited Cerence Inc.'s (the "Company's") internal control over financial reporting as of September 30, 2021, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (the "COSO criteria"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 30, 2021, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of Cerence Inc. (the "Company") as of September 30, 2021 and 2020, the related consolidated and combined statements of operations and comprehensive income (loss), consolidated statements of equity and combined statement of changes in parent company equity, and cash flows for each of the three years in the period ended September 30, 2021, and the related notes and our report dated November 22, 2021 expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Item 9A, Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit of internal control over financial reporting in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ BDO USA, LLP

Boston, Massachusetts

November 22, 2021

CERENCE INC.
CONSOLIDATED AND COMBINED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

	Year Ended September 30, 2021	2020	2019
Revenues:			
License	$ 202,183	$ 164,268	$ 172,379
Connected services	109,534	97,469	78,690
Professional services	75,465	69,230	52,246
Total revenues	387,182	330,967	303,315
Cost of revenues:			
License	3,544	2,783	2,069
Connected services	25,727	31,768	37,562
Professional services	64,287	64,963	51,214
Amortization of intangible assets	7,516	8,337	8,498
Total cost of revenues	101,074	107,851	99,343
Gross profit	286,108	223,116	203,972
Operating expenses:			
Research and development	112,070	88,899	93,061
Sales and marketing	38,683	33,398	36,261
General and administrative	56,979	49,386	25,926
Amortization of intangible assets	12,690	12,544	12,524
Restructuring and other costs, net	5,092	16,458	24,404
Acquisition-related costs	—	—	944
Total operating expenses	225,514	200,685	193,120
Income from operations	60,594	22,431	10,852
Interest income	109	585	—
Interest expense	(13,997)	(22,737)	—
Other income (expense), net	1,563	(23,319)	332
Income (loss) before income taxes	48,269	(23,040)	11,184
Provision for (benefit from) income taxes	2,376	(4,724)	(89,084)
Net income (loss)	$ 45,893	$ (18,316)	$ 100,268
Net income (loss) per share:			
Basic	$ 1.22	$ (0.50)	$ 2.76
Diluted	$ 1.17	$ (0.50)	$ 2.76
Weighted-average common share outstanding:			
Basic	37,752	36,428	36,391
Diluted	39,289	36,428	36,391

Refer to accompanying Notes to the Consolidated and Combined Financial Statements.

CERENCE INC.

CONSOLIDATED AND COMBINED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

	Year Ended September 30,		
	2021	2020	2019
Net income (loss)	$ 45,893	$ (18,316)	$ 100,268
Other comprehensive (loss) income:			
Foreign currency translation adjustments	(1,980)	15,805	(3,866)
Pension adjustments, net	(87)	1,178	(1,176)
Unrealized loss on available-for-sale securities	(10)	(1)	—
Total other comprehensive (loss) income	(2,077)	16,982	(5,042)
Comprehensive income (loss)	$ 43,816	$ (1,334)	$ 95,226

Refer to accompanying Notes to the Consolidated and Combined Financial Statements.

CERENCE INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	September 30, 2021	September 30, 2020
ASSETS		
Current assets:		
Cash and cash equivalents	$ 128,428	$ 136,067
Marketable securities	30,435	11,662
Accounts receivable, net of allowances of $395 and $1,394 at September 30, 2021 and September 30, 2020, respectively	45,560	50,900
Deferred costs	6,095	7,256
Prepaid expenses and other current assets	76,530	44,220
Total current assets	287,048	250,105
Long-term marketable securities	7,339	—
Property and equipment, net	31,505	29,529
Deferred costs	31,702	38,161
Operating lease right of use assets	14,901	20,096
Goodwill	1,128,511	1,128,198
Intangible assets, net	25,348	45,616
Deferred tax assets	159,293	160,974
Other assets	20,081	14,938
Total assets	$ 1,705,728	$ 1,687,617
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 11,636	$ 8,447
Deferred revenue	78,394	112,156
Short-term operating lease liabilities	4,562	5,700
Short-term debt	6,250	6,250
Accrued expenses and other current liabilities	64,467	66,078
Total current liabilities	165,309	198,631
Long-term debt, net of discounts and issuance costs	265,093	266,872
Deferred revenue, net of current portion	198,343	212,573
Long-term operating lease liabilities	12,216	17,821
Other liabilities	32,822	31,649
Total liabilities	673,783	727,546
Commitments and contingencies (Note 14)		
Stockholders' Equity:		
Common stock, $0.01 par value, 560,000 shares authorized as of September 30, 2021; 38,025 and 36,842 shares issued and outstanding as of September 30, 2021 and September 30, 2020, respectively	381	369
Accumulated other comprehensive income	1,634	3,711
Additional paid-in capital	1,002,353	974,307
Retained earnings (accumulated deficit)	27,577	(18,316)
Total stockholders' equity	1,031,945	960,071
Total liabilities and stockholders' equity	$ 1,705,728	$ 1,687,617

Refer to accompanying Notes to the Consolidated and Combined Financial Statements.

CERENCE INC.
CONSOLIDATED STATEMENTS OF EQUITY AND
COMBINED STATEMENT OF CHANGES IN PARENT COMPANY EQUITY
(In thousands)

	Shares	Amount	Additional Paid-In Capital	(Accumulated Deficit) Retained Earnings	Net Parent Investment	Accumulated Other Comprehensive (Loss) Income	Total
Balance at October 1, 2018	-	$ -	$ -	$ -	$ 1,017,276	$ (23,957)	$ 993,319
Accumulated adjustment related to the adoption of ASC 606	-	-	-	-	6,974	-	6,974
Net income	-	-	-	-	100,268	-	100,268
Other comprehensive loss	-	-	-	-	-	(5,042)	(5,042)
Net transfer to Parent	-	-	-	-	(27,391)	-	(27,391)
Balance at September 30, 2019	-	-	-	-	1,097,127	(28,999)	1,068,128
Net loss	-	-	-	(18,316)	-	-	(18,316)
Other comprehensive income	-	-	-	-	-	16,982	16,982
Distribution to Parent	-	-	-	-	(152,978)	-	(152,978)
Net (decrease) increase in net parent investment	-	-	-	-	(6,098)	15,728	9,630
Reclassification of net parent investment in Cerence	-	-	938,051	-	(938,051)	-	-
Issuance of common stock at separation	36,391	364	(364)	-	-	-	-
Issuance of common stock	706	7	1,311	-	-	-	1,318
Stock withheld to cover tax withholdings requirements upon stock vesting	(255)	(2)	(9,367)	-	-	-	(9,369)
Convertible Senior Notes conversion feature (net of taxes of $4,678 and issuance costs of $627)	-	-	14,371	-	-	-	14,371
Stock-based compensation	-	-	30,305	-	-	-	30,305
Balance at September 30, 2020	36,842	369	974,307	(18,316)	-	3,711	960,071
Net income	-	-	-	45,893	-	-	45,893
Other comprehensive loss	-	-	-	-	-	(2,077)	(2,077)
Issuance of common stock	1,718	17	11,505	-	-	-	11,522
Stock withheld to cover tax withholdings requirements upon stock vesting	(535)	(5)	(46,004)	-	-	-	(46,009)
Stock-based compensation	-	-	62,545	-	-	-	62,545
Balance at September 30, 2021	38,025	$ 381	$ 1,002,353	$ 27,577	$ -	$ 1,634	$ 1,031,945

Refer to accompanying Notes to the Consolidated and Combined Financial Statements.

CERENCE INC.
CONSOLIDATED AND COMBINED STATEMENTS OF CASH FLOWS
(In thousands)

	Year Ended September 30, 2021	2020	2019
Cash flows from operating activities:			
Net income (loss)	$ 45,893	$ (18,316)	$ 100,268
Adjustments to reconcile net income (loss) to net cash provided by operations:			
Depreciation and amortization	29,661	30,041	28,844
(Benefit from) provision for credit loss reserve	(415)	704	—
Stock-based compensation	60,555	47,285	29,682
Non-cash interest expense	5,013	5,286	—
Loss on debt extinguishment	—	19,279	—
Deferred tax benefit	(4,419)	(10,568)	(101,223)
Other	(606)	—	—
Changes in operating assets and liabilities:			
Accounts receivable	5,751	15,154	904
Prepaid expenses and other assets	(30,661)	(30,311)	(8,836)
Deferred costs	6,984	(1,381)	4,339
Accounts payable	3,411	(2,430)	10,130
Accrued expenses and other liabilities	(1,125)	26,040	6,289
Deferred revenue	(45,653)	(35,994)	17,674
Net cash provided by operating activities	74,389	44,789	88,071
Cash flows from investing activities:			
Capital expenditures	(12,047)	(19,012)	(4,517)
Purchases of marketable securities	(42,471)	(11,663)	—
Sale and maturities of marketable securities	16,350	—	—
Purchase of debt securities	(2,000)	—	—
Payments for equity securities	(2,563)	—	—
Other investing activities	1,100	—	—
Net cash used in investing activities	(41,631)	(30,675)	(4,517)
Cash flows from financing activities:			
Net transactions with Parent	—	12,964	(83,554)
Distributions to Parent	—	(152,978)	—
Proceeds from long-term debt, net of discount	—	547,719	—
Payments for long-term debt issuance costs	(520)	(6,402)	—
Principal payments of long-term debt	(6,252)	(271,563)	—
Common stock repurchases for tax withholdings for net settlement of equity awards	(45,769)	(9,369)	—
Principal payments of lease liabilities arising from a finance leases	(486)	(136)	—
Proceeds from the issuance of common stock	11,522	1,318	—
Net cash (used in) provided by financing activities	(41,505)	121,553	(83,554)
Effects of exchange rate changes on cash and cash equivalents	1,108	400	—
Net change in cash and cash equivalents	(7,639)	136,067	—
Cash and cash equivalents at beginning of year	136,067	—	—
Cash and cash equivalents at end of year	$ 128,428	$ 136,067	$ —
Supplemental information:			
Cash paid for income taxes	$ 6,177	$ 2,181	$ 12,139
Cash paid for interest	$ 9,550	$ 14,733	$ —

Refer to accompanying Notes to the Consolidated and Combined Financial Statements.

1. Organization

History

On October 1, 2019, (the "Distribution Date"), Nuance Communications ("Nuance" or "the Parent"), a leading provider of speech and language solutions for businesses and consumers around the world, completed the complete legal and structural separation and distribution to its stockholders of all of the outstanding shares of our common stock, and its consolidated subsidiaries, in a tax free spin-off (the "Spin-Off"). The distribution was made in the amount of one share of our common stock for every eight shares of Nuance common stock (the "Distribution") owned by Nuance's stockholders as of 5:00 p.m. Eastern Time on September 17, 2019, the record date of the Distribution.

In connection with the Distribution, on September 30, 2019, we filed an Amended and Restated Certificate of Incorporation with the Secretary of State of the State of Delaware, which became effective on October 1, 2019. Our Amended and Restated By-laws also became effective on October 1, 2019. On October 2, 2019, our common stock began regular-way trading on the Nasdaq Global Select Market under the ticker symbol CRNC.

Business

Cerence Inc. (referred to in this Annual Report on Form 10-K as "we," "our," "us," "ourselves," the "Company" or "Cerence") is a global, premier provider of AI-powered assistants and innovations for connected and autonomous vehicles. Our customers include all major automobile original equipment manufacturers ("OEMs"), or their tier 1 suppliers worldwide. We deliver our solutions on a white-label basis, enabling our customers to deliver customized virtual assistants with unique, branded personalities and ultimately strengthening the bond between automobile brands and end users. We generate revenue primarily by selling software licenses and cloud-connected services. In addition, we generate professional services revenue from our work with OEMs and suppliers during the design, development and deployment phases of the vehicle model lifecycle and through maintenance and enhancement projects.

COVID-19 Update

In March 2020, the World Health Organization characterized COVID-19 as a pandemic. In an effort to contain COVID-19 or slow its spread, governments around the world have enacted various measures, some of which have been subsequently rescinded, modified or reinstated, including orders to close all businesses not deemed "essential," isolate residents to their homes or places of residence, and practice social distancing.

We have taken numerous steps in our approach to addressing the COVID-19 pandemic, and we will continue to closely monitor ongoing developments in connection with the COVID-19 pandemic and its impact on our business.

The full extent to which the ongoing COVID-19 pandemic adversely affects our financial performance will depend on future developments, many of which are outside of our control, are highly uncertain and cannot be predicted, including, but not limited to, the duration and scope of the pandemic, its severity, the emergence of new variants of the virus, the development and availability of effective treatments and vaccines, the speed at which vaccines are administered, and how quickly and to what extent normal economic and operating conditions can resume. The COVID-19 pandemic could also result in additional governmental restrictions and regulations, which could adversely affect our business and financial results. In addition, a recession, depression or other sustained adverse market impact resulting from COVID-19 could materially and adversely affect our business, our access to needed capital and liquidity, and the value of our common stock. Even after the COVID-19 pandemic has lessened or subsided, we may continue to experience adverse impacts on our business and financial performance as a result of its global economic impact.

2. Basis of Presentation

Fiscal 2021 and 2020

The accompanying consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States ("GAAP") and the rules and regulations of the Securities and Exchange Commission ("SEC"). The consolidated financial statements reflect all adjustments considered necessary for a fair presentation of the consolidated results of operations and financial position for the fiscal years presented. All such adjustments are of a normal recurring nature.

Fiscal 2019

Standalone financial statements had not been historically prepared for the Cerence business. The accompanying combined financial statements have been prepared from the Parent's historical accounting records and are presented on a "carve out" basis to include the historical financial position, results of operations and cash flows applicable to the Cerence business. As a direct ownership relationship did not exist among all the various business units comprising the Cerence business, Nuance's investment in the Cerence business is shown in lieu of stockholders' equity in the combined financial statements.

The Combined Statement of Operations includes all revenues and costs directly attributable to Cerence as well as an allocation of expenses related to functions and services performed by centralized Parent organizations. These corporate expenses have been allocated to the Cerence business based on direct usage or benefit, where identifiable, with the remainder allocated on a pro rata basis of revenues, headcount, number of transactions or other measures as determined appropriate. The Combined Statement of Cash Flows presents these corporate expenses that are cash in nature as cash flows from operating activities, as this is the nature of these costs at the Parent. Non-cash expenses allocated from the Parent include corporate depreciation and amortization and stock-based compensation included as add-back adjustments to reconcile net income to net cash provided by operations. As described in Note 3(l) and Note 17, current and deferred income taxes and related tax expense have been determined based on the standalone results of the Cerence business by applying Accounting Standards Codification ("ASC") No. 740, *Income Taxes*, ("ASC 740"), to the Cerence business's operations in each country as if it were a separate taxpayer (i.e. following the Separate Return Methodology).

The Cerence business was dependent upon technologies which were owned by various entities within the Parent structure. While these combined financial statements use various methods to allocate the cost of these technologies to the Cerence business, this does not purport to reflect the cost of an arm's length license arrangement.

The combined financial statements include the allocation of certain assets and liabilities that have historically been held at the Nuance corporate level or by shared entities but which are specifically identifiable or allocable to the Cerence business. These shared assets and liabilities have been allocated to the Cerence business on the basis of direct usage when identifiable, or allocated on a pro rata basis of revenue, headcount or other systematic measures that reflect utilization of the services provided to or benefits received by Cerence. The Parent used a centralized approach to cash management and financing its operations. Accordingly, none of the cash, cash equivalents, marketable securities, foreign currency hedges or debt and related interest expense has been allocated to the Cerence business in the combined financial statements. The Parent's short and long-term debt has not been pushed down to the Cerence business's combined financial statements because the Cerence business was not the legal obligor of the debt and the Parent's borrowings were not directly attributable to the Cerence business.

The Parent maintained various stock-based compensation plans at a corporate level. Cerence employees participated in those programs and a portion of the cost of those plans has been included in the Cerence business's Combined Statement of Operations. However, the stock-based compensation expense has been included within the net parent investment. Refer to Note 13 for further description of the accounting for stock-based compensation.

Transactions between the Parent and the Cerence business are considered to be effectively settled in the combined financial statements at the time the transaction was recorded. The total net effect of the settlement of these intercompany transactions was reflected in the Combined Statement of Cash Flows as a financing activity and in the Combined Statement of Changes in Parent Company Equity as net parent investment. Refer to Note 3(p) for further description.

All of the allocations and estimates in the combined financial statements are based on assumptions that management believes are reasonable. However, the combined financial statements included herein may not be indicative of the results of operations and cash flows if the Cerence business had been a separate, standalone entity during the periods presented.

3. Summary of Significant Accounting Policies

(a) Principles of Consolidation

Fiscal years 2021 and 2020

The accompanying consolidated financial statements include the accounts of the Company, as well as those of our wholly owned subsidiaries. All significant intercompany transactions and balances are eliminated in consolidation.

Fiscal year 2019

The combined financial statements present the statement of operations, changes in Parent company equity and cash flows of the Cerence business. All significant balances and transactions between entities in the Cerence business have been eliminated for these combined financial statements. All significant balances between Parent (excluding the Cerence business) and the Cerence business are included in Parent company equity in the Combined Statement of Changes in Parent Company Equity.

(b) Use of Estimates

The Consolidated and Combined Financial Statements are prepared in accordance with GAAP, which requires management to make estimates and assumptions. These estimates, judgments and assumptions can affect the reported amounts in the financial statements and the footnotes thereto. Actual results could differ materially from these estimates. On an ongoing basis, we evaluate our estimates, assumptions and judgments. Significant estimates inherent to the preparation of financial statements include: revenue recognition; the allowances for credit losses and doubtful accounts; accounting for deferred costs; accounting for internally developed software; the valuation of goodwill and intangible assets; accounting for business combinations; accounting for stock-based compensation; accounting for income taxes; accounting for leases; accounting for convertible debt; and loss contingencies. We base our estimates on historical experience, market participant fair value considerations, projected future cash flows, and various other factors that are believed to be reasonable under the circumstances. Actual amounts could differ significantly from these estimates.

(c) Revenue Recognition

We primarily derive revenue from the following sources: (1) royalty-based software license arrangements, (2) connected services, and (3) professional services. Revenue is reported net of applicable sales and use tax, value-added tax and other transaction taxes imposed on the related transaction including mandatory government charges that are passed through to our customers. We account for a contract when both parties have approved and committed to the contract, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

Our arrangements with customers may contain multiple products and services. We account for individual products and services separately if they are distinct—that is, if a product or service is separately identifiable from other items in the contract and if a customer can benefit from it on its own or with other resources that are readily available to the customer.

We currently recognize revenue after applying the following five steps:

- identification of the contract, or contracts, with a customer;
- identification of the performance obligations in the contract, including whether they are distinct within the context of the contract;
- determination of the transaction price, including the constraint on variable consideration;
- allocation of the transaction price to the performance obligations in the contract; and
- recognition of revenue when, or as, performance obligations are satisfied.

We allocate the transaction price of the arrangement based on the relative estimated standalone selling price (“SSP”) of each distinct performance obligation. In determining SSP, we maximize observable inputs and consider a number of data points, including:

- the pricing of standalone sales (when available);
- the pricing established by management when setting prices for deliverables that are intended to be sold on a standalone basis;
- contractually stated prices for deliverables that are intended to be sold on a standalone basis; and
- other pricing factors, such as the geographical region in which the products are sold and expected discounts based on the customer size and type.

We only include estimated amounts in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. We reduce transaction prices for estimated returns and other allowances that represent variable consideration under Accounting Standards Codification (“ASC”) 606, which we estimate based on historical return experience and other relevant factors, and record a corresponding refund liability as a component of accrued expenses and other current liabilities. Other forms of contingent revenue or variable consideration are infrequent.

Revenue is recognized when control of these product or services are transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those products or services.

We assess the timing of the transfer of products or services to the customer as compared to the timing of payments to determine whether a significant financing component exists. In accordance with the practical expedient in ASC 606-10-32-18, we do not assess the existence of a significant financing component when the difference between payment and transfer of deliverables is a year or less. If the difference in timing arises for reasons other than the provision of finance to either the customer or us, no financing component is deemed to exist. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our services, not to receive or provide financing from or to customers. We do not consider set-up fees nor other upfront fees paid by our customers to represent a financing component.

Reimbursements for out-of-pocket costs generally include, but are not limited to, costs related to transportation, lodging and meals. Revenue from reimbursed out-of-pocket costs is accounted for as variable consideration.

(d) Business Combinations

We determine and allocate the purchase price of an acquired company to the tangible and intangible assets acquired and liabilities assumed as of the date of acquisition. Results of operations and cash flows of acquired companies are included in our operating results from the date of acquisition. The purchase price allocation process requires us to use significant estimates and assumptions, which include:

- estimated fair values of intangible assets;
- estimated fair values of legal performance commitments to customers, assumed from the acquiree under existing contractual obligations (classified as deferred revenue);
- estimated income tax assets and liabilities assumed from the acquiree;
- estimated fair value of pre-acquisition contingencies assumed from the acquiree; and
- estimated fair value of any contingent consideration which is established at the acquisition date and included in the total purchase price. The contingent consideration is then adjusted to fair value, with any measurement-period adjustment recorded against goodwill. Adjustments identified subsequent to the measurement period are recorded within acquisition-related costs.

While we use our best estimates and assumptions as part of the purchase price allocation process to accurately value assets acquired and liabilities assumed at the business combination date, our estimates and assumptions are inherently uncertain and subject to refinement. As a result, during the measurement period, which is generally one year from the acquisition date, any adjustment to the assets acquired and liabilities assumed is recorded against goodwill in the period in which the amount is determined. Any adjustment identified subsequent to the measurement period is included in operating results in the period in which the amount is determined.

(e) Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and highly liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less.

(f) Marketable Securities

Marketable securities consist of commercial paper and corporate bonds. We classify our marketable securities as available-for-sale at the time of purchase and reevaluate such classification as of each balance sheet date. We may sell these securities at any time for use in current operations even if they have not yet reached maturity. We classify our marketable securities as either short-term or long-term based on the nature of each security. We record marketable securities at fair value, with the unrealized gains or losses included within Accumulated other comprehensive income (loss) on the Consolidated Balance Sheets until realized. Interest income earned from our marketable securities is reported within Interest income on the Consolidated and Combined Statements of Operations. We evaluate our marketable securities to assess whether those with unrealized loss positions are other than temporarily impaired. We consider impairment to be other than temporary if they are related to deterioration in credit risk or if it is likely we will sell the securities before the recovery of their cost basis. Realized gains and losses and declines in value judged to be other than temporary are determined based on the specific identification method and are reported in Other income (expense), net on the Consolidated and Combined Statements of Operations.

(g) Goodwill

Goodwill represents the excess of the purchase price in a business combination over the fair value of net assets acquired. Goodwill is not amortized but tested annually for impairment or when indicators of impairment are present. The test for goodwill impairment involves a qualitative assessment of impairment indicators. If indicators are present, a quantitative test of impairment is performed. Goodwill impairment, if any, is determined by comparing the reporting unit’s fair value to its carrying value. An impairment loss is recognized in an amount equal to the excess of the reporting unit’s carrying value over its fair value, up to the amount of goodwill allocated to the reporting unit. Goodwill is tested for impairment annually on July 1, the first day of the fourth quarter of the fiscal year. There is no goodwill impairment for the years ended September 30, 2021, 2020, and 2019.

We believe our Chief Executive Officer (“CEO”) is our chief operating decision maker (“CODM”). Our CEO approves all major decisions, including reorganizations and new business initiatives. Our CODM reviews routine consolidated operating information and makes decisions on the allocation of resources at this level, as such, we have concluded that we have one operating segment.

For the purpose of testing goodwill for impairment, all goodwill acquired in a business combination is assigned to one or more reporting units. A reporting unit represents an operating segment or a component within an operating segment for which discrete financial information is available and is regularly reviewed by segment management for performance assessment and resource allocation. Components of similar economic characteristics are aggregated into one reporting unit for the purpose of goodwill impairment assessment. Reporting units are identified annually and re-assessed periodically for recent acquisitions or any changes in segment reporting structure. Upon consideration of our components, we have concluded that our goodwill is associated with one reporting unit.

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

On July 1, 2021, we completed the annual impairment testing of our goodwill. We elected to rely on a qualitative assessment and as a result we determined it is more likely than not that the fair value of our reporting unit is greater than its carrying amount.

(h) Long-Lived Assets with Definite Lives

Our long-lived assets consist principally of technology and patents, customer relationships, internally developed software, property and equipment. Customer relationships are amortized over their estimated economic lives based on the pattern of economic benefits expected to be generated from the use of the asset. Other definite-lived assets are amortized over their estimated economic lives using the straight-line method. The remaining useful lives of long-lived assets are re-assessed periodically for any events and circumstances that may change the future cash flows expected to be generated from the long-lived asset or asset group.

Internally developed software consists of capitalized costs incurred during the application development stage, which include costs to design the software configuration and interfaces, coding, installation and testing. Costs incurred during the preliminary project stage, along with post-implementation stages of internally developed software, are expensed as incurred. Internally developed software costs that have been capitalized are typically amortized over the estimated useful life, commencing with the date when an asset is ready for its intended use. Equipment is stated at cost and depreciated over the estimated useful life. Leasehold improvements are depreciated over the shorter of the related remaining lease term or the estimated useful life. Depreciation is computed using the straight-line method. Repair and maintenance costs are expensed as incurred. The cost and related accumulated depreciation of sold or retired assets are removed from the accounts and any gain or loss is included in the results of operations for the period.

Long-lived assets with definite lives are tested for impairment whenever events or changes in circumstances indicate the carrying value of a specific asset or asset group may not be recoverable. We assess the recoverability of long-lived assets with definite lives at the asset group level. Asset groups are determined based upon the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. When the asset group is also a reporting unit, goodwill assigned to the reporting unit is also included in the carrying amount of the asset group. For the purpose of the recoverability test, we compare the total undiscounted future cash flows from the use and disposition of the assets with its net carrying amount. When the carrying value of the asset group exceeds the undiscounted future cash flows, the asset group is deemed to be impaired. The amount of the impairment loss represents the excess of the asset or asset group’s carrying value over its estimated fair value, which is generally determined based upon the present value of estimated future pre-tax cash flows that a market participant would expect from use and disposition of the long-lived asset or asset group. There was no impairment of long-lived assets during the years ended September 30, 2021, 2020, and 2019.

(i) Allowance for Credit Losses

<u>Fiscal year 2021</u>

We are exposed to credit losses primarily through our sales of software licenses and services to customers. We determine credit ratings for each customer in our portfolio based upon public information and information obtained directly from our customers. A credit limit for each customer is established and in certain cases we may require collateral or prepayment to mitigate credit risk. Our expected loss methodology is developed using historical collection experience, current customer credit information, current and future economic and market conditions and a review of the current status of the customer's account balances. We monitor our ongoing credit exposure through reviews of customer balances against contract terms and due dates, current economic conditions, and dispute resolution. Estimated credit losses are written off in the period in which the financial asset is no longer collectible.

The change in the allowance for credit losses for the fiscal year ended September 30, 2021 is as follows (dollars in thousands):

	Allowance for Credit Losses
Balance as of September 30, 2020	$ 1,394
Current period recoveries	(415)
Write-offs	(112)
Foreign exchange impact on ending balance	12
Balance as of September 30, 2021	$ 879

Fiscal years 2020 and 2019

We record allowances for doubtful accounts for the estimated probable losses on uncollected accounts receivable. The allowance is based upon the credit worthiness of our customers, our historical experience, the age of the receivable, and current market and economic conditions. Receivables are written off against these allowances in the period they are determined to be uncollectible. For the years ended September 30, 2020 and 2019, the activity related to the allowance for doubtful accounts was as follows (dollars in thousands):

	Allowance for Doubtful Accounts
Balance at October 1, 2018	$ 954
Bad debt provisions	401
Write-offs, net of recoveries	(490)
Balance at September 30, 2019	865
Bad debt provisions	704
Write-offs, net of recoveries	(175)
Balance at September 30, 2020	$ 1,394

(j) Research and Development

Research and development ("R&D") costs related to software that is or will be sold or licensed externally to third-parties, or for which a substantive plan exists to sell or license such software in the future, incurred subsequent to the establishment of technological feasibility, but prior to the general release of the product, are capitalized and amortized to cost of revenue over the estimated useful life of the related products. We have determined that technological feasibility is reached shortly before the general release of the software products. Costs incurred after technological feasibility is established have not been material. R&D costs are otherwise expensed as incurred.

(k) Acquisition-related Costs

Acquisition-related costs include those costs related to potential and realized acquisitions. These costs consist of (i) transition and integration costs, including retention payments, transitional employee costs and earn-out payments, and other costs related to integration activities and (ii) professional service fees, including financial advisory, legal, accounting, and other outside services incurred in connection with acquisition activities and disputes.

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

	Year Ended September 30,		
	2021	2020	2019
Transition and integration costs	$ —	$ —	$ 563
Professional service fees	—	—	381
Total	$ —	$ —	$ 944

(l) Income Taxes

Fiscal years 2021 and 2020

We account for income taxes using the assets and liabilities method, as prescribed by ASC No. 740, *Income Taxes*, or ASC 740.

Deferred Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amount of assets and liabilities and their respective tax bases. The method also requires the recognition of future tax benefits such as net operating loss carryforwards, to the extent that realization of such benefits is more likely than not after consideration of all available evidence. As the income tax returns are not due and filed until after the completion of our annual financial reporting requirements, the amounts recorded for the current period reflect estimates for the tax-based activity for the period. In addition, estimates are often required with respect to, among other things, the appropriate state and foreign income tax rates to use, the potential utilization of operating loss carry-forwards and valuation allowance required, if any, for tax assets that may not be realizable in the future. Tax laws and tax rates vary substantially in these jurisdictions and are subject to change given the political and economic climate. We report and pay income tax based on operational results and applicable law. Our tax provision contemplates tax rates currently in effect to determine both our currency and deferred tax positions.

Any significant fluctuations in rates or changes in tax laws could cause our estimates of taxes we anticipate either paying or recovering in the future to change. Such changes could lead to either increases or decreases in our effective tax rates.

We have historically estimated the future tax consequences of certain items, including accruals that cannot be deducted for income tax purposes until such expenses are paid or the related assets are disposed. We believe the procedures and estimates used in our accounting for income taxes are reasonable and in accordance with established tax law. The income tax estimates used have not resulted in material adjustments to income tax expense in subsequent period when the estimates are adjusted to the actual filed tax return amounts.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the fiscal years in which those temporary differences are expected to be recovered or settled. With respect to earnings expected to be indefinitely reinvested offshore, we do not accrue tax for the repatriations of such foreign earnings.

Valuation Allowance

We regularly review our deferred tax assets for recoverability considering historical profitability, projected future taxable income, the expected timing of the reversals of existing temporary differences and tax planning strategies. In assessing the need for a valuation allowance, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets. The weight given to the positive and negative evidence is commensurate with the extent to which the evidence may be objectively verified. If positive evidence regarding projected future taxable income, exclusive of reversing taxable temporary differences, existed it would be difficult for it to outweigh objective negative evidence of recent financial reporting losses.

Uncertain Tax Positions

We operate in multiple jurisdictions through wholly owned subsidiaries and our global structure is complex. The estimates of our uncertain tax positions involve judgements and assessment of the potential tax implications related to legal entity restructuring, intercompany transfer and acquisition or divestures. We recognize tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. Our tax positions are subject to audit by taxing authorities across multiple global jurisdictions and the resolution of such audits may span multiple years. Tax laws are complex and often subject to varied interpretations, accordingly, the ultimate outcome with respect to taxes we may own may differ from the amounts recognized.

Fiscal year 2019

Income taxes as presented herein attribute current and deferred income taxes of the Parent to the Cerence business's standalone financial statements in a manner that is systematic, rational, and consistent with the asset and liability method prescribed by ASC 740. Accordingly, the Cerence business's income tax provision was prepared following the "Separate Return Method." The Separate Return Method applies ASC 740 to the standalone financial statements of each member of the consolidated group as if the group member were a separate taxpayer and a standalone enterprise. As a result, actual tax transactions included in the consolidated financial statements of the Parent may not be included in the combined financial statements of the Cerence business. Similarly, the tax treatment of certain items reflected in the combined financial statements of the Cerence business may not be reflected in the consolidated financial statements and tax returns of the Parent; therefore, such items as net operating losses, credit carryforwards and valuation allowances may exist in the standalone financial statements that may or may not exist in the Parent's consolidated financial statements.

The breadth of the Cerence business's operations and the global complexity of tax regulations require assessments of uncertainties and judgments in estimating taxes that the Cerence business would have paid if it had been a separate taxpayer. The final taxes that would have been paid are dependent upon many factors, including negotiations with taxing authorities in various jurisdictions, outcomes of tax litigation and resolution of disputes arising from federal, state and international tax audits in the normal course of business. The provision for income taxes is determined using the asset and liability approach of accounting for income taxes. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. This method also requires the recognition of future tax benefits relating to net operating loss carryforwards and tax credits, to the extent that realization of such benefits is more likely than not after consideration of all available evidence. The provision for income taxes represents income taxes paid by the parent or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax basis of the Cerence business's assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted.

Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized. In assessing the need for a valuation allowance, we consider both positive and negative evidence related to the likelihood of realization of the deferred tax assets. The weights assigned to the positive and negative evidences are commensurate with the extent to which the evidence may be objectively verified. If positive evidence regarding projected future taxable income, exclusive of reversing taxable temporary differences, existed, it would be difficult for it to outweigh objective negative evidence of recent financial reporting losses.

In general, the taxable income (loss) of the various Cerence business entities was included in the Parent's consolidated tax returns, where applicable in jurisdictions around the world. As such, separate income tax returns were not prepared for any Cerence business entities. Consequently, income taxes currently payable are deemed to have been remitted to the Parent, in cash, in the period the liability arose and income taxes currently receivable are deemed to have been received from the Parent in the period that a refund could have been recognized by the Cerence business had the Cerence business been a separate taxpayer.

(m) Accumulated Other Comprehensive Income

The components of accumulated other comprehensive income, reflected in the Consolidated Statements of Equity, consists of the following (dollars in thousands):

	September 30,	
	2021	**2020**
Foreign currency translation adjustments	$ 3,284	$ 5,264
Net unrealized losses on post-retirement benefits	(1,639)	(1,552)
Net unrealized losses on available-for-sale securities	(11)	(1)
Accumulated other comprehensive income	$ 1,634	$ 3,711

No income tax provisions or benefits are recorded for foreign currency translation adjustments as the undistributed earnings in our foreign subsidiaries are expected to be indefinitely reinvested.

(n) Concentration of Risk

Financial instruments that potentially subject us to significant concentrations of credit risk primarily consist of trade accounts receivable. We perform ongoing credit evaluations of our customers' financial condition and limit the amount of credit extended when deemed appropriate. One customer accounted for 12.1% of our Accounts receivable, net balance at September 30, 2021. Two customers accounted for 14.8% and 10.9% of our Accounts receivable, net balance at September 30, 2020.

(o) Foreign Currency Translation

The functional currency of a foreign subsidiary is generally the local currency. We translate the financial statements of foreign subsidiaries to U.S. dollars using month-end exchange rates for assets and liabilities, and average rates for the reporting period for revenues, costs, and expenses. We record translation gains and losses in Accumulated other comprehensive income as a component of stockholders' equity and parent company equity. We record net foreign exchange transaction gains and losses resulting from the conversion of the transaction currency to the functional currency within Other income (expense), net. Foreign currency transaction (gains) losses for the fiscal years ended September 30, 2021, 2020 and 2019 were ($1.7) million, $2.4 million, and ($0.3) million, respectively.

(p) Net Parent Investment

In the Combined Statement of Changes in Parent Company Equity, net parent investment represents the Parent's historical investment in the Cerence business, accumulated net earnings after taxes and the net effect of transactions with, and allocations from, the Parent.

(q) Stock-Based Compensation

Fiscal years 2021 and 2020

Stock-based compensation primarily consists of restricted stock units with service or market/performance conditions. Equity awards are measured at the fair market value of the underlying stock at the grant date. We recognize stock compensation expense using the straight-line attribution method over the requisite service period. We record forfeitures as they occur. For performance-based restricted stock units, the compensation cost is recognized based on the number of units expected to vest upon the achievement of the performance conditions. Shares are issued on the vesting dates net of the applicable statutory tax withholding to be paid by us on behalf of our employees. As a result, fewer shares are issued to the employee than the number of awards outstanding. We record a liability for the tax withholding to be paid by us as a reduction to Additional paid-in capital. We record any income tax effect related to stock-based awards through the Consolidated and Combined Statements of Operations. Excess tax benefits are recognized as deferred tax assets upon settlement and are subject to regular review for valuation allowance.

Fiscal year 2019

The Parent maintained certain stock compensation plans for the benefit of certain of its officers, directors and employees, including grants of employee stock options, purchases under employee stock purchase plans and restricted awards. The combined financial statements included certain expenses of the Parent that were allocated to the Cerence business for stock-based compensation. The stock-based compensation expense was recognized over the requisite service period, based on the grant date fair value of the awards and the number of the awards expected to be vested based on service and performance conditions, net of forfeitures. We recorded any tax effect related to stock-based awards through the Combined Statement of Operations. Excess tax benefits were recognized as deferred tax assets upon settlement and were subject to regular review for valuation allowance.

(r) Leases

We have entered into a number of facility and equipment leases which qualify as operating leases under GAAP. We also have a limited number of equipment leases that qualify as financing leases. We determine if contracts with vendors represent a lease or have a lease component under GAAP at contract inception. Our leases have remaining terms ranging from less than one year to seven years. Some of our leases include options to extend or terminate the lease prior to the end of the agreed upon lease term. For purposes of calculating lease liabilities, lease terms include options to extend or terminate the lease when it is reasonably certain that we will exercise such options.

Operating lease right of use assets and liabilities are recognized based on the present value of the future minimum lease payments over the lease term at the lease commencement date. As our leases generally do not provide an implicit rate, we use an estimated incremental borrowing rate in determining the present value of future payments. The incremental borrowing rate represents an estimate of the interest rate we would incur at lease commencement to borrow an amount equal to the lease payments on a collateralized basis over the term of a lease within a particular location and currency environment.

Operating leases are included in Operating lease right of use assets, Short-term operating lease liabilities, and Long-term operating lease liabilities on our Consolidated Balance Sheets as of September 30, 2021 and 2020. Finance leases are included in Property and equipment, net, Accrued expenses and other current liabilities, and Other liabilities on our Consolidated Balance Sheets as of September 30, 2021 and 2020.

Lease costs for minimum lease payments is recognized on a straight-line basis over the lease term. For operating leases, costs are included within Cost of revenues, Research and development, Sales and marketing, and General and administrative lines on the Consolidated and Combined Statements of Operations. For financing leases, amortization of the finance right of use assets is included within Research and Development, Sales and marketing, and General and administrative lines on the Consolidated and Combined Statements of Operations, and interest expense is included within Interest expense.

For operating leases, the related cash payments are included in the operating cash flows on the Consolidated and Combined Statements of Cash Flows. For financing leases, the related cash payments for the principal portion of the lease liability are included in the financing cash flows on the Consolidated and Combined Statement of Cash Flows and the related cash payments for the interest portion of the lease liability are included within the operating section of the Consolidated and Combined Statement of Cash Flows.

(s) Convertible Debt

We bifurcate the debt and equity (the contingently convertible feature) components of our convertible debt instruments in a manner that reflects our nonconvertible debt borrowing rate at the time of issuance. The equity components of our convertible debt instruments are recorded within stockholders' equity with an allocated issuance premium or discount. The debt issuance premium or discount is amortized to Interest expense in our Consolidated and Combined Statements of Operations using the effective interest method over the expected term of the convertible debt.

We assess the short-term and long-term classification of our convertible debt on each balance sheet date. Whenever the holders have a contractual right to convert, the carrying amount of the convertible debt is reclassified to current liabilities, with the corresponding equity component classified from additional paid-in capital to mezzanine equity, as needed.

(t) Net Income (Loss) Per Share

Basic net income (loss) per share is computed using the weighted-average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted-average number of common shares, giving effect to potentially dilutive securities outstanding during the period. Potentially dilutive securities consist of restricted stock units, contingently issuable shares, and potential issuance of stock upon conversion of our Notes, as more fully described in Note 18. The dilutive effect of the Notes is reflected in net income per share by application of the "if-converted" method. The "if-converted" method is only assumed in periods where such application would be dilutive. In applying the "if-converted" method for diluted net income per share, we would assume conversion of the Notes at a ratio of 26.7271 shares of our common stock per $1,000 principal amount of the Notes. Assumed converted shares of our common stock are weighted for the period the Notes were outstanding.

(u) Recently Adopted Accounting Standards

In June 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, ("ASU 2016-13"), which requires the measurement and recognition of expected credit losses for financial assets held at amortized cost, including trade receivables. ASU 2016-13 replaces the existing incurred loss impairment model with an expected loss model that requires the use of forward-looking information to calculate credit loss estimates. This standard is effective for interim and annual reporting periods beginning after December 15, 2019. This standard is required to be adopted using the modified retrospective basis, with a cumulative-effect adjustment to Accumulated deficit as of the beginning of the first reporting period in which the guidance of this standard is effective.

We adopted ASU 2016-13 using the modified retrospective approach as of October 1, 2020. The effects of applying ASU 2016-13 as a cumulative-effect adjustment to Retained earnings was immaterial.

(v) Issued Accounting Standards Not Yet Adopted

From time to time, new accounting pronouncements are issued by the FASB and are adopted by us as of the specified effective dates. Unless otherwise discussed, such pronouncements did not have or will not have a significant impact on our consolidated financial position, results of operations or cash flows, or do not apply to our operations.

In March 2020, the FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, ("ASU 2020-04"). The update provides optional guidance for a limited period of time to ease the potential burden in accounting for (or recognizing the effects of) contract modifications on financial reporting, caused by reference rate reform. ASU 2020-04 is effective for all entities as of March 12, 2020 through December 31, 2022. We are currently evaluating the impact of the adoption of this standard on our consolidated financial statements.

In August 2020, the FASB issued ASU No. 2020-06, *Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*, ("ASU 2020-06"). ASU 2020-06 simplifies the accounting for debt with conversion options, revises the criteria for applying the derivatives scope exception for contracts in an entity's own equity, and improves the consistency for the calculation of earnings per share. The guidance is effective for annual reporting periods and interim periods within those annual reporting periods beginning after December 15, 2021, our fiscal 2023. Early adoption is permitted for annual periods and interim periods within those annual periods beginning after December 15, 2020, our fiscal 2022. We are currently evaluating the impact of the adoption of this guidance on our consolidated financial statements.

4. Revenue Recognition

We primarily derive revenue from the following sources: (1) royalty-based software license arrangements, (2) connected services, and (3) professional services. Revenue is reported net of applicable sales and use tax, value-added tax and other transaction taxes imposed on the related transaction including mandatory government charges that are passed through to our customers. We account for a contract when both parties have approved and committed to the contract, the rights of the parties are identified, payment terms are identified, the contract has commercial substance and collectability of consideration is probable.

Our arrangements with customers may contain multiple products and services. We account for individual products and services separately if they are distinct—that is, if a product or service is separately identifiable from other items in the contract and if a customer can benefit from it on its own or with other resources that are readily available to the customer.

We recognize revenue after applying the following five steps:

- identification of the contract, or contracts, with a customer;
- identification of the performance obligations in the contract, including whether they are distinct within the context of the contract;
- determination of the transaction price, including the constraint on variable consideration;
- allocation of the transaction price to the performance obligations in the contract; and
- recognition of revenue when, or as, performance obligations are satisfied.

We allocate the transaction price of the arrangement based on the relative estimated standalone selling price (“SSP”) of each distinct performance obligation. In determining SSP, we maximize observable inputs and consider a number of data points, including:

- the pricing of standalone sales (when available);
- the pricing established by management when setting prices for deliverables that are intended to be sold on a standalone basis;
- contractually stated prices for deliverables that are intended to be sold on a standalone basis; and
- other pricing factors, such as the geographical region in which the products are sold and expected discounts based on the customer size and type.

We only include estimated amounts in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved. We reduce transaction prices for estimated returns and other allowances that represent variable consideration under Accounting Standards Codification (“ASC”) 606, which we estimate based on historical return experience and other relevant factors, and record a corresponding refund liability as a component of Accrued expenses and other current liabilities. Other forms of contingent revenue or variable consideration are infrequent.

Revenue is recognized when control of these product or services are transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those products or services.

We assess the timing of the transfer of products or services to the customer as compared to the timing of payments to determine whether a significant financing component exists. In accordance with the practical expedient in ASC 606-10-32-18, we do not assess the existence of a significant financing component when the difference between payment and transfer of deliverables is a year or less. If the difference in timing arises for reasons other than the provision of finance to either the customer or us, no financing component is deemed to exist. The primary purpose of our invoicing terms is to provide customers with simplified and predictable ways of purchasing our services, not to receive or provide financing from or to customers. We do not consider set-up fees nor other upfront fees paid by our customers to represent a financing component.

Reimbursements for out-of-pocket costs generally include, but are not limited to, costs related to transportation, lodging and meals. Revenue from reimbursed out-of-pocket costs is accounted for as variable consideration.

(a) Performance Obligations

Licenses

Embedded software and technology licenses operate without access to the external networks and information. Embedded licenses sold with non-distinct professional services to customize and/or integrate the underlying software and technology are accounted for as a combined performance obligation. Revenue from the combined performance obligation is recognized over time based upon the progress towards completion of the project, which is measured based on the labor hours already incurred to date as compared to the total estimated labor hours.

Revenue from distinct embedded software and technology licenses, which do not require professional services to customize and/or integrate the software license, is recognized at the point in time when the software and technology is made available to the customer and control is transferred. For income statement presentation purposes, we separate distinct embedded license revenue from professional services revenue based on their relative SSPs.

Revenue from embedded software and technology licenses sold on a royalty basis, where the license of non-exclusive intellectual property is the predominant item to which the royalty relates, is recognized in the period the usage occurs in accordance with ASC 606-10-55-65(A).

Connected Services

Connected services, which allow our customers to use the hosted software over the contract period without taking possession of the software, are provided on a usage basis as consumed or on a fixed fee subscription basis. Subscription basis revenue represents a single promise to stand-ready to provide access to our connected services. Our connected services contract terms generally range from one to five years.

As each day of providing services is substantially the same and the customer simultaneously receives and consumes the benefits as access is provided, we have determined that our connected services arrangements are a single performance obligation comprised of a series of distinct services. These services include variable consideration, typically a function of usage. We recognize revenue as each distinct service period is performed (i.e., recognized as incurred).

Our connected service arrangements generally include services to develop, customize, and stand-up applications for each customer. In determining whether these services are distinct, we consider dependence of the cloud service on the up-front development and stand-up, as well as availability of the services from other vendors. We have concluded that the up-front development, stand-up and customization services are not distinct performance obligations, and as such, revenue for these activities is recognized over the period during which the cloud-connected services are provided, and is included within Connected services revenue. There can be instances where the customer purchases a software license that allows them to take possession of the software to enable hosting by the customer or a third-party. For such arrangements, the performance obligation of the license is completed at a point in time once the customer takes possession of the software.

Professional Services

Revenue from distinct professional services, including training, is recognized over time based upon the progress towards completion of the project, which is measured based on the labor hours already incurred to date as compared to the total estimated labor hours.

(b) Significant Judgments

Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. Our license contracts often include professional services to customize and/or integrate the licenses into the customer's environment. Judgment is required to determine whether the license is considered distinct and accounted for separately, or not distinct and accounted for together with professional services. Furthermore, hybrid contracts that contain both embedded and connected license and professional services are analyzed to determine if the products and services are distinct or have stand-alone functionality to determine the revenue treatment.

Judgments are required to determine the SSP for each distinct performance obligation. When the SSP is directly observable, we estimate the SSP based upon the historical transaction prices, adjusted for geographic considerations, customer classes, and customer relationship profiles. In instances where the SSP is not directly observable, we determine the SSP using information that may include market conditions and other observable inputs. We may have more than one SSP for individual products and services due to the stratification of those products and services by customers and circumstances. In these instances, we may use information such as the size of the customer and geographic region in determining the SSP. Determining the SSP for performance obligations which we never sell separately also requires significant judgment. In estimating the SSP, we consider the likely price that would have resulted from established pricing practices had the deliverable been offered separately and the prices a customer would likely be willing to pay. For contracts that contain future royalties, the allocation of SSP is determined using any fixed payments as well as the forecasted volume usage associated with royalties.

(c) Disaggregated Revenue

Revenues, classified by the major geographic region in which our customers are located, for the fiscal years ended September 30, 2021, 2020 and 2019 (dollars in thousands):

	Year Ended September 30,		
	2021	2020	2019
Revenues:			
United States	$ 135,033	$ 129,338	$ 131,877
Other Americas	175	16	1,044
Germany	114,936	100,674	78,258
Other Europe, Middle East and Africa	29,964	25,394	20,478
Japan	62,840	50,936	44,472
Other Asia-Pacific	44,234	24,609	27,186
Total net revenues	$ 387,182	$ 330,967	$ 303,315

Revenues within the United States, Germany, and Japan accounted for more than 10% of revenue for all periods presented.

Revenues relating to two customers accounted for $72.0 million, or 18.6%, and $41.6 million, or 10.8% of revenue for the fiscal year ended September 30, 2021. Revenues relating to one customer accounted for $76.9 million, or 23.2%, of revenue for the fiscal year ended September 30, 2020. Revenues relating to two customers accounted for $62.7 million, or 20.7%, and $37.4 million, or 12.3% of revenue for the fiscal year ended September 30, 2019.

(d) Contract Acquisition Costs

In conjunction with the adoption of ASC 606, we are required to capitalize certain contract acquisition costs. The capitalized costs primarily relate to paid commissions. In accordance with the practical expedient in ASC 606-10-10-4, we apply a portfolio approach to estimate contract acquisition costs for groups of customer contracts. We elect to apply the practical expedient in ASC 340-40-25-4 and will expense contract acquisition costs as incurred where the expected period of benefit is one year or less. Contract acquisition costs are deferred and amortized on a straight-line basis over the period of benefit, which we have estimated to be, on average, between one and eight years. The period of benefit was determined based on an average customer contract term, expected contract renewals, changes in technology and our ability to retain customers, including canceled contracts. We assess the amortization term for all major transactions based on specific facts and circumstances. Contract acquisition costs are classified as current or noncurrent assets based on when the expense will be recognized. The current and noncurrent portions of contract acquisition costs are included in Prepaid expenses and other current assets, and in Other assets, respectively. As of September 30, 2021 and 2020, we had $6.9 million and $5.6 million of contract acquisition costs. We had amortization expense of $1.9 million, $1.5 million and $0.7 million related to these costs during the fiscal years ended September 30, 2021, 2020 and 2019. There was no impairment related to contract acquisition costs.

(e) Capitalized Contract Costs

We capitalize incremental costs incurred to fulfill our contracts that (i) relate directly to the contract, (ii) are expected to generate resources that will be used to satisfy our performance obligation under the contract, and (iii) are expected to be recovered through revenue generated under the contract. Our capitalized costs consist primarily of setup costs, such as costs to standup, customize and develop applications for each customer, which are incurred to satisfy our stand-ready obligation to provide access to our connected offerings. These contract costs are expensed to cost of revenue as we satisfy our stand-ready obligation over the contract term which we estimate to be between one and eight years, on average. The contract term was determined based on an average customer contract term, expected contract renewals, changes in technology, and our ability to retain customers, including canceled contracts. We classify these costs as current or noncurrent based on the timing of when we expect to recognize the expense. The current and noncurrent portions of capitalized contract fulfillment costs are presented as Deferred costs. As of September 30, 2021 and 2020, we had $37.8 million and $45.4 million of capitalized contract costs.

We had amortization expense of $15.4 million, $12.0 million and $10.6 million related to these costs during the fiscal years ended September 30, 2021, 2020 and 2019, respectively. There was no impairment related to contract costs capitalized.

(f) Trade Accounts Receivable and Contract Balances

We classify our right to consideration in exchange for deliverables as either a receivable or a contract asset. A receivable is a right to consideration that is unconditional (i.e. only the passage of time is required before payment is due). We present such receivables in Accounts receivable, net in our Consolidated Balance Sheets at their net estimated realizable value. We maintain an allowance for credit losses to provide for the estimated amount of receivables and contract assets that may not be collected. The allowance is based upon an assessment of customer creditworthiness, historical payment experience, the age of outstanding receivables and other applicable factors.

Our contract assets and liabilities are reported in a net position on a contract-by-contract basis at the end of each reporting period.

Contract assets include unbilled amounts from long-term contracts when revenue recognized exceeds the amount billed to the customer, and right to payment is not solely subject to the passage of time. Contract assets are included in Prepaid expenses and other current assets. As of September 30, 2021, we had $59.1 million of current contract assets. The table below shows significant changes in contract assets (dollars in thousands):

	Contract assets
Balance as of October 1, 2019	$ 9,219
Revenues recognized but not billed	52,682
Amounts reclassified to accounts receivable, net	(31,624)
Balance as of September 30, 2020	$ 30,277
Revenues recognized but not billed	89,217
Amounts reclassified to accounts receivable, net	(60,351)
Balance as of September 30, 2021	$ 59,143

Our contract liabilities, which we present as Deferred revenue, consist of advance payments and billings in excess of revenues recognized. We classify deferred revenue as current or noncurrent based on when we expect to recognize the revenues. As of September 30, 2021, we had $276.7 million of deferred revenue. The table below shows significant changes in deferred revenue (dollars in thousands):

	Deferred revenue
Balance as of October 1, 2019	$ 353,284
Amounts billed but not recognized	96,126
Revenue recognized	(124,681)
Balance as of September 30, 2020	$ 324,729
Amounts billed but not recognized	105,540
Revenue recognized	(153,532)
Balance as of September 30, 2021	$ 276,737

(g) Remaining Performance Obligations

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied or partially unsatisfied at September 30, 2021 (dollars in thousands):

	Within One Year	Two to Five Years	Greater than Five Years	Total
Total revenue	$ 144,679	$ 172,723	$ 19,028	$ 336,430

The table above includes fixed backlogs and does not include variable backlogs derived from contingent usage-based activities, such as royalties and usage-based connected services.

5. Earnings Per Share

Basic earnings per share is computed by dividing net income (loss) by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted-average number of shares of common stock outstanding during the period, increased to include the number of shares of common stock that would have been outstanding had potential dilutive shares of common stock been issued. The dilutive effect of restricted stock units is reflected in diluted net income per share by applying the treasury stock method.

The dilutive effect of the Notes (as defined in Note 18) is reflected in net income per share by application of the “if-converted” method. The “if-converted” method is only assumed in periods where such application would be dilutive. In applying the “if-converted” method for diluted net income per share, we would assume conversion of the Notes at a ratio of 26.7271 shares of our common stock per $1,000 principal amount of the Notes. Assumed converted shares of our common stock are weighted for the period the Notes were outstanding.

There were no Cerence equity awards outstanding prior to the Spin-Off, thus the computation of basic and diluted earnings per common share for all prior periods disclosed was calculated using the shares issued in connection with the Spin-Off totaling 36.4 million shares.

The following table presents the reconciliation of the numerator and denominator for calculating net income (loss) per share:

	September 30,		
in thousands, except per share data	2021	2020	2019
Numerator:			
Net income (loss) - basic and diluted	$ 45,893	$ (18,316)	$ 100,268
Denominator:			
Weighted average common shares outstanding - basic	37,752	36,428	36,391
Dilutive effect of restricted stock awards	1,405	-	-
Dilutive effect of contingently issuable stock awards	132	-	-
Weighted average common shares outstanding - diluted	39,289	36,428	36,391
Net income (loss) per common share:			
Basic	$ 1.22	$ (0.50)	$ 2.76
Diluted	$ 1.17	$ (0.50)	$ 2.76

We exclude weighted-average potentially issuable shares from the calculations of diluted net income (loss) per share during the applicable periods because their inclusion would have been anti-dilutive. The following table sets forth potential shares that were considered anti-dilutive for the fiscal years ended September 30, 2021, 2020 and 2019:

	Year Ended September 30,		
in thousands	2021	2020	2019
Restricted stock awards	-	1,058	-
Contingently issuable stock awards	-	151	-
Conversion option of our Notes	4,677	1,538	-

6. Fair Value Measurements

Fair value is defined 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. Valuation techniques must maximize the use of observable inputs and minimize the use of unobservable inputs. When determining fair value measurements for assets and liabilities recorded at fair value, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use in pricing the asset or liability.

The classification of a financial asset or liability within the hierarchy is based upon the lowest level input that is significant to the fair value measurement as of the measurement date as follows:

- Level 1 - Inputs are unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 - Inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the assets or liabilities.
- Level 3 - Unobservable inputs that are supported by little or no market activity.

The following table presents information about our financial assets that are measured at fair value and indicates the fair value hierarchy of the valuation inputs used (dollars in thousands) as of:

	September 30, 2021					
	Fair Value		Cash and Cash Equivalents		Marketable Securities	
Level 1:						
Money market funds (a)	$	75,873	$	75,873	$	-
Level 2:						
Time deposits, $2,965 at cost (a)		2,965		2,965		-
Commercial paper, $18,080 at cost (b)		18,080		-		18,080
Corporate bonds, $19,704 at cost (b)		19,694		-		19,694
Debt securities, $2,000 at cost (c)		2,000		-		-
Total assets	$	118,612	$	78,838	$	37,774

	September 30, 2020					
	Fair Value		Cash and Cash Equivalents		Marketable Securities	
Level 1:						
Money market funds (a)	$	101,437	$	101,437	$	-
Level 2:						
Commercial paper, $9,883 at cost (b)		9,883		-		9,883
Corporate bonds, $1,780 at cost (b)		1,779		-		1,779
Total assets	$	113,099	$	101,437	$	11,662

(a) Money market funds and other highly liquid investments with original maturities of 90 days or less are included within Cash and cash equivalents in the Consolidated Balance Sheets.

(b) Commercial paper and corporate bonds with original maturities greater than 90 days are included within Marketable securities in the Consolidated Balance Sheets and classified as current or noncurrent based upon whether the maturity of the financial asset is less than or greater than 12 months.

(c) Debt securities are included within Prepaid and other current assets in the Consolidated Balance Sheets and classified as current given the maturity of the financial asset is less than 12 months.

During the fiscal years ended September 30, 2021 and 2020, we recorded an immaterial amount of unrealized losses related to our marketable securities within Accumulated other comprehensive income. We did not have any marketable securities during fiscal year 2019.

The carrying amounts of certain financial instruments, including cash held in banks, accounts receivable, and accounts payable, approximate fair value due to their short-term maturities and are excluded from the fair value tables above.

Derivative financial instruments are recognized at fair value and are classified within Level 2 of the fair value hierarchy. See *Note 7 – Derivative Financial Instruments* for additional details.

Long-term debt

The estimated fair value of our Long-term debt is determined by Level 2 inputs and is based on observable market data including prices for similar instruments. As of September 30, 2021 and 2020, the estimated fair value of our Notes was $469.0 million and $271.0 million, respectively. The Notes are recorded at face value less unamortized debt discount and transaction costs on our Consolidated Balance Sheets. The carrying amount of the Senior Credit Facilities (as defined in Note 18) approximates fair value given the underlying interest rate applied to such amounts outstanding is currently set to the prevailing market rate.

Equity securities

During the fiscal year 2021, we made a non-controlling equity investment in a privately held company. We evaluated the equity investment under the voting model and concluded consolidation was not applicable. We accounted for the investment by electing the measurement alternative for investments without readily determinable fair values and for which we do not have the ability to exercise significant influence. The non-marketable equity securities are carried at cost less any impairment, plus or minus adjustments resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer, which is recorded within the Consolidated and Combined Statements of Operations. We hold $2.6 million of investments without readily determinable fair values as of September 30, 2021. The investment is included within Other assets on the Consolidated Balance Sheets. There have been no adjustments to the carrying value of the investment resulting from impairments or observable price changes.

7. Derivative Financial Instruments

We operate internationally and, in the normal course of business, are exposed to fluctuations in foreign currency exchange rates related to third-party vendor and intercompany payments for goods and services within our non-U.S. subsidiaries. We use foreign exchange forward contracts that are not designated as hedges to manage currency risk. The contracts can have maturities up to three years. At September 30, 2021, the total notional amount of forward contracts was $61.0 million. At September 30, 2021, the weighted-average remaining maturity of these instruments was approximately 11.9 months.

The following table summarizes the fair value and presentation in the Consolidated Balance Sheets for derivative instruments as of September 30, 2021 and 2020 (dollars in thousands):

Derivatives not designated as hedges	Classification	Fair Value September 30, 2021	Fair Value September 30, 2020
Foreign currency forward contracts	Prepaid expenses and other current assets	$ 1,235	$ -
Foreign currency forward contracts	Other assets	365	-
Foreign currency forward contracts	Accrued expenses and other current liabilities	131	-
Foreign currency forward contracts	Other liabilities	$ 148	$ -

The following tables display a summary of the income (loss) related to foreign currency forward contracts within the Consolidated and Combined Statements of Operations for the fiscal years ended September 30, 2021, 2020 and 2019 (dollars in thousand):

Derivatives not designated as hedges	Classification	Gain recognized in earnings Year Ended September 30, 2021	2020	2019
Foreign currency forward contracts	Other income (expense), net	$ 2,512	$ -	$ -

8. Goodwill and Intangible Assets

(a) Goodwill

The changes in the carrying amount of goodwill for the fiscal years ended September 30, 2021 and 2020 were as follows (dollars in thousands):

	Total
Balance as of October 1, 2019	$ 1,119,329
Effect of foreign currency translation	8,869
Balance as of September 30, 2020	1,128,198
Effect of foreign currency translation	313
Balance as of September 30, 2021	$ 1,128,511

(b) Intangible Assets, Net

The following tables summarizes the gross carrying amounts and accumulated amortization of intangible assets by major class (dollars in thousands):

	September 30, 2021 Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (Years)
Customer relationships	$ 110,485	$ (88,638)	$ 21,847	2.2
Technology and patents	90,738	(87,237)	3,501	0.9
Total	$ 201,223	$ (175,875)	$ 25,348	

	September 30, 2020			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Remaining Life (Years)
Customer relationships	$ 110,512	$ (75,915)	$ 34,597	3.0
Technology and patents	90,658	(79,639)	11,019	1.6
Total	$ 201,170	$ (155,554)	$ 45,616	

Amortization expense for acquired technology and patents is included in the cost of revenue in the accompanying Consolidated and Combined Statements of Operations and amounted to $7.5 million, $8.3 million, and $8.5 million for the fiscal years ended September 30, 2021, 2020, and 2019, respectively. Additionally, amortization expense for intangible assets of the Parent utilized by the Cerence business amounted to $22 thousand in the fiscal year ended September 30, 2019, and is included in the cost of revenue as shown in Note 16. Amortization expense for customer relationships is included in operating expenses and amounted to $12.7 million, $12.6 million, and $12.5 million in the fiscal years ended September 30, 2021, 2020, and 2019, respectively. Estimated amortization for each of the five succeeding years and thereafter as of September 30, 2021, is as follows (dollars in thousands):

Year Ending September 30,	Cost of Revenues	Operating Expenses	Total
2022	$ 2,983	$ 11,661	$ 14,644
2023	414	6,052	6,466
2024	104	2,362	2,466
2025		1,772	1,772
2026	—	—	—
Thereafter	—	—	—
Total	$ 3,501	$ 21,847	$ 25,348

9. Property and Equipment, Net

Property and equipment, net consisted of the following (dollars in thousands):

	Useful Life (In years)	September 30, 2021	September 30, 2020
Machinery and equipment	3-5	$ 7,577	$ 7,746
Computers, software and equipment	3-5	42,380	42,705
Leasehold improvements	2-15	8,493	10,513
Furniture and fixtures	5-7	4,150	4,691
Finance leases		3,437	2,710
Construction in progress		12,379	4,547
Subtotal		78,416	72,912
Less: accumulated depreciation		(46,911)	(43,383)
Total		$ 31,505	$ 29,529

As of September 30, 2021 and 2020, the net book value of capitalized internal-use software costs was $5.3 million and $6.9 million, respectively, which are included within computers, software, and equipment. Depreciation expense for the fiscal years ended September 30, 2021, 2020, and 2019 was $9.5 million, $9.2 million, and $6.2 million, respectively, which included amortization expense of $3.4 million, $3.1 million, and $2.7 million, respectively, for internally developed software costs.

The following table presents our property and equipment, net by geography at September 30, 2021 and 2020 (dollars in thousands):

	September 30, 2021	September 30, 2020
Long-lived assets:		
United States	$ 22,550	$ 19,898
Canada	2,850	3,464
Germany	1,973	2,573
Other countries	4,132	3,594
Total long-lived assets	$ 31,505	$ 29,529

10. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following (dollars in thousands):

	September 30, 2021	September 30, 2020
Compensation	$ 39,536	$ 37,960
Sales and other taxes payable	8,574	14,688
Cost of revenue related liabilities	4,634	3,683
Professional fees	3,604	2,458
Interest payable	1,919	2,703
Other	6,200	4,586
Total	$ 64,467	$ 66,078

11. Restructuring and Other Costs, Net

Restructuring and other costs, net include restructuring expenses as well as other charges that are unusual in nature, are the result of unplanned events, and arise outside of the ordinary course of our business such as employee severance costs, costs for consolidating duplicate facilities, and separation costs directly attributable to the Cerence business becoming a standalone public company.

The following table sets forth the fiscal year ended September 30, activity relating to restructuring charges (dollars in thousands):

	Personnel	Facilities	Restructuring Subtotal	Other	Total
Balance at October 1, 2018	$ 2,269	$ 6	$ 2,275	$ 777	$ 3,052
Restructuring and other costs, net	130	1,704	1,834	22,570	24,404
Cash payments	(1,910)	(1,684)	(3,594)	(19,471)	(23,065)
Balance at September 30, 2019	489	26	515	3,876	4,391
Restructuring and other costs, net	3,694	1,037	4,731	11,727	16,458
Non-cash adjustment	—	(1,031)	(1,031)	—	(1,031)
Cash payments	(3,420)	(26)	(3,446)	(13,675)	(17,121)
Foreign exchange impact on ending balance	1	4	5	—	5
Balance at September 30, 2020	764	10	774	1,928	2,702
Restructuring and other costs, net	1,689	1,394	3,083	2,009	5,092
Non-cash adjustment	—	1,809	1,809	—	1,809
Cash payments	(839)	(1,265)	(2,104)	(2,403)	(4,507)
Foreign exchange impact on ending balance	6	(67)	(61)	—	(61)
Balance at September 30, 2021	$ 1,620	$ 1,881	$ 3,501	$ 1,534	$ 5,035

Fiscal Year 2021

For the fiscal year ended September 30, 2021, we recorded restructuring charges of $5.1 million, which included a $1.7 million severance charge related to the elimination of personnel across multiple functions, $1.4 million charge resulting from the closure of facilities that will no longer be utilized, and $2.0 million related to other one-time charges.

Fiscal Year 2020

For the fiscal year ended September 30, 2020, we recorded restructuring charges of $16.5 million, which included a $3.7 million severance charge related to the elimination of personnel across multiple functions, $1.0 million resulting from the restructuring of facilities that will no longer be utilized, and $11.7 million related to costs incurred to establish the Cerence business as a standalone public company.

Fiscal Year 2019

For the fiscal year ended September 30, 2019, we recorded restructuring charges of $24.4 million, which included $0.1 million severance charge related to the elimination of personnel across multiple functions, $1.7 million primarily resulting from the restructuring of facilities that will no longer be utilized, and $22.6 million related to professional service fees incurred to establish Cerence business as a standalone public company.

12. Leases

We have entered into a number of facility and equipment leases which qualify as operating leases under GAAP. We also have a limited number of equipment leases that qualify as finance leases. We determine if contracts with vendors represent a lease or have a lease component under GAAP at contract inception. Our leases have remaining terms ranging from less than one year to seven years. Some of our leases include options to extend or terminate the lease prior to the end of the agreed upon lease term. For purposes of calculating lease liabilities, lease terms include options to extend or terminate the lease when it is reasonably certain that we will exercise such options.

Operating lease right of use assets and liabilities are recognized based on the present value of the future minimum lease payments over the lease term at the lease commencement date. As our leases generally do not provide an implicit rate, we use an estimated incremental borrowing rate in determining the present value of future payments. The incremental borrowing rate represents an estimate of the interest rate we would incur at lease commencement to borrow an amount equal to the lease payments on a collateralized basis over the term of a lease within a particular location and currency environment.

The following table presents certain information related to lease term and incremental borrowing rates for leases as of September 30, 2021 and 2020:

	September 30, 2021	September 30, 2020
Weighted-average remaining lease term (in months):		
Operating leases	52.2	55.9
Finance leases	47.1	55.8
Weighted-average discount rate:		
Operating leases	5.1%	7.4%
Finance leases	4.4%	4.4%

The following table presents the lease-related assets and liabilities reported in the Consolidated Balance Sheets as of September 30, 2021 and 2020 (dollars in thousands):

	Classification	September 30, 2021	September 30, 2020
Assets			
Operating lease assets	Operating lease right of use assets	$ 14,901	$ 20,096
Finance lease assets	Property and equipment, net	1,700	1,414
Total lease assets		$ 16,601	$ 21,510
Liabilities			
Current			
Operating	Short-term operating lease liabilities	$ 4,562	$ 5,700
Finance	Accrued expenses and other current liabilities	430	271
Noncurrent			
Operating	Long-term operating lease liabilities	$ 12,216	$ 17,821
Finance	Other liabilities	1,234	1,088
Total lease liability		$ 18,442	$ 24,880

The following table presents lease expense for the fiscal years ended September 30, 2021 and 2020 (dollars in thousands):

	Year Ended September 30,	
	2021	2020
Finance lease costs:		
Amortization of right of use asset	$ 410	$ 255
Interest on lease liability	63	22
Operating lease cost	7,619	8,245
Variable lease cost	2,142	1,060
Sublease income	(207)	(206)
Total lease cost	$ 10,027	$ 9,376

For the fiscal years ended September 30, 2021 and 2020, cash payments related to operating leases were $7.8 million and $8.0 million, respectively. For the fiscal years ended September 30, 2021 and 2020, cash payments related to financing leases were $0.5 million and $0.1 million, respectively, of which an immaterial amount related to the interest portion of the lease liability. For the fiscal years ended September 30, 2021 and 2020, right of use assets obtained in exchange for lease obligations were $2.9 million and $7.9 million, respectively.

The table below reconciles the undiscounted future minimum lease payments under non-cancelable leases to the total lease liabilities recognized on the Consolidated Balance Sheet as of September 30, 2021 (dollars in thousands):

Year Ending September 30,	Operating Leases	Financing Leases	Total
2022	$ 5,289	$ 480	$ 5,769
2023	4,087	468	4,555
2024	3,748	417	4,165
2025	2,319	362	2,681
2026	1,525	53	1,578
Thereafter	1,521	—	1,521
Total future minimum lease payments	$ 18,489	$ 1,780	$ 20,269
Less effects of discounting	(1,711)	(116)	(1,827)
Total lease liabilities	$ 16,778	$ 1,664	$ 18,442
Reported as of September 30, 2021			
Short-term lease liabilities	$ 4,562	$ 430	$ 4,992
Long-term lease liabilities	12,216	1,234	13,450
Total lease liabilities	$ 16,778	$ 1,664	$ 18,442

13. Stockholders' Equity

Share-based Compensation Plans

Prior to the Spin-Off from Nuance, the Parent maintained a number of stock-based compensation programs at the corporate level in which the Cerence business's employees participated. All awards granted under the programs relate to the Parent's common stock.

Per the Amended and Restated Certificate of Incorporation, which was adopted on October 1, 2019, 600,000,000 shares of capital stock have been authorized, consisting of 40,000,000 shares of Preferred Stock, par value $0.01 per share, or ("Preferred Stock"), and 560,000,000 shares of Common Stock, par value $0.01 per share ("Common Stock").

On October 2, 2019, we registered the issuance of 6,350,000 shares of Common Stock, consisting of 5,300,000 shares of Common Stock reserved under the Cerence 2019 Equity Incentive Plan, ("Equity Incentive Plan"), and 1,050,000 shares of Common Stock that are reserved for issuance under the Cerence 2019 Employee Stock Purchase Plan ("ESPP"). On January 1, 2021, in accordance with the automatic annual increase provision of the Equity Incentive Plan, an aggregate of 1,130,547 shares of Common Stock were added to the shares available for issuance under the Equity Incentive Plan.

The Equity Incentive Plan provides for the grant of incentive stock options, stock awards, stock units, stock appreciation rights, and certain other stock-based awards. Awards issued under the Plan may not have a term greater than ten years from the date of grant.

In connection with the Spin-Off from Nuance, all outstanding Nuance restricted stock units and performance stock units held by Cerence employees were cancelled, and regranted such employees economically equivalent restricted stock units of Cerence. 1,208,931 restricted stock units were issued in connection with the Spin-Off.

Restricted Awards

The fair value of Restricted Awards, including Restricted Stock Units and Restricted Stock, is measured based upon the market price of the underlying common stock as of the date of grant. Restricted Awards generally vest over a period of two to four years. We also include certain Restricted Awards with vesting solely dependent on the achievement of specified performance targets. The fair value of Restricted Awards is amortized to expense over the awards applicable requisite service period. In the event that the employees' employment with us terminates, or in the case of awards with only performance targets, if those targets are not met, any unvested shares are forfeited.

In fiscal years ended September 30, 2021 and 2020, we withheld payroll taxes totaling $46.0 million and $9.4 million, respectively, related to the vesting of Restricted Awards.

Restricted Units are not included in issued and outstanding common stock until the shares are vested and released. The table below summarizes activity related to Restricted Stock Units:

	Non-Vested Restricted Stock Units					
	Time-Based Shares	Performance-Based Shares	Total Shares	Weighted-Average Grant-Date Fair Value	Weighted-Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Non-vested at October 1, 2020	2,042,918	771,387	2,814,305	$ 18.63		
Granted	678,647	290,035	968,682	$ 61.48		
Vested	(1,267,363)	(403,502)	(1,670,865)	$ 35.78		
Forfeited	(33,670)	(3,301)	(36,971)	$ 52.48		
Non-vested at September 30, 2021	1,420,532	654,619	2,075,151	$ 44.20	0.82	$ 199,435
Expected to vest			2,075,151	$ 44.20	0.82	$ 199,435

Employee Stock Purchase Plan

On October 2, 2019, we adopted the ESPP and approved 1,050,000 shares for issuance under this plan. The ESPP is administered by our Board of Directors' Compensation Committee.

The ESPP provides for the issuance of shares of our common stock to participating employees. At the end of each designated offering period, which occurs every six months on February 15 and August 15, employees can elect to purchase shares of our common stock with contributions of up to 12% of their base pay, accumulated via payroll deductions, at an amount equal to 85% of the lower of our stock price on (i) the first day of the offering period, or (ii) the last day of the offering period.

We use the Black-Scholes option pricing model to calculate the fair value of shares issued under the ESPP. The Black-Scholes model relies on a number of key assumptions to calculate estimated fair values. The following table sets forth the weighted-average key assumptions and fair value results for shares issued under the ESPP during the fiscal years ended September 30, 2021 and 2020:

	Year Ended September 30,	
	2021	2020
Expected dividend yield	0.00%	0.00%
Risk-free interest rate	0.10%	1.56%
Expected volatility	96.61%	58.18%
Expected life (in years)	0.50	0.50
Weighted-average fair value of shares issued (per share)	$ 35.13	$ 8.93

The following table sets forth the quantities and average prices of shares issued under the ESPP for the fiscal years ended September 30, 2021 and 2020:

	Year Ended September 30,	
	2021	2020
Shares issued under the ESPP	44,172	63,503
Average price of shares issued	$ 73.40	$ 20.66

Stock-based Compensation

Prior to the Spin-Off, stock-based compensation expense recorded by the Cerence business includes the expense associated with the employees historically attributable to the Cerence business's operations and the expense associated with the allocation of stock compensation expense for corporate employees.

During fiscal years ended September 30, 2021 and 2020, we recognize stock-based compensation expenses over the requisite service periods. Our share-based awards are classified within equity. Stock-based compensation for the anticipated Restricted Awards has been adjusted to reflect our estimated achievement under the modified targets and is recorded prospectively over the requisite service period.

The amounts included in the Consolidated and Combined Statements of Operations related to stock-based compensation are as follows (dollars in thousands):

	Year Ended September 30,		
	2021	2020	2019
Cost of licensing	$ —	$ —	$ 21
Cost of connected services	865	1,382	827
Cost of professional services	4,895	4,191	1,048
Research and development	16,538	13,944	15,946
Sales and marketing	12,533	9,580	6,137
General and administrative	25,724	18,188	5,703
Total	$ 60,555	$ 47,285	$ 29,682

14. Commitments and Contingencies

Litigation and Other Claims

Similar to many companies in the software industry, we are involved in a variety of claims, demands, suits, investigations and proceedings that arise from time to time relating to matters incidental to the ordinary course of our business, including at times actions with respect to contracts, intellectual property, employment, benefits and securities matters. At each balance sheet date, we evaluate contingent liabilities associated with these matters in accordance with ASC 450 *Contingencies*. If the potential loss from any claim or legal proceeding is considered probable and the amount can be reasonably estimated, we accrue a liability for the estimated loss. Significant judgments are required for the determination of probability and the range of the outcomes, and estimates are based only on the best information available at the time. Due to the inherent uncertainties involved in claims and legal proceedings and in estimating losses that may arise, actual outcomes may differ from our estimates. Contingencies deemed not probable or for which losses were not estimable in one period may become probable, or losses may become estimable in later periods, which may have a material impact on our results of operations and financial position. As of September 30, 2021, accrued losses were not material to our consolidated and combined financial statements, and we do not expect any pending matter to have a material impact on our consolidated and combined financial statements.

Guarantees and Other

We include indemnification provisions in the contracts we enter with customers and business partners. Generally, these provisions require us to defend claims arising out of our products' infringement of third-party intellectual property rights, breach of contractual obligations and/or unlawful or otherwise culpable conduct. The indemnity obligations generally cover damages, costs and attorneys' fees arising out of such claims. In most, but not all cases, our total liability under such provisions is limited to either the value of the contract or a specified, agreed-upon amount. In some cases, our 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 we could be required to make under all the indemnification provisions is unlimited, we believe the estimated fair value of these provisions is minimal due to the low frequency with which these provisions have been triggered.

We indemnify our directors and officers to the fullest extent permitted by Delaware law, which provides among other things, indemnification to directors and officers for expenses, judgments, fines, penalties and settlement amounts incurred by such persons in their capacity as a director or officer of the Company, regardless of whether the individual is serving in any such capacity at the time the liability or expense is incurred. Additionally, in connection with certain acquisitions, we agreed to indemnify the former officers and members of the boards of directors of those companies, on similar terms as described above, for a period of six years from the acquisition date. In certain cases, we purchase director and officer insurance policies related to these obligations, which fully cover the six-year period. To the extent that we do not purchase a director and officer insurance policy for the full period of any contractual indemnification, and such directors and officers do not have coverage under separate insurance policies, we would be required to pay for costs incurred, if any, as described above.

As of September 30, 2021, we have a $1.7 million letter of credit that is used as a security deposit in connection with our leased Bellevue, Washington office space. In the event of default on the underlying lease, the landlord would be eligible to draw against the letter of credit. The letter of credit is subject to aggregate reductions, provided that we are not in default under the underlying lease. We also have letters of credit in connection with security deposits for other facility leases totaling $0.6 million in the aggregate. These letters of credit have various terms and expire during fiscal year 2022 and beyond, while some of the letters of credit may automatically renew based on the terms of the underlying agreements.

15. Pension and Other Post-Retirement Benefits

As discussed within Note 16, we entered into an Employee Matters Agreement with Nuance, which provides that we establish certain compensation and benefit plans for the benefit of our employees following the Spin-Off, including a 401(k) savings plan, which accepts direct rollovers of account balances from the Nuance 401(k) savings plan for any of our employees who elect to do so. In addition, we assumed certain assets and liabilities with respect to our current and former employees under certain of Nuance’s U.S. and non-U.S. defined benefit pension plans (with assets and liabilities allocated based on formulas specified in the Employee Matters Agreement for each pension plan).

Defined Contribution Plans

We have 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 of our U.S. employees who meet minimum age and service requirements, and allows participants to defer a portion of their annual compensation on a pre-tax basis. We match 50% of employee contributions up to 6% of eligible salary. We incurred charges for contributions to these 401(k) defined contribution plans of $0.7 million, $0.7 million, and $1.0 million for the fiscal years ended September 30, 2021, 2020, and 2019, respectively.

Defined Benefit Pension Plans

We sponsor certain defined benefit pension plans that are offered primarily by our foreign subsidiaries. Many of these plans were assumed as part of the Spin-Off or are required by local regulatory requirements. We may deposit funds for these plans with insurance companies, third party trustees or into government-managed accounts consistent with local regulatory requirements, as applicable.

The total defined benefit plan pension expenses incurred for these plans were $0.9 million, $0.5 million, and $0.4 million for the fiscal years ended September 30, 2021, 2020, and 2019, respectively. Our aggregate projected benefit obligation and aggregate net liability for defined benefit plans as of September 30, 2021 was $14.7 million and $8.7 million, as of September 30, 2020 was $8.3 million and $7.1 million, and as of September 30, 2019 was $7.3 million and $6.8 million, respectively.

For the fiscal years ended September 30, 2021, 2020 and 2019, charges for contributions to defined benefit pension plans were not material to the Consolidated and Combined Statements of Operations.

16. Relationship with Parent and Related Entities

Prior to the Spin-Off, the Cerence business had been managed and operated in the normal course of business consistent with other affiliates of the Parent. Accordingly, certain shared costs had been allocated to the Cerence business and reflected as expenses in the standalone combined financial statements. Management considers the allocation methodologies used to be reasonable and appropriate reflections of the historical Parent expenses attributable to the Cerence business for purposes of the standalone financial statements. However, the expenses reflected in the combined financial statements may not be indicative of the actual expenses that would have been incurred during the periods presented if the Cerence business historically operated as a separate, standalone entity.

(a) General Corporate Overhead Allocation

The Parent provided facilities, information services and certain corporate and administrative services to the Cerence business. Expenses relating to these services have been allocated to the Cerence business and are reflected in the combined financial statements. Where direct assignment is not possible or practical, these costs were allocated on a pro rata basis of revenues, headcount or other measures. The following table summarizes the components of general allocated corporate expenses for the year ended September 30, 2019 (dollars in thousands):

	Year Ended September 30, 2019
Facility	$ 6,299
Depreciation	1,637
Amortization	22
Facility and other usage charges	7,958
Information services	8,633
Corporate and administrative services	22,166
Total	$ 38,757

(b) Cash Management and Financing

The Cerence business participated in the Parent’s centralized cash management and financing programs. Disbursements were made through centralized accounts payable systems, which were operated by the Parent.

Cash receipts were transferred to centralized accounts which were also maintained by the Parent. As cash was disbursed and received by the Parent, it was accounted for by the Cerence business through the net parent investment.

Historically, the Cerence business had received funding from the Parent for the Cerence business’s operating and investing cash needs. Parent’s third-party debt and the related interest expense were not allocated to the Cerence business for any of the years presented prior to the Spin-Off, as the Cerence business was not the legal obligor of the debt and the Parent’s borrowings were not directly attributable to the Cerence business.

(c) Intercompany Receivables/Payables

All significant intercompany transactions between the Cerence business and the Parent and its non-Cerence businesses have been included in these Consolidated and Combined Financial Statements and are considered to be effectively settled for cash at the time the transaction is recorded. The total net effect of the settlement of these intercompany transactions have been accounted for through parent company net investment in the Combined Statements of Changes in Parent Company Equity and the Combined Statement of Cash Flows as a financing activity.

The following table summarizes the components of the net transfers to Parent for the fiscal years ended September 30, 2021, 2020, and 2019 (dollars in thousands):

	Year Ended September 30,		
	2021	2020	2019
Net transactions with Parent	$ —	$ (6,098)	$ (83,554)
Distribution to Parent	—	(152,978)	—
Net reclassification of net parent investment in Cerence	—	(938,051)	—
Stock-based compensation	—	—	29,682
Accrued bonus	—	—	9,478
Corporate depreciation and amortization	—	—	1,659
Fixed asset reclasses from the Parent	—	—	10,088
Voicebox Purchase Accounting Adjustment	—	—	3,591
Intangible asset reclasses from the Parent	—	—	1,665
Net transfer to Parent	$ —	$ (1,097,127)	$ (27,391)

Agreements with Nuance

In connection with the Spin-Off, we entered into several agreements with Nuance that set forth the principal actions taken or to be taken in connection with the Spin-Off and that govern the relationship of the parties following the Spin-Off, including the following:

- **Separation and Distribution Agreement*:*** We entered into a Separation and Distribution Agreement with Nuance in advance of the Distribution. The Separation and Distribution Agreement sets forth our agreements with Nuance regarding the principal actions to be taken in connection with the Spin-Off. It also sets forth other agreements that govern aspects of our relationship with Nuance following the Spin-Off.
- **Tax Matters Agreement*:*** We entered into a Tax Matters Agreement with Nuance that governs the respective rights, responsibilities and obligations of Nuance and us after the Distribution with respect to all tax matters (including tax liabilities, tax attributes, tax returns and tax contests).
- **Transition Services Agreement:** We entered into a Transition Services Agreement pursuant to which Nuance will provide us, and we will provide Nuance, with certain specified services for a limited time to help ensure an orderly transition following the Distribution.
- **Employee Matters Agreement:** We entered into an Employee Matters Agreement with Nuance that addresses employment and employee compensation and benefits matters. The Employee Matters Agreement addresses the allocation and treatment of assets and liabilities relating to employees and compensation and benefit plans and programs in which our employees participated prior to the Spin-Off.
- **Intellectual Property Agreement:** We entered into an Intellectual Property Agreement with Nuance, pursuant to which we granted to Nuance, and Nuance granted to us, perpetual, non-exclusive, royalty-free licenses to certain patents and technology, as well as certain other intellectual property that have historically been shared between us and Nuance.
- **Transitional Trademark License Agreement:** We entered into a Transitional Trademark License Agreement with Nuance, pursuant to which Nuance granted us a non-exclusive, royalty free license to continue using certain of Nuance’s trademarks, trade names and service marks with respect to the “Nuance” and “Dragon” brands in connection with the sale, marketing and other commercialization of our products and services.
- **OEM and Distribution License Agreements:** We entered into four OEM and Distribution License Agreements with Nuance. Under three of the four agreements, Cerence licenses to Nuance designated Cerence technologies for Nuance’s internal use and for distribution to Nuance end-users and resellers. Under the final agreement, Nuance licenses to Cerence designated Nuance technologies for Cerence’s internal use and for distribution to Cerence end-users and resellers. All agreements contain customary commercial terms for arrangements of this nature.

17. Income Taxes

Prior to the consummation of the Spin-Off, Cerence's operating results were included in Parent's various consolidated U.S. federal and state income tax returns, as well as non-U.S. filings. For the purposes of our Consolidated and Combined Financial Statements for periods prior to the Spin-Off, income tax expense and deferred tax balances have been recorded as if we filed tax returns on a standalone basis separate from the Parent. The Separate Return Method applies the accounting guidance for income taxes to the standalone financial statements as if we were a separate taxpayer and a standalone enterprise prior to the separation from Parent.

Recent Tax Legislation

The Coronavirus Aid, Relief, and Economic Security Act ("CARES ACT") became law on March 27, 2020. The CARES ACT was in response to the market volatility and instability resulting from the COVID-19 pandemic and includes provisions to support individuals and businesses in the form of loans, grants, and tax changes, among other types of relief. The CARES ACT did not have a material impact on our (benefit from) provision for income taxes during the period.

On December 22, 2017, the Tax Cuts and Jobs Act ("TCJA") was signed into law. The TCJA significantly revises the U.S. corporate income tax by, among other things, lowering corporate income tax rates, implementing a hybrid territorial tax system and imposing a one-time repatriation tax on foreign cash and earnings.

We are subject to additional requirements of the TCJA during the fiscal years ended September 30, 2021, 2020 and 2019. Those provisions include a tax on global intangible low-taxed income ("GILTI") and foreign-derived intangible income ("FDII"). We have elected to account for GILTI as a period cost and therefore included GILTI expense in the effective tax rate calculation. Our estimates may be revised in future periods as we obtain additional data and as the IRS issues new guidance implementing the law changes.

Provision for (benefit from) income taxes

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

	Year Ended September 30,		
	2021	2020	2019
Domestic	$ 20,933	$ (27,889)	$ (22,904)
Foreign	27,336	4,849	34,088
Income (loss) before income taxes	$ 48,269	$ (23,040)	$ 11,184

The components of provision for (benefit from) income taxes are as follows (dollars in thousands):

	Year Ended September 30,		
	2021	2020	2019
Current:			
Federal	$ —	$ —	$ 5,352
State	35	—	1,059
Foreign	6,760	5,844	5,728
Total current	$ 6,795	$ 5,844	$ 12,139
Deferred:			
Federal	5,437	(1,636)	(6,210)
State	5,001	(239)	(1,593)
Foreign	(14,857)	(8,693)	(93,420)
Total deferred	(4,419)	(10,568)	(101,223)
Provision for (benefit from) income taxes	$ 2,376	$ (4,724)	$ (89,084)
Effective income tax rate	4.9%	20.5%	(796.5)%

The provision for (benefit from) income taxes differed from the amount computed by applying the federal statutory rate to our income (loss) before income taxes as follows (dollars in thousands):

	Year Ended September 30,		
	2021	2020	2019
Federal tax provision at statutory rate	$ 10,137	$ (4,838)	$ 2,270
State tax, net of federal benefit	3,979	(221)	(490)
Foreign tax rate and other foreign related tax items	(15,626)	(2,347)	(4,764)
Uncertain tax positions	861	(887)	57,631
Stock-based compensation	1,629	3,456	—
Global intangible low-taxed income	554	336	3,923
Foreign-derived intangible income	—	—	(547)
Capital losses	—	—	8,187
Change in U.S. valuation allowance	(225)	—	(8,187)
Non-deductible expenditures	3,999	2,728	2,707
R&D credits	(2,932)	(2,951)	(1,675)
Intangible property transfers	—	—	(148,139)
Provision for (benefit from) income taxes	$ 2,376	$ (4,724)	$ (89,084)

The effective income tax rate is based upon the income for the year, the composition of the income in different countries, and adjustments, if any, for the potential tax consequences, benefits or resolutions of audits or other tax contingencies. Our aggregate income tax rate in foreign jurisdictions is lower than our income tax rate in the United States. Our effective tax rate may be adversely affected by earnings being lower than anticipated in countries where we have lower statutory tax rates and higher than anticipated in countries where we have higher statutory tax rates. We believe that it is not more likely than not that the tax benefit from the U.S. capital loss will be realized. As a result, we recorded a full valuation allowance against the capital loss.

Our effective tax rate for the fiscal year 2021 differed from the U.S. federal statutory rate of 21.0%, primarily due to our composition of jurisdictional earnings, U.S. inclusions of foreign taxable income as a result of changes in applicable tax laws in 2017, and an income tax benefit of $15.9 million related to an increase in the Netherlands tax rate enacted in the first quarter of fiscal year 2021.

The effective tax rate for the fiscal year 2020 differed from the U.S. federal statutory rate of 21.0%, primarily due to our composition of jurisdictional earnings, R&D incentives, and an income tax benefit of approximately $5.0 million related to an increase in tax rates in the Netherlands enacted in the first quarter of fiscal year 2020.

The effective income tax rate in fiscal year 2019 differs from the U.S. federal statutory rate of 21.0%, primarily due to a net tax benefit of $91.7 million related to intangible property transfers, partially offset by an uncertain tax position. The net tax benefit is also partially offset by GILTI tax expense of $3.9 million.

As of September 30, 2021, we have not provided taxes on undistributed earnings of our foreign subsidiaries, which may be subject to foreign withholding taxes upon repatriation, as we consider these earnings indefinitely reinvested. Our indefinite reinvestment determination is based on the future operational and capital requirements of our domestic and foreign operations. We expect our international cash and cash equivalents and marketable securities will continue to be used for our foreign operations and therefore do not anticipate repatriating these funds. As of September 30, 2021, it is not practical to calculate the unrecognized deferred tax liability on these earnings due to the complexities of the utilization of foreign tax credits and other tax assets.

Deferred tax assets (liabilities) consist of the following as of September 30, 2021 and 2020 (dollars in thousands):

	September 30,	
	2021	2020
Deferred tax assets:		
Net operating loss carryforwards	$ 17,098	$ 17,347
Capital loss carryforwards	8,187	9,557
Federal credit carryforwards	5,160	3,665
Accrued expenses and other reserves	5,992	4,536
Difference in timing of revenue related items	39,105	51,483
Acquired intangibles	102,481	94,389
Interest limitations carryforward	7,319	9,399
Operating lease liabilities	5,065	6,568
Depreciation	2,723	1,682
Deferred compensation	2,174	1,465
Pension obligation	1,870	2,522
Other	1,249	1,726
Total deferred tax assets	$ 198,423	$ 204,339
Valuation allowance for deferred tax assets	(12,209)	(13,491)
Deferred tax assets	$ 186,214	$ 190,848
Deferred tax liabilities:		
Depreciation	$ (4,636)	$ (3,381)
Acquired intangibles	(17,204)	(21,255)
Convertible debt	(3,349)	(4,406)
Operating lease right-of-use assets	(4,303)	(5,677)
Other	(163)	(2,457)
Total deferred tax liabilities	(29,655)	(37,176)
Net deferred tax assets	$ 156,559	$ 153,672

Deferred tax assets are reduced by a valuation allowance if, based on the weight of available positive and negative evidence, it is more likely than not that some portion or all the deferred tax assets will not be realized. As of September 30, 2021, we have $8.2 million and $4.0 million in valuation allowance against our net domestic and foreign deferred tax assets, respectively. As of September 30, 2020, we had $9.8 million and $3.7 million in valuation allowance against our net domestic and foreign deferred tax assets, respectively.

As of September 30, 2021, we have U.S. federal net operating loss (“NOL”) carryforwards of $15.0 million, state NOL carryforwards of $4.3 million, and foreign NOL carryforwards of $99.9 million, before uncertain tax positions of $32.8 million. As of September 30, 2020, we have U.S. federal NOL carryforwards of $20.1 million, state NOL carryforwards of $6.1 million, and foreign NOL carryforwards of $75.6 million, before uncertain tax position amounts of $18.2 million. These carryforwards will expire at various dates beginning in 2026 and extending up to an unlimited period. As of September 30, 2021 and 2020, unlimited federal NOLs are $15.0 million and $20.1 million, respectively, and unlimited Netherlands NOLs include $70.1 million and $57.1 million, respectively.

As of September 30, 2021, we have U.S. federal research and development carryforwards and foreign tax credit carryforwards of $10.8 million, before uncertain tax positions of $9.1 million, state research and development credits of $0.3 million, and foreign research and development credits of $4.3 million. As of September 30, 2020, we have U.S. federal research and development carryforwards $0.9 million, and foreign research and development credits of $2.8 million. These carryforwards will expire at various dates beginning in 2022 and extending up to 2041.

Uncertain Tax Positions

ASC 740 prescribes the accounting for uncertainty in income taxes recognized in the financial statements. We regularly assess the outcome of potential examinations in each of the taxing jurisdictions when determining the adequacy of the amount of unrecognized tax benefit recorded. We recognize tax benefits from uncertain tax positions only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit which is more likely than not to be realized upon ultimate settlement. We recognize interest and penalties related to unrecognized tax positions in our provision for (benefit from) income taxes line of our Consolidated and Combined Statements of Operations.

The aggregate changes in the balance of our gross unrecognized tax benefits were as follows (dollars in thousands):

	September 30, 2021	September 30, 2020
Balance at the beginning of the year	$ 67,358	$ 60,821
Beginning balance adjustment	9,884	3,999
Increases related to tax positions taken from prior periods	9,367	3,304
Increases related to tax positions taken during current period	768	328
Decreases for tax settlements and lapse in statutes	(233)	(1,094)
Balance at the end of the year	$ 87,144	$ 67,358

For the periods prior to the Spin-Off, the unrecognized tax benefits reflected in the financial statements were determined using the Separate Return Method. As a result of the Spin-Off, in fiscal year 2020, we recognized a beginning balance adjustment of $2.1 million of liabilities for unrecognized tax benefits, determined on an asset and liability method, that stay with the legal entities included in the Spin-Off of the Cerence business from the Parent, which were recorded through Parent company investment, net of corresponding indemnification assets. During fiscal year 2021, we finalized pre-spin tax attributes and recognized as beginning balance adjustments uncertain tax positions of $9.1 million on certain tax credit carryforwards. As of September 30, 2021 and 2020, beginning balance adjustments include cumulative translation adjustments of $0.8 million and $1.9 million, respectively.

Increases related to tax positions taken from prior period include the effect of tax rate changes of $9.4 million and $3.3 million at September 30, 2021 and 2020, respectively.

As of September 30, 2021, $87.1 million of the unrecognized tax benefits, if recognized, would impact our effective tax rate. We do not expect a significant change in the amount of unrecognized tax benefits within the next 12 months. We recognized interest related to uncertain tax positions in our provision for (benefit from) income taxes of $0.3 million, ($0.1) million and $0.5 million during fiscal years 2021, 2020 and 2019 respectively. We recorded interest of $4.2 million and $3.7 million as of September 30, 2021 and 2020, respectively.

We are subject to U.S. federal income tax, various state and local taxes and international income taxes in numerous jurisdictions. The 2018 through 2020 years remain open for all purposes of examination by the IRS and other taxing authorities in material jurisdictions.

18. Long-Term Debt

Long-term debt consisted of the following (in thousands):

	September 30, 2021	September 30, 2020
3.00% Convertible Senior Notes due 2025, net of unamortized discount of $15,019 and $18,546, respectively, and deferred issuance costs of $3,776 and $4,664, respectively. Effective interest rate 6.29%.	$ 156,205	$ 151,791
Senior Credit Facilities, net of unamortized discount of $1,829 and $1,820, respectively, and deferred issuance costs of $221 and $287, respectively. Effective interest rate 2.86% and 4.02%, respectively.	115,138	121,331
Total debt	$ 271,343	$ 273,122
Less: current portion	(6,250)	(6,250)
Total long-term debt	$ 265,093	$ 266,872

The following table summarizes the maturities of our borrowing obligations as of September 30, 2021 (in thousands):

Fiscal Year	Convertible Senior Notes	Senior Facilities	Total
2022	$ —	$ 6,250	$ 6,250
2023	—	10,938	10,938
2024	—	12,500	12,500
2025	175,000	87,500	262,500
2026	—	—	—
Thereafter	—	—	—
Total before unamortized discount and issuance costs and current portion	$ 175,000	$ 117,188	$ 292,188
Less: unamortized discount and issuance costs	(18,795)	(2,050)	(20,845)
Less: current portion of long-term debt	—	(6,250)	(6,250)
Total long-term debt	$ 156,205	$ 108,888	$ 265,093

3.00% Senior Convertible Notes due 2025

On June 2, 2020, in an effort to refinance our debt structure, we issued $175.0 million in aggregate principal amount of 3.00% Convertible Senior Notes due 2025 (the "Notes"), including the initial purchasers' exercise in full of their option to purchase an additional $25.0 million principal amount of the Notes, between us and U.S. Bank National Association, as trustee (the "Trustee"), in a private offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. The net proceeds from the issuance of the Notes were $169.8 million after deducting transaction costs. We used net proceeds from the issuance of the Notes to repay a portion of our indebtedness under the Credit Agreement, dated October 1, 2019, by and among us, the lenders and issuing banks party thereto and Barclays Bank PLC, as administrative agent (the "Existing Facility").

The Notes are senior, unsecured obligations and will accrue interest payable semiannually in arrears on June 1 and December 1 of each year, beginning on December 1, 2020, at a rate of 3.00% per year. The Notes will mature on June 1, 2025, unless earlier converted, redeemed, or repurchased. The Notes are convertible into cash, shares of our common stock or a combination of cash and shares of our common stock, at our election. As of September 30, 2021, the if-converted value of the Notes exceeds its principal amount by $274.5 million.

A holder of Notes may convert all or any portion of its Notes at its option at any time prior to the close of business on the business day immediately preceding March 1, 2025 only under the following circumstances: (1) during any fiscal quarter commencing after the fiscal quarter ending on September 30, 2020 (and only during such fiscal quarter), if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price on each applicable trading day; (2) during the five business day period after any ten consecutive trading day period (the "measurement period") in which the "trading price" per $1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of our common stock and the conversion rate on each such trading day; (3) if we call such Notes for redemption, at any time prior to the close of business on the business day immediately preceding the redemption date; or (4) upon the occurrence of specified corporate events. On or after March 1, 2025 until the close of business on the second scheduled trading day immediately preceding the maturity date, a holder may convert all or any portion of its Notes at any time, regardless of the foregoing.

The conversion rate will initially be 26.7271 shares of our common stock per $1,000 principal amount of Notes (equivalent to an initial conversion price of approximately $37.42 per share of our common stock). The conversion rate is subject to adjustment in some events but will not be adjusted for any accrued and unpaid interest. In addition, following certain corporate events that occur prior to the maturity date or if we deliver a notice of redemption, we will, in certain circumstances, increase the conversion rate for a holder who elects to convert its Notes in connection with such a corporate event or convert its Notes called for redemption in connection with such notice of redemption, as the case may be.

We may not redeem the Notes prior to June 5, 2023. We may redeem for cash all or any portion of the Notes, at our option, on a redemption date occurring on or after June 5, 2023 and on or before the 31st scheduled trading day immediately before the maturity date, if the last reported sale price of our common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive), including the trading day immediately preceding the date on which we provide notice of redemption, during any 30 consecutive trading day period ending on, and including, the trading day immediately preceding the date on which we provide notice of redemption at a redemption price equal to 100% of the principal amount of the notes to be redeemed, plus accrued and unpaid interest to, but excluding, the redemption date. No sinking fund is provided for the Notes.

If we undergo a “fundamental change”, subject to certain conditions, holders may require us to repurchase for cash all or any portion of their Notes at a fundamental change repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date.

The indenture governing the Notes contains customary terms and covenants, including that upon certain events of default occurring and continuing, either the Trustee or the holders of not less than 25% in aggregate principal amount of the Notes then outstanding may declare the entire principal amount of all the Notes plus accrued special interest, if any, to be immediately due and payable.

At issuance, we accounted for the Notes by allocating proceeds from the Notes into debt and equity components according to the accounting standards for convertible debt instruments that may be fully or partially settled in cash upon conversion. The initial carrying amount of the debt component, which approximates its fair value, was estimated by using an interest rate for nonconvertible debt, with terms similar to the Notes. The excess of the principal amount of the Notes over the fair value of the debt component was recorded as a debt discount and a corresponding increase in additional paid-in capital. The debt discount is accreted to the carrying value of the Notes over their expected term as interest expense using the interest method. Upon issuance of the Notes, we recorded $155.3 million as debt and $19.7 million as additional paid-in capital in stockholders’ equity. As of September 30, 2021 and 2020, the carrying amount of the equity component, net of taxes and transaction costs was $14.4 million.

We incurred transaction costs of $5.6 million relating to the issuance of the Notes. In accounting for these costs, we allocated the costs of the offering between debt and equity in proportion to the fair value of the debt and equity recognized. The transaction costs allocated to the debt component of approximately $5.0 million were recorded as a direct deduction from the face amount of the Notes and are being amortized as interest expense over the term of the Notes using the interest method. The transaction costs allocated to the equity component of approximately $0.6 million were recorded as a decrease in additional paid-in capital.

The interest expense recognized related to the Notes for the fiscal years ended September 30, 2021 and 2020 was as follows (dollars in thousands):

	Year Ended September 30,	
	2021	**2020**
Contractual interest expense	$ 5,246	$ 1,753
Amortization of debt discount	3,527	1,131
Amortization of issuance costs	887	285
Total interest expense related to the Notes	$ 9,660	$ 3,169

The conditional conversion feature of the Notes was triggered during the fiscal year ended September 30, 2021, and the Notes were convertible as of September 30, 2021, with no Notes being converted. Whether any of the Notes will be converted in future quarters will depend on the satisfaction of one or more of the conversion conditions in the future. If one or more holders elect to convert their Notes at a time when any such Notes are convertible, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional shares), we would be required to settle a portion or all of our conversion obligation through the payment of cash, which could adversely affect our liquidity.

Senior Credit Facilities

On June 12, 2020 (the “Financing Closing Date”), in connection with our effort to refinance our existing indebtedness, we entered into a Credit Agreement, by and among the Borrower, the lenders and issuing banks party thereto and Wells Fargo Bank, N.A., as administrative agent (the “Credit Agreement”), consisting of a four-year senior secured term loan facility in the aggregate principal amount of $125.0 million (the “Term Loan Facility”). The net proceeds from the issuance of the Term Loan Facility were $123.0 million, which together with proceeds from the Notes was intended to pay in full all indebtedness under the Existing Facility, and paid fees and expenses in connection with the Senior Credit Facilities. We also entered into a senior secured first-lien revolving credit facility in an aggregate principal amount of $50.0 million (the “Revolving Facility” and, together with the Term Loan Facility, the “Senior Credit Facilities”), which shall be drawn on in the event that our working capital and other cash needs are not supported by our operating cash flow. As of September 30, 2021, there were no amounts outstanding under the Revolving Facility.

Our obligations under the Credit Agreement are jointly and severally guaranteed by certain of our existing and future direct and indirect wholly owned domestic subsidiaries, subject to certain exceptions customary for financings of this type. All obligations are secured by substantially all of our tangible and intangible personal property and material real property, including a perfected first-priority pledge of all (or, in the case of foreign subsidiaries or subsidiaries (“FSHCO”) that own no material assets other than equity interests in foreign subsidiaries that are “controlled foreign corporations” or other FSHCOs, 65%) of the equity securities of our subsidiaries held by any loan party, subject to certain customary exceptions and limitations.

On December 17, 2020 (the “Amendment No. 1 Effective Date”), we entered into Amendment No. 1 to the Credit Agreement (the “Amendment”). The Amendment extended the scheduled maturity date of the revolving credit and term facilities from June 12, 2024 to April 1, 2025.

The Amendment revised certain interest rates in the Credit Agreement. Following delivery of a compliance certificate for the first full fiscal quarter after the Amendment No. 1 Effective Date, the applicable margins for the revolving credit and term facilities is subject to a pricing grid based upon the net total leverage ratio as follows (i) if the net total leverage ratio is greater than 3.00 to 1.00, the applicable margin is LIBOR plus 3.00% or ABR plus 2.00%; (ii) if the net total leverage ratio is less than or equal to 3.00 to 1.00 but greater than 2.50 to 1.00, the applicable margin is LIBOR plus 2.75% or ABR plus 1.75%; (iii) if the net total leverage ratio is less than or equal to 2.50 to 1.00 but greater than 2.00 to 1.00, the applicable margin is LIBOR plus 2.50% or ABR plus 1.50%; (iv) if the net total leverage ratio is less than or equal to 2.00 to 1.00 but greater than 1.50 to 1.00, the applicable margin is LIBOR plus 2.25% or ABR plus 1.25%; and (v) if the net total leverage ratio is less than or equal to 1.50 to 1.00, the applicable margin is LIBOR plus 2.20% or ABR plus 1.00%. As a result of the Amendment, the applicable LIBOR floor was reduced from 0.50% to 0.00%. From the Amendment No. 1 Effective Date until the fiscal quarter ended December 31, 2020, the interest rate was LIBOR plus 2.50%. For the three months ended March 31, 2021, the interest rate was LIBOR plus 2.25%. For the three months ended June 30, 2021, the interest rate was LIBOR plus 2.25%. For the three months ended September 30, 2021, the interest rate was LIBOR plus 2.25%. Total interest expense relating to the Senior Credit Facilities for the fiscal year ended September 30, 2021 and 2020 was $4.1 million and $1.5 million, respectively, reflecting the coupon and accretion of the discount.

In addition, the quarterly commitment fee required to be paid based on the unused portion of the Revolving Facility is subject to a pricing grid based upon the net total leverage ratio as follows (i) if the net total leverage ratio is greater than 3.00 to 1.00, the unused line fee is 0.500%; (ii) if the net total leverage ratio is less than or equal to 3.00 to 1.00 but greater than 2.50 to 1.00, the unused line fee is 0.450%; (iii) if the net total leverage ratio is less than or equal to 2.50 to 1.00 but greater than 2.00 to 1.00, the unused line fee is 0.400%; (iv) if the net total leverage ratio is less than or equal to 2.00 to 1.00 but greater than 1.50 to 1.00, the unused line fee is 0.350%; and (v) if the net total leverage ratio is less than or equal to 1.50 to 1.00, the unused line fee is 0.300%.

The Amendment revised the amount by which we are obligated to make quarterly principal payments. Through the fiscal quarter ending December 31, 2022, we are obligated to make quarterly principal payments in an aggregate amount equal to 1.25% of the original principal amount of the Term Loan Facility. From the fiscal quarter ending March 31, 2023 and for each fiscal quarter thereafter, we are obligated to make quarterly principal payments in an aggregate amount equal to 2.50% of the original principal amount of the Term Loan Facility, with the balance payable at the maturity date thereof.

Borrowings under the Credit Agreement are prepayable at our option without premium or penalty. We may request, and each lender may agree in its sole discretion, to extend the maturity date of all or a portion of the Senior Credit Facilities subject to certain conditions customary for financings of this type. The Credit Agreement also contains certain mandatory prepayment provisions in the event that we incur certain types of indebtedness or receives net cash proceeds from certain non-ordinary course asset sales or other dispositions of property, in each case subject to terms and conditions customary for financings of this type.

The Credit Agreement contains certain affirmative and negative covenants customary for financings of this type that, among other things, limit our and our subsidiaries’ ability to incur additional indebtedness or liens, to dispose of assets, to make certain fundamental changes, to designate subsidiaries as unrestricted, to make certain investments, to prepay certain indebtedness and to pay dividends, or to make other distributions or redemptions/repurchases, in respect of our and our subsidiaries’ equity interests. In addition, the Credit Agreement contains financial covenants, each tested quarterly, (1) a net secured leveraged ratio of not greater than 3.25 to 1.00; (2) a net total leverage ratio of not greater than 4.25 to 1.00; and (3) minimum liquidity of at least $75 million. The Credit Agreement also contains events of default customary for financings of this type, including certain customary change of control events. As of September 30, 2021, we were in compliance with all Credit Agreement covenants.

19. Impact on Previously Issued Financial Statements for Immaterial Adjustments

During the quarter ended March 31, 2021, we identified three immaterial errors and made adjustments to correct those errors that affected previously issued consolidated financial statements.

- During the first quarter of fiscal 2021, we recognized an immaterial amount of connected services revenue which related to fiscal year 2020.

- During the first quarter of fiscal 2021, the estimated achievement percentage relating to our long-term incentive plan increased. We did not originally record the corresponding cumulative adjustment to stock-based compensation during the three months ended December 31, 2020.

- During the fourth quarter of fiscal 2020, we recorded a restructuring accrual relating to the closure of a facility under *ASC 420 Exit or Disposal Cost Obligation* when *ASC 842 Leases* should have been applied. During the three months ended December 31, 2020, a partial true up was recorded to the restructuring accrual.

We also recorded certain adjustments to income taxes reflecting the tax effect of the aforementioned adjustments.

During the year ended September 30, 2020, right of use assets obtained in exchange for lease obligations was $7.9 million. We have updated *Note 12 - Leases* to reflect the prior year amount.

We assessed the materiality, both quantitatively and qualitatively, in accordance with the SEC's Staff Accounting Bulletin ("SAB") No. 99 and SAB No. 108, and concluded that these identified errors were not material to any of the previously issued financial statements. In order to present the impact of these resulting adjustments, previously issued financial statements have been revised and are presented as "As Revised" in the tables presented below.

Revised Consolidated Statement of Operations Amounts:	Three Months Ended December 31, 2019		
	As Reported	Adjustment	As Revised
Total revenues	77,459	246	77,705
Gross profit	51,525	246	51,771
Loss from operations	(2,097)	246	(1,851)
Loss before income taxes	(8,760)	246	(8,514)
Provision for income taxes	3,002	(233)	2,769
Net loss	$ (11,762)	$ 479	$ (11,283)
Net loss per share:			
Basic	$ (0.33)		$ (0.31)
Diluted	$ (0.33)		$ (0.31)

Revised Consolidated Statement of Operations Amounts:	Three Months Ended March 31, 2020		
	As Reported	Adjustment	As Revised
Total revenues	86,495	328	86,823
Gross profit	57,765	328	58,093
Income from operations	12,006	328	12,334
Income before income taxes	5,777	328	6,105
Benefit from income taxes	(6,718)	11	(6,707)
Net income	$ 12,495	$ 317	$ 12,812
Net income per share:			
Basic	$ 0.34		$ 0.35
Diluted	$ 0.33		$ 0.34

Revised Consolidated Statement of Operations Amounts:	Three Months Ended June 30, 2020		
	As Reported	Adjustment	As Revised
Total revenues	74,810	387	75,197
Gross profit	47,207	387	47,594
Loss from operations	(4,696)	387	(4,309)
Loss before income taxes	(30,650)	387	(30,263)
Benefit from income taxes	(2,469)	258	(2,211)
Net loss	$ (28,181)	$ 129	$ (28,052)
Net loss per share:			
Basic	$ (0.77)		$ (0.77)
Diluted	$ (0.77)		$ (0.77)

Revised Consolidated Statement of Operations Amounts:	Year Ended September 30, 2020		
	As Reported	Adjustment	As Revised
Total revenues	329,646	1,321	330,967
Gross profit	221,795	1,321	223,116
Income from operations	19,331	3,100	22,431
Loss before income taxes	(26,140)	3,100	(23,040)
Benefit from income taxes	(5,509)	785	(4,724)
Net loss	$ (20,631)	$ 2,315	$ (18,316)
Net loss per share:			
Basic	$ (0.57)		$ (0.50)
Diluted	$ (0.57)		$ (0.50)

Revised Consolidated Balance Sheet Amounts:	September 30, 2020		
	As Reported	Adjustment	As Revised
ASSETS			
Total current assets	249,148	957	250,105
Total assets	$ 1,687,445	$ 172	$ 1,687,617
LIABILITIES AND STOCKHOLDERS' EQUITY			
Total current liabilities	200,774	(2,143)	198,631
Total liabilities	729,689	(2,143)	727,546
Total stockholders' equity	957,756	2,315	960,071
Total liabilities and stockholders' equity	$ 1,687,445	$ 172	$ 1,687,617

Revised Condensed Consolidated Statement of Operations Amounts:	Three Months Ended December 31, 2020		
	As Reported	Adjustment	As Revised
Total revenues	94,964	(1,321)	93,643
Total cost of revenues	26,881	7	26,888
Gross profit	68,083	(1,328)	66,755
Total operating expenses	47,811	1,400	49,211
Income from operations	20,272	(2,728)	17,544
Income before income taxes	14,254	(2,728)	11,526
Benefit from income taxes	(7,384)	(2,031)	(9,415)
Net income	$ 21,638	$ (697)	$ 20,941
Net income per share:			
Basic	$ 0.58		$ 0.56
Diluted	$ 0.54		$ 0.53

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not Applicable.

Item 9A. Controls and Procedures.

Evaluation of disclosure controls and procedures. Based on the evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act required by Exchange Act) Rules 13a-15(b) or 15d-15(b), our principal executive officer and principal financial officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed by Cerence in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

Management report on internal control over financial reporting. Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles and include those policies and procedures that:

- Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and disposals of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions and that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of our internal control over financial reporting as of September 30, 2021, utilizing the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in the 2013 Internal Control-Integrated Framework. Based on the results of this assessment, management (including our Chief Executive Officer and our Chief Financial Officer) has concluded that, as of September 30, 2021, our internal control over financial reporting was effective based on those criteria.

The attestation report concerning the effectiveness of our internal control over financial reporting as of September 30, 2021 issued by BDO USA, LLP, an independent registered public accounting firm, appears in Item 8 of this Annual Report on Form 10-K.

Changes in internal control over financial reporting. There were no material changes in our internal control over financial reporting during the three months ended September 30, 2021 that have materially affected, or are reasonability likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.

None.

Item 9C. Disclosure Regarding Foreign Jurisdictions that Prevent Inspections.

Not Applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

Our Board of Directors adopted a Code of Business Conduct and Ethics for all of our directors, officers and employees on October 2, 2019. Our Code of Business Conduct and Ethics can be found at our website: www.cerence.com. We will provide to any person without charge, upon request, a copy of our Code of Business Conduct and Ethics. Such a request should be made in writing and addressed to Investor Relations, Cerence Inc., 1 Burlington Woods Drive, Suite 301A, Burlington, MA 01803.

To date, there have been no waivers under our Code of Business Conduct and Ethics. We will post any waivers, if and when granted, of our Code of Business Conduct and Ethics on our website at *www.cerence.com*.

The additional information required by this Item for the Company will be set forth in the Company's Proxy Statement for the 2022 Annual Meeting of Stockholders, which information is hereby incorporated by reference.

Item 11. Executive Compensation.

The information required by this Item for the Company will be set forth in the Company's Proxy Statement for the 2022 Annual Meeting of Stockholders, which information is hereby incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The information required by this Item for the Company will be set forth in Company's Proxy Statement for the 2022 Annual Meeting of Stockholders, which information is hereby incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

The information required by this Item for the Company will be set forth in the Company's Proxy Statement for the 2022 Annual Meeting of Stockholders, which information is hereby incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

The information required by this Item for the Company will be set forth in Company's Proxy Statement for the 2022 Annual Meeting of Stockholders, which information is hereby incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) The following documents are filed as a part of this Report:

(1) All Financial Statements— See Index to Financial Statements in Item 8 of this Report;

(2) Financial Statement Schedules — All schedules have been omitted as the requested information is inapplicable or the information is presented in the financial statements or related notes included as part of this Report.

(3) Exhibits — See Item 15(b) of this Report below.

(b) Exhibits.

EXHIBIT INDEX

Exhibit Index #	Exhibit Description	Filed Herewith	Incorporated by Reference			
			Form	File No.	Exhibit	Filing Date
2.1	Separation and Distribution Agreement between Nuance Communications, Inc. and Cerence Inc.		8-K	001-39030	2.1	October 2, 2019
3.1	Amended and Restated Certificate of Incorporation of Cerence Inc.		8-K	001-39030	3.1	October 2, 2019
3.2	Amended and Restated By-Laws of Cerence Inc.		8-K	001-39030	3.2	October 2, 2019
4.1	Indenture, dated as of June 2, 2020, between Cerence Inc. and U.S. Bank, National Association, as Trustee.		8-K	001-39030	4.1	June 2, 2020
4.2	Form of Global Note, representing Cerence Inc.'s 3.00% Convertible Senior Notes due 2025 (included as Exhibit A to the Indenture filed as Exhibit 4.1).		8-K	001-39030	4.1	June 2, 2020
4.3	Description of Registrant's Securities		10-K	001-39030	4.3	November 19, 2020
10.1	Tax Matters Agreement between Nuance Communications, Inc. and Cerence Inc.		8-K	001-39030	10.1	October 2, 2019
10.2	Transition Services Agreement between Nuance Communications, Inc. and Cerence Operating Company		8-K	001-39030	10.2	October 2, 2019
10.3	Employee Matters Agreement between Nuance Communications, Inc. and Cerence Inc.		8-K	001-39030	10.3	October 2, 2019
10.4	Intellectual Property Agreement between Nuance Communications, Inc. and Cerence Inc.		8-K	001-39030	10.4	October 2, 2019
10.5	Transitional Trademark License Agreement between Nuance Communications, Inc. and Cerence Inc.		8-K	001-39030	10.5	October 2, 2019
10.6†	Offer Letter of Sanjay Dhawan, dated February 14, 2019		10	001-39030	10.6	August 21, 2019
10.7†	Change of Control and Severance Agreement between Sanjay Dhawan and Nuance Communications, Inc.		10	001-39030	10.7	August 21, 2019
10.8†	Amendment to Offer Letter of Sanjay Dhawan, dated August 26, 2019		10/A	001-39030	10.8	September 4, 2019
10.9†	Cerence 2019 Equity Incentive Plan		S-8	333-234040	4.3	October 2, 2019
10.10†	Cerence 2019 Employee Stock Purchase Plan		S-8	333-234040	4.6	October 2, 2019
10.11†	Form of Change of Control and Severance Agreement - NEO		10-K	001-39030	10.14	December 19, 2020
10.12	Indemnification Agreement		10-K	001-39030	10.15	December 19, 2020

10.13†	Restricted Stock Unit Award Agreement		10-K	001-39030	10.13	November 19, 2020
10.14†	Performance-Based Restricted Stock Unit Award Agreement		10-K	001-39030	10.14	November 19, 2020
10.15	Credit Agreement, dated June 12, 2020, by and between Cerence Inc., the lenders and issuing banks party thereto and Wells Fargo Bank, N.A., as administrative agent.		8-K	001-39030	10.1	June 17, 2020
10.16	Subsidiary Guarantee Agreement, dated June 12, 2020, by and between certain domestic subsidiaries of Cerence, as subsidiary guarantors, and Wells Fargo Bank, N.A., as administrative agent.		8-K	001-39030	10.2	June 17, 2020
10.17	Collateral Agreement, dated June 12, 2020, by and between Cerence Inc. and certain subsidiaries of Cerence, as pledgors, and Wells Fargo Bank, N.A., as collateral agent.		8-K	001-39030	10.3	June 17, 2020
10.18†	Amendment No. 1 to Cerence 2019 Equity Incentive Plan		10-K	001-39030	10.18	November 19, 2020
10.19	Amendment No. 1, dated as of December 17, 2020, by and among Cerence Inc., the lenders and issuing banks party thereto and Wells Fargo Bank, N.A., as administrative agent		8-K	001-39030	10.1	December 21, 2020
10.20†	CEO Change of Control and Severance Agreement		10-Q	001-39030	10.2	February 8, 2021
21.1	Subsidiaries of the Registrant	X				
23.1	Consent of BDO USA, LLP, Independent Registered Public Accounting Firm.	X				
24.1	Power of Attorney (including in signature pages hereto)	X				
31.1	Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X				
31.2	Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	X				
32.1	Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X				
32.2	Certification of Principal Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	X				
101.INS	Inline XBRL Instance Document	X				
101.SCH	Inline XBRL Taxonomy Extension Schema Document.	X				
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document.	X				
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document.	X				
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document.	X				
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document.	X				
104	Cover Page Interactive Data File (formatted as Inline XBRL with applicable taxonomy extension information contained in Exhibits 101.*)	X				

† Management contract or compensatory plan or arrangement

Item 16. Form 10-K Summary

Not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized**.**

CERENCE INC.

Date: November 22, 2021

By: /s/ Sanjay Dhawan
Sanjay Dhawan
Chief Executive Officer
(Principal Executive Officer)

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each individual whose signature appears below constitutes and appoints each of Sanjay Dhawan, Mark Gallenberger and Leanne Fitzgerald, acting singly, his or her true and lawful agent, proxy and attorneys-in-fact, each with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K and to file the same with all exhibits thereto, and all documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done, as fully to all intents and purposes as he or she might or could do in person, and hereby ratifying and confirming all that said attorneys-in-fact and agents or any of them, or their or his or her substitute or substitutes, may lawfully do or cause to be done by virtue hereof. This power of attorney may be executed in counterparts.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ Sanjay Dhawan Sanjay Dhawan	Chief Executive Officer and Director *(Principal Executive Officer)*	November 22, 2021
/s/ Mark Gallenberger Mark Gallenberger	Chief Financial Officer *(Principal Financial Officer and Principal Accounting Officer)*	November 22, 2021
/s/ Arun Sarin Arun Sarin	Chairman of the Board	November 22, 2021
/s/ Thomas Beaudoin Thomas Beaudoin	Director	November 22, 2021
/s/ Marianne Budnik Marianne Budnik	Director	November 22, 2021
/s/ Sanjay Jha Sanjay Jha	Director	November 22, 2021
/s/ Kristi Ann Matus Kristi Ann Matus	Director	November 22, 2021
/s/ Alfred Nietzel Alfred Nietzel	Director	November 22, 2021

Exhibit 21.1

SUBSIDIARIES OF CERENCE INC.

Subsidiary Name	Jurisdiction	Type
Cerence AI LLC	Delaware	Domestic
Cerence Operating Company	Delaware	Domestic
Consolidated Mobile Corporation	Delaware	Domestic
VoiceBox Technologies LLC	Delaware	Domestic
AMS Solutions Corporation	Massachusetts	Domestic
Multi-Corp International Ltd.	Barbados	International
Cerence BVBA	Belgium	International
Cerence Acquisition ULC	Canada	International
Cerence Holding Inc.	Canada	International
Cerence Technologies Inc.	Canada	International
Zi Corporation	Canada	International
Zi Corporation of Canada, Inc.	Canada	International
845162 Alberta Ltd.	Canada	International
Cerence Communications Technology (Shanghai) Co. Ltd.	China	International
Cerence Software Technology (Beijing) Co. Ltd.	China	International
Huayu Zi Software Technology (Beijing) Co, Ltd.	China	International
USA Shenyu Technologies (Shenzhen) Co., Ltd.	China	International
Cerence Deutschland GmbH	Germany	International
Cerence GmbH	Germany	International
VoiceBox Technologies Deutschland GmbH	Germany	International
Asia Translations & Telecommunications Ltd.	Hong Kong SAR	International
Cerence Hong Kong Limited	Hong Kong SAR	International
Huayu Zi Software Technology Ltd.	Hong Kong SAR	International
Telecom Technology Corporation Limited	Hong Kong SAR	International
Zi Corporation (H.K.) Ltd.	Hong Kong SAR	International
Zi Corporation of Hong Kong Ltd.	Hong Kong SAR	International
Cerence Services (India) LLP	India	International
Cerence Services Ireland Limited	Ireland	International
Cerence S.r.l.	Italy	International
Cerence Japan K.K.	Japan	International
Cerence B.V.	Netherlands	International
Cerence Holding B.V.	Netherlands	International
Cerence Service B.V.	Netherlands	International
VoiceBox Technologies Europe B.V.	Netherlands	International
Cerence Operations S.L.	Spain	International
Cerence Ltd.	South Korea	International
Cerence AB	Sweden	International
Cerence Switzerland AG	Switzerland	International
Cerence Taiwan Ltd.	Taiwan	International
Cerence Limited	United Kingdom	International

Exhibit 23.1

Consent of Independent Registered Public Accounting Firm

Cerence Inc.
Burlington, Massachusetts

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 333-234040 and No. 333-254398) of Cerence Inc. of our reports dated November 22, 2021, relating to the consolidated and combined financial statements, and the effectiveness of Cerence Inc.'s internal control over financial reporting, which appear in this Annual Report on Form 10-K.

/s/ BDO USA, LLP

Boston, Massachusetts
November 22, 2021

Exhibit 31.1

CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Sanjay Dhawan, certify that:

1. I have reviewed this Annual Report on Form 10-K of Cerence Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the fiscal years covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the fiscal years presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 22, 2021

By: /s/ Sanjay Dhawan
Sanjay Dhawan
Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION PURSUANT TO
RULES 13a-14(a) AND 15d-14(a) UNDER THE SECURITIES EXCHANGE ACT OF 1934,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Mark Gallenberger, certify that:

1. I have reviewed this Annual Report on Form 10-K of Cerence Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the fiscal years covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the fiscal years presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 22, 2021

By: /s/ Mark Gallenberger
Mark Gallenberger
Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Cerence Inc. (the “Company”) on Form 10-K for the fiscal year ending September 30, 2021 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 22, 2021

By: /s/ Sanjay Dhawan
Sanjay Dhawan
Chief Executive Officer
(Principal Executive Officer)

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Cerence Inc. (the “Company”) on Form 10-K for the fiscal year ending September 30, 2021 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

Date: November 22, 2021

By: /s/ Mark Gallenberger
Mark Gallenberger
Chief Financial Officer
(Principal Financial Officer)