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NUAN - Q1 2020 Nuance Communications Inc Earnings Call

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OVERVIEW:

Co. reported 1Q20 results. Expects 2Q20 non-GAAP revenue to be \$353-367m. Expects FY20 non-GAAP EPS to be \$0.82-0.90 and 2Q20 non-GAAP EPS to be \$0.15-0.19.



FEBRUARY 05, 2020 / 10:00PM, NUAN - Q1 2020 Nuance Communications Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Nuance First Quarter 2020 Results Conference Call. (Operator Instructions)
Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Tracy Krumme, Senior Vice President of Investor Relations. Thank you. Please go ahead.

Tracy H. Krumme - *Nuance Communications, Inc. - SVP of IR*

Good afternoon, everyone. Before we begin, I would like to remind everyone that our discussion includes predictions, estimates, expectations and other forward-looking statements. These statements are subject to risks and uncertainties that could cause material differences in our actual results. Please refer to our recent SEC filings for a discussion of these risks. All references to income statement results are non-GAAP, unless otherwise stated.

As noted in our press release, we issued prepared remarks in advance of this call, which are available on our IR website. That material is intended to supplement our comments on this call today. And as a reminder, this call is being recorded.

With us today from Nuance are: Chief Executive Officer, Mark Benjamin; and Chief Financial Officer, Dan Tempesta; as well as our Chief Revenue Officer, Rob Dahdah, who will be available for the Q&A session. In terms of format, Mark will cover the quarter's highlights, then Dan will provide financial insights as well as updated comments on our outlook for 2020. Following that, we'll open the call to Q&A.

And with that, I'd like to turn the call over to Mark.

Mark D. Benjamin - *Nuance Communications, Inc. - CEO & Director*

Thank you, Tracy. Good afternoon, everyone, and thanks for joining us.



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First, I'd like to say, I know many of you attended our Investor Day in December. I want to thank you for taking the time to join us for that event. I hope you found it helpful and gained a better understanding of the new Nuance, including our strong market position, significant growth opportunities and strategic direction for the foreseeable future.

Now turning our attention to our Q1 performance. As you saw in our materials today, we got off to a great start this fiscal year. We had an excellent quarter, delivering once again on what we said we would do.

To point out a few highlights, we beat the high end of both our revenue and EPS guidance range and delivered margins in line with our expectations. We made continued progress in our pivot to the cloud with strong Dragon Medical cloud performance and notable strength from our new cloud solutions, PowerScribe One and CDE One, giving us confidence in our full year ARR forecast.

We had a record quarter in our Enterprise business. We made good progress with international expansion, launching Dragon Medical cloud in 3 new countries. On ACI, early adopter clients are already reporting significant improvements in physician satisfaction, patient throughput and time required for completion of their clinical documentation.

And finally, in line with our continued focus on capital allocation, we paid down \$300 million in high-yield bonds and repurchased 5.7 million shares. Subsequent to quarter end, we repurchased 1.1 million shares and today announced the redemption of \$47 million of our 2.75% convertible debentures to be paid in March, representing a further step to strengthen our capital structure while maintaining a strong cash balance.

Digging a bit deeper into our health care division, we saw strong performance, including ongoing strength in our Dragon Medical cloud, which delivered 51% year-over-year revenue growth. We also continue to execute on our international market expansion, launching our Dragon Medical cloud-based platform in France, Belgium and the Netherlands. This is on the heels of our Q4 launch in Australia, plus additional expansion expected later in the year in EU countries, such as Germany.

To help capture the exciting pipeline that's building overseas, in just the past few months, we've increased our international direct sales force by 20%. This is in line with the sales force expansion that we touched upon during our Q4 call and at Investor Day.

Overall, I'm very pleased with the significant interest in our solutions and the excellent customer feedback we are receiving on the value and ROI it provides.

Advancing state-of-the-art innovation in ways that improves health care delivery and reduces clinician burnout continues to be paramount. During the quarter, we brought a record number of new health care products to market, including cloud-based CAPD solutions that will be additive to ARR this year. These include clinical guidance, emergency department guidance, pediatric guidance and solutions for ambulatory surgical centers and cardiovascular CAPD.

We also showcased the latest version of our cloud-based PowerScribe One platform and AI Marketplace at the annual radiology society of North America conference in December. We conducted 500 demonstrations, and the feedback was extremely positive. According to one of our new customers with PowerScribe One, their reports are better. Their radiologists are happier, there's less repetitive and error-prone data entry and their content is more consistent. These themes resonated throughout the show, and we are pleased with the interest and response we received from potential and current customers.

We are also excited about advancing the development of ACI and our strategic partnership with Microsoft. We expect that, together, we will transform the physician-patient experience by accelerating the delivery of our ACI solution.

We are on track for a formal launch in fiscal Q2, as previously communicated, and are already supporting 5 specialties with early adopters of the solution. I'm confident that those of you who experienced the ACI demonstration at Investor Day now better understand the transformative impact we are driving with this technology. We would also like to extend an invitation for those of you that are interested to join us at our booth at HIMSS in Orlando during March. Here, you will see all of our featured products as well as the latest version of ACI.



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In addition to creating leading-edge innovations, our focus on providing a superior customer experience is also being recognized. We continue to see improvements in our Net Promoter Scores relative to Dragon Medical, CDI, EHR services and our quality and transcription platforms.

As further evidence of our customers' heightened preference for our solutions, in October, we are ranked #1 overall by Black Book Research for end-to-end coding, clinical documentation improvement, transcription and speech technology for the seventh consecutive year.

Turning to Enterprise. We delivered strong results with record revenue of \$139 million, representing 7% year-over-year growth. We continue to see steady growth driven by increasing demand for superior customer engagement solutions across both digital and voice channels.

Today, consumers want to engage anywhere and anytime from a wide set of channels, driving the need for our intelligent engagement solutions.

Customer wins in the quarter included IVR voice solutions and services for Travelers Insurance and Con Edison and intelligent engagement, digital and security solutions for Deutsche Telekom, among others.

In addition to growth in the quarter, our enterprise solutions secured several industry awards, including the highest score in Opus Research 2019 enterprise intelligent assistance evaluation as well as being named a leader by Ovum in its recent decision matrix on intelligent virtual agents.

Other progress in the quarter includes execution against our 3-pillar strategy that I outlined during Investor Day. I'd like to briefly address each of them. The first pillar I discussed was our go-to-market focus. We're beginning to see the benefits of our centralized marketing and sales organization and the creation of a new commercial operations team that has helped to align compensation models with our cloud-based solutions. We regularly review our sales performance, roll out new sales enablement training and have implemented new incentives to reward our top performers. These programs are having a positive effect on our sales force and bookings. I'm thrilled with the work our team is doing, and I want to thank them for an excellent start to the year.

The second pillar relates to accelerating innovation, which is key. We continue to make investments that will expand our portfolio and drive addressable market growth. We are coming off a year where CTO, Joe Petro, and his R&D team completed a high-performance engineering transformation and delivered a modern core technology platform. This team is optimized, excited and focused on delivering measurable results, and this was evident in Q1 where we had a record number of new product launches.

The third pillar surrounds allocating resources to unlock growth. In that spirit, we are shifting our R&D teams to the highest growth opportunities and have allocated 80% of our R&D budget to drive innovation and product advancement. We're focusing our sales and marketing dollars on growth plays to ensure we have the most impact to go after the white space.

In health care, this means investing in our international and U.S. ambulatory and community hospital sales force. In Enterprise, we're going deeper in our industry verticals and investing in high-growth products like security and biometrics and tooling and analytics.

While technology is only as good as the people behind it, we continue to make investments that support our employees and make Nuance an even better place to work. In addition to rolling out career development programs, including internal hackathons to foster greater innovation, we have made significant enhancements to our global benefits and policies. This has resulted in recent accolades, such as being named one of Built In Boston's best places to work and being named one of Montreal's top employers. I'm proud of our strong culture that is driven by purpose and focused on delivering business-led solutions for our customers. These, in turn, will power innovation, drive growth in our company and incremental value for our shareholders.

Before turning the line to Dan, I'd like to say that while I'm very pleased with our start to the year, it's still early, and we are not taking our foot off the gas. We will continue to execute against our focused strategy and advance our state-of-the-art conversational AI and Ambient technologies. We will also continue to make meaningful investments in programs and resources that support our talented employees because they are our competitive edge, and all these accomplishments are because of them.



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On behalf of our Board of Directors, I would also like to quickly thank our shareholders for their support at our recent Annual Shareholder Meeting. We have listened and incorporated your feedback into significant changes to our governance and compensation policies. We are committed to ongoing communication to ensure our policies and practices reflect your input and enhance long-term value creation.

With that, let me turn the line over to Dan.

Daniel D. Tempesta - Nuance Communications, Inc. - Executive VP & CFO

Thanks, Mark, and good afternoon, everyone.

Since we entered 2020 a simpler company, my comments will be meaningfully shorter than recent quarters. This should leave us plenty of time for Q&A. Also, I would like to note that the historical financial statements that we are presenting today for comparison purposes have been recast to account for the Automotive results within discontinued operations. Unless otherwise stated, our commentary will address our results from continuing operations only, which is comprised of health care, Enterprise and our Other business segment.

As Mark discussed, our Q1 results were strong across the board. In health care, we had a very good start to the year for Dragon Medical cloud in emerging ARR, particularly with growing demand for our new cloud-based PowerScribe One and CDE One products. You'll recall our ARR guidance for full year is \$375 million to \$400 million, which consists of approximately \$60 million to \$70 million from the emerging category. This represents a 30% increase on total ARR when compared to last year. Given this good start, we feel confident in the 2020 guidance we provided last quarter.

Turning to revenue. We saw strength in both our health care and Enterprise divisions. In health care, while organic revenue declined 1% year-over-year, importantly, the mix shift towards subscription offerings continued slightly ahead of plans. Dragon Medical cloud saw excellent performance. And in addition to the significant year-over-year growth Mark discussed earlier, we also saw sequential quarterly revenue growth of \$6 million. As expected, this growth was offset by a corresponding decline in Dragon Medical on-premise maintenance revenue.

During Q1, Dragon Medical license revenue came back to normal levels after an oversized Q4 2019, which included a large onetime government deal, as we discussed last quarter.

Radiology and Other, which includes several product offerings in the early stage of cloud migration, delivered 3% growth despite these model shifts. And lastly, declines of both our nonstrategic HIM transcription and EHR implementation services were in line with our plans. In Enterprise, as Mark discussed, we posted a record revenue quarter with better-than-expected license revenue in both voice IVR and intelligent engagement. In particular, we achieved very strong year-over-year growth in security and biometrics, and turned in another strong quarter for our digital offerings. This is consistent with our expectations that intelligent engagement, comprised of both digital and security solutions, will be the primary driver of the Enterprise growth projections in 2020.

While we are pleased with these results, Q1 included larger license revenue deals that were originally planned for later in the year. We, therefore, view the revenue overachievement is timing-related as opposed to any fundamental change in our business trajectory.

Moving down the income statement. Operating margin was 26.5%, benefiting from the strength in gross margin, while at the same time, operating expenses were up compared to last year. This was also in line with our plans as we ramp our critical research initiatives and expand our sales coverage in the number of areas that Mark detailed earlier. We are very pleased with our execution in the first quarter of driving our most important growth-focused initiatives.

Below the operating margin line, our net interest expense declined nearly \$12 million year-over-year as we paid off a total of \$600 million in high-yield debt over the past 12 months and our Other income benefited by approximately \$3 million of transition services provided to both Cerence and Kofax. Our EPS came in above the high end of our guidance range due to the favorable operating results in a smaller share count as we repurchased 5.7 million shares of our common stock during the quarter for a total consideration of \$92 million. We ended the quarter with \$510 million of -- in cash and marketable securities and generated cash flow from operations of \$54 million. Cash flow was down approximately \$30



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million due to the clearing of liabilities resulting from the Automotive spin and other related restructuring activities. This is consistent with what we discussed during our Q4 earnings call.

Turning now to our fiscal 2020 guidance. With the strong start to the year, we are reaffirming our revenue guidance and increasing our EPS estimate range by \$0.02 to \$0.82 to \$0.90. We are reducing our non-GAAP effective tax rate to a range of 24% to 25% to reflect our latest view on domestic and foreign profit mix while also lowering our full year cash tax by \$2 million to \$5 million due to a favorable tax rate change. We are also decreasing our share count to account for the recent buyback activity. And lastly, we are updating our year-end cash and marketable securities guidance to a range of \$664 million to \$704 million to account for share repurchases through January 31 and the expected \$47 million debt paydown.

All other financial and ARR guidance remains unchanged. As a reminder, these details can be found in our prepared remarks document available on our Investor website.

Turning to Q2 guidance. We project non-GAAP revenue in a range of \$353 million to \$367 million and non-GAAP EPS in a range of \$0.15 to \$0.19.

Lastly, before opening the call to questions, I would like to let you know that we will be attending the SVB Leerink healthcare conference on February 26 and the Oppenheimer healthcare conference on March 17. Both conferences are in New York City, and we hope to see you there.

With that, let me turn it back to the operator to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Saket Kalia with Barclays.

Saket Kalia - Barclays Bank PLC, Research Division - Senior Analyst

Mark, maybe just to start with you. A lot of talk about international, particularly in health care. And you had talked about the expansion into 3 other countries in the quarter. Can you just talk about where you are in terms of ramping the sales teams internationally? You touched on that, but I'd love if you could fill that out just a little bit more. And then relatedly, can you just talk about how customers internationally are responding to Dragon Medical One just in terms of underlying demand?

Mark D. Benjamin - Nuance Communications, Inc. - CEO & Director

Sure. So Rob is -- Rob Dahdah is here with us as well. So Saket, I'll let him respond first, and then maybe I'll just follow up after Rob goes.

Robert Dahdah - Nuance Communications, Inc. - Executive VP & Chief Revenue Officer

Yes. So hi, Saket. It's Rob Dahdah. Just wanted to say thanks for the question. I always like it when sales gets -- to hit that lead off here. And so first question, the -- where we are in terms of planning and the rollout. We're very well positioned here early on. As you know, we just launched cloud in a couple of additional countries. And so it's still fairly early, but the teams are ramped up. So we have the sales capacity ready to go in those areas, and that's where we've chosen to invest in additional sales capacity. We also have partners in the region that we'll start to bring up to speed as well. And so we feel like we're really well positioned from a personnel standpoint. And then reception in the market has been initially very good. It's probably like a lot of things that get launched. You have some really aggressive early adopters that are interested to learn more and move quickly. You have this big middle group that's -- plays a little wait and see to see who goes first, and then you kind of have that long tail. So -- but early on, we feel like it's been very well received, although it is extremely early. I mean France is literally 6 weeks open. And so again, we're optimistic, and we feel really good about where we are.

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Saket Kalia - *Barclays Bank PLC, Research Division - Senior Analyst*

Got it. That's helpful. Maybe for my follow-up for you, Dan, maybe just shifting gears outside of health care. Can you just talk a little bit about that Other revenue line? I think it was about \$9 million and change in revenue this quarter. Obviously, getting to be a much smaller part of the business but still a slight drag on growth. So how do you sort of think about the timing on that Other revenue line bottoming?

Daniel D. Tempesta - *Nuance Communications, Inc. - Executive VP & CFO*

Sure. Saket, thanks for the question. Yes, it was \$9 million this quarter. We've guided this year a mid-guide of \$30 million. Last year, it was over \$60 million. So it's a pretty sizable decrease year-over-year in '20, and it is impacting the growth. Going forward, it's -- that \$30 million level, it'll be a little bit less next year, but the drag will be much more reduced. And you're really left as you enter next year with the sort of pure-play voicemail to text business. So a slight decline from that \$30 million but nowhere near the size that we saw this year.

Mark D. Benjamin - *Nuance Communications, Inc. - CEO & Director*

Yes. Yes, Saket. And the only thing I'd add is -- and you've obviously followed the story quite well. So the -- these were all very intentional moves we made when we look back to end of '18 into '19 around wind-down and those types of actions. So as Dan mentioned, this is the tough compare year in that category. Believe me, I do the same math you're doing on the growth rate. It is in the other category, nonstrategic, but it does -- the compare gets significantly easier in '21.

Operator

Your next question comes from Sanjit Singh with Morgan Stanley.

Sanjit Kumar Singh - *Morgan Stanley, Research Division - VP*

You haven't talked about ICD and I feel like in a couple of years. And maybe just to do just a fast-check on going from ICD-10 to ICD-11, what is your sense of timing there? Now what does that -- as we look at the ICD-10 transition, what types of impact does that have on the business in terms of was that a material catalyst for the revenue and coding business? Any sort of color on how we should think about ICD-11 coming up in the next year or so?

Mark D. Benjamin - *Nuance Communications, Inc. - CEO & Director*

Yes. So Sanjit, thanks for the question. A little hard to hear you, but I think you're asking an ICD-10 versus 11, what it could mean, obviously, to the business. I think as we know that's -- it's a multiyear look at this point relative to adoption of a new coding. Obviously, the complexity tends to strengthen our solution and our value proposition within the health care business, but nothing immediately in the near term or even midterm have we factored in to really change the complexion of our business. But certainly, the complexity of our health care systems tends to do well for our customers that are using our solutions.

Sanjit Kumar Singh - *Morgan Stanley, Research Division - VP*

Got it. That makes sense. And then just a follow-up question on the Dragon Medical cloud performance this quarter. An acceleration in year-over-year growth was really great to see. I'm not sure if that has -- reflects a really strong Q4 bookings quarter. But in terms of what were sort of the factors that drove that acceleration, was it just continued penetration of the base? Or are you starting to see some initial uptake of Dragon Medical cloud in international or maybe even some share gains with some of your competitors? I just wanted to understand the year-over-year acceleration this quarter.



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Daniel D. Tempesta - Nuance Communications, Inc. - Executive VP & CFO

Sanjit, it's Dan. Thanks for the question. We did -- as we talked about at year-end, we did have good bookings quarters in Q3 and Q4. And so you do see some of that conversion coming through here. Overall, we're pleased with how Dragon cloud is performing. We talked a little bit about the ARR guidance, and we remain comfortable there. So yes, a lot of it's the conversions coming through.

Operator

Your next question comes from Dan Ives with Wedbush Securities.

Daniel Harlan Ives - Wedbush Securities Inc., Research Division - MD of Equity Research

So in terms of like the Analyst Day, you guys have obviously laid it out. But I guess I'm just more interested in terms of from Mark and also Rob. In terms of larger deals, especially on the health care side, especially within a lot of these hospitals, I mean, were there a lot of deals, pipeline maybe look longer term out, and now you're starting to see that accelerate and maybe even deal cycles are sort of shortening relative to the new product portfolio, regulatory and just everything you're seeing with ACI?

Mark D. Benjamin - Nuance Communications, Inc. - CEO & Director

Yes. Dan, it's Mark. I'll let Rob follow me on this. I mean, as you know, we've historically played very well in the up end of the health care space, of the provider space serving a large percentage of the acute IDN. So we continue to do, I think, exceptionally well relative to Nuance and winning in the markets. I don't think we have seen any change necessarily in the market dynamic as far as decision speed and timing. I mean, certainly, every quarter, we have a number of deals that are large, medium and small and kind of a mixture. I mean, certainly, as we move internationally, we could see and we expect to see a pipeline expansion. Also in the mid-market, the ambulatory community space, we would probably see faster speed of decision within those -- within that segment but obviously with less size attached to them. So I'll let Rob comment.

Robert Dahdah - Nuance Communications, Inc. - Executive VP & Chief Revenue Officer

Yes. Mark said he'll let me follow, but he took up most of the answer right there. So I think as Mark said, we have -- as we expanded out into that mid-market space, those have shorter sales cycles. So we are seeing a faster turnaround on those. If anything, what you might start to see is a little bit of -- because of what we're doing with ACI and thinking about the -- just the road map to ACI, we have a way in now to some of the competitors' accounts that were potentially difficult to pull. Now they're a lot more interested because that's part of their road to ACI. So we see that. But overall, it's pretty much as Mark described.

Daniel Harlan Ives - Wedbush Securities Inc., Research Division - MD of Equity Research

Yes. And maybe to that point, to follow up, I mean with the ACI, Microsoft, more strategic, are the conversations changing? And they're like when you have customers come into headquarters, conversations now are changing relative to where it was 3, 6, 9 months ago.

Robert Dahdah - Nuance Communications, Inc. - Executive VP & Chief Revenue Officer

Yes. I mean there is absolutely -- there's no doubt that, that changed -- the conversation had changed the game, frankly, not only with customers coming in to see us when we're on site with customers and where we have the opportunity to leverage our partnership in their global technology center. So there's no doubt that, that changed the game. And we've been seeing a lot of positive reception to the announcement. A matter of fact, 100% positive reception to the announcement. Haven't bumped into someone that looked at it differently. And so we -- and we're just in the very early stages of that, and we're working very well together. We have access to the top levels of Microsoft literally to the C-suite. I worked directly



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with their head of sales. We have full engagement on their team and just a lot of excitement on both sides of the ball. So it's still very early, obviously, but it's a very positive aspect of what we're looking at as we go into the year.

Mark D. Benjamin - Nuance Communications, Inc. - CEO & Director

Yes, Dan, this is Mark. So I mean that's certainly very much the case. In my near 2 years here at Nuance, the amount of excitement, not just within health care around ACI, but we've made a number of product initiatives and launches also in our Enterprise business. So the conversations have remarkably changed and expanded with our markets, our customers. So it's a -- these hallways today are very busy with customer meetings, with prospect meetings across both business lines. So it is -- and I mentioned this in my opening remarks, this was kind of a record quarter of product launches really across all of Nuance, do-it-yourself tools and platforms, cloud-based voice biometrics, certainly, ACI and the Microsoft Reach. It's all -- it's really a very exciting time for sales.

Daniel Harlan Ives - Wedbush Securities Inc., Research Division - MD of Equity Research

And just one follow-up, what's Dan doing with all of the free time now that everything is done?

Mark D. Benjamin - Nuance Communications, Inc. - CEO & Director

I mean, I was hoping you knew the answer, Dan, because I can't figure it out myself. But I often wonder.

Operator

(Operator Instructions) Your next question comes from Jeff Van Rhee with Craig-Hallum.

Jeffrey Lee Van Rhee - Craig-Hallum Capital Group LLC, Research Division - Partner & Senior Research Analyst

A couple of questions for me. Dragon, maybe start there. I just wonder, Mark, if you talk to -- I mean, obviously, putting up very good numbers. You reiterated the guide, I think, taken a pretty conservative approach to it, but the numbers are good. 2 questions, I guess. One, how has the total drag in seat count trended over -- year-over-year, sort of trailing 12 over the 12 prior if you combine the prem and the cloud? So I guess I'm just curious in the total seat count growth. And then if you would also along those lines, just what percent of the Dragon premise base is yet left to be migrated and namely are still on the premise?

Daniel D. Tempesta - Nuance Communications, Inc. - Executive VP & CFO

Yes, Jeff, this is Dan. We generally don't give seat counts during the quarter. We've historically done that towards the end of the year. So we exited this past year with around 38% of the U.S. market. We talked around 550,000 users. So we haven't provided and we won't provide on a quarterly basis. But maybe at year-end, we'll provide a little bit more information. And of course, we are starting to, in the early days, make a little bit of progress internationally now with these new products rolling out and as Rob is gearing up. So I think the other way to track those types of seats is to watch the revenue grow and to watch the ARR guidance, which we're holding at this point.

Mark D. Benjamin - Nuance Communications, Inc. - CEO & Director

Yes, Jeff, this is Mark. So I mean everything Dan said, obviously, I agree with. And we also don't get into the breakout of customer conversions versus greenfield within a specific quarter because it can move around depending on size of deal. Certainly, we expect the numbers to grow certainly and continue to grow on the DMO side just given the expansion, certainly in the mid-market, and as Dan mentioned, internationally. But it will continue to move up, and I think we'll disclose more of that, as Dan mentioned, but we're pleased with the start, certainly.

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Jeffrey Lee Van Rhee - *Craig-Hallum Capital Group LLC, Research Division - Partner & Senior Research Analyst*

Fair enough. So then maybe shift gears over to the ACI. I mean, as you said, it's, in many respects, a game-changing product. Can you talk about the pilots? I know you announced some initial pilots, but where are you now with respect to the number of pilots? And in terms of the sort of the target customers as we're just about at launch here, what's the exposure? And what -- to what degree is their pipeline what -- does the pipeline look like? Certainly, you did the demo at the Analyst Day. And it sounds like from what you said the stat and throughput and completion rates, all the metrics seem to be coming in well ahead. So your customers have got to be excited about it. Just give a little sense of the pilot and the progression from pilot phase in the pipe and ultimately revenues here.

Mark D. Benjamin - *Nuance Communications, Inc. - CEO & Director*

Yes. So I'll make a couple of comments, and Rob will probably have some pipeline and some views on the market. Obviously, we're on track to go GA with ACI this quarter. So we had always said, first calendar quarter, our second fiscal, so we're on track and on plan to do that. Our "early adopters," our pilot customers that have dispatched the solution across some of the early specialties, obviously, we're measuring all of the key metrics relative to the solution and what we believe to be game-changing technology. And I'd say that we're gaining confidence more and more each and every day, and it's very positive. So from productivity improvements, from physician satisfaction, from patient satisfaction and opt-in rates. So there's just a number of, I think, items that give us, I think, confidence going into GA this quarter. And certainly, there's not a customer or prospect out there that isn't showing significant interest in the solution, and maybe Rob you'll comment.

Robert Dahdah - *Nuance Communications, Inc. - Executive VP & Chief Revenue Officer*

Yes. I mean, as Mark said, the pipeline of interest is unprecedented, frankly. No one is not interested in learning more and not so interested that they wouldn't get on a plane and come to Burlington to see it firsthand, so and in -- at the C level, the right level and in groups. So that's certainly a very promising start for us. We've -- there's literally not barely a day or 2 goes by we don't have large groups of folks through here looking at it, walking away, wondering how they can make it work. So we feel very well positioned with that. Obviously, we learn something every day. And as we get deployed in real time, we'll be able to have more info there, but it's very positive.

Jeffrey Lee Van Rhee - *Craig-Hallum Capital Group LLC, Research Division - Partner & Senior Research Analyst*

Yes. Yes. Appreciate it. One last for me then. Just briefly, Rob, back to you for a second on the sales side. In terms of the engagement with Microsoft, you've outlined some of the particulars. But from your seat, what is the engagement like? What is the joint go-to-market like? What is the actual go-to-market hand-in-hand look like with them? What are you doing? What are they doing? Can you fill in any gaps there?

Robert Dahdah - *Nuance Communications, Inc. - Executive VP & Chief Revenue Officer*

Yes. Well, again, we're -- there's some stuff I, for competitive reasons, won't be able to share. But I can tell you, it's a high level of engagement. There are dedicated teams and dedicated leads that are working very closely together to make this work. We have access at the top level. Again, but you know that by design that I have direct access to their head of sales. He reaches out to see what's going on here, and it's not buried in some mid level. It's very much at the highest levels. And so there's a great amount of attention on it. The early days are very much -- we're not needing to push this. It's a grassroots type of thing where the folks' feet on the street are reaching out to learn more. And so it's been very much a pull through the organization, and that's an exciting thing when you think about the scale they have to help in terms of our go-to-market. And it's not just in the health care space. It's across all of our business that would be relevant to them in the cloud. So again, early on, but very promising in -- at every level. And certainly, interest on the street when we go out and talk to customers and prospects, it's definitely something meaningful to them to know that this is a real partnership that's something that they look at as a validation of the work that we're doing together.



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Operator

Your next question comes from Shaul Eyal with Oppenheimer.

Shaul Eyal - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Congrats to a strong start of 2020. First question could be for Mark, Dan or Rob. Mark, you mentioned about investing for growth earlier in the prepared remarks where, on the health care side, investing in the ambulatory care, on the Enterprise side for security. Can you talk a little bit more about the security area you would like to invest in? And would this be done organically or inorganically?

Mark D. Benjamin - *Nuance Communications, Inc. - CEO & Director*

Okay. Sure. So this is Mark. I'll start off and certainly Rob or Dan -- I mean, certainly, we are investing in a number of places across our 2 key businesses relative to solutions. I think your question was around -- in our Enterprise business around our voice biometrics solution. And that's really -- that has been a market-leading product of ours really well before I joined the company so for some time. And again, that solution is largely known as my voice is my password as one example of that. We've made investments in that solution to continue to, I think, be market leading. We've also taken that solution to the cloud, which we refer to as Gatekeeper. We think that offers a different deployment method that's appealing to some buyers in the market. We continue to sell both. So that's just one example where we're making investments in the business. And again, if you remember, last year, all throughout the year, we took costs out early in the year and ramped our investments, and you're seeing that today. You're seeing it in the R&D investments. You're seeing that in the sales investments and really all of our go-to-market. So it's not just within Enterprise, but certainly all of Nuance.

Daniel D. Tempesta - *Nuance Communications, Inc. - Executive VP & CFO*

The only thing I'll add is -- the only thing I'll add there is the cloud native investment was a big push, but we've had voice biometrics and security biometrics some time, and there's really been increased investment in the go-to-market strategy, and that's really there was a lot of that in 2019, and that continues into 2020.

Shaul Eyal - *Oppenheimer & Co. Inc., Research Division - MD & Senior Analyst*

Okay. And then the second question maybe for Rob on the sales force. You mentioned about 20% expansion. Was -- can you give us a little bit more color on the new compensation structure in place? It sounds like your sales team is very fired up and motivated off the earlier remarks.

Robert Dahdah - *Nuance Communications, Inc. - Executive VP & Chief Revenue Officer*

Yes. So kind of 2 points in there on the 20% of international expansion. We're on track there. We're well positioned. So we feel good about that, obviously, following where we made significant investments for cloud deployments. So that -- good position there. In terms of the comp plans, it really -- it's a great lever to be able to pull as a leader -- sales leader in the comp plans. You'd be able to get folks to concentrate on the things that matter most for our customers and our organization. And so we had great support from the company to be able to reengineer some of these and focus them on the things that we need. And we have a great reception from the team, as you mentioned. And so it's never a kind of an event. It's always a work in progress, and we're going to continue to monitor and make sure we're in the right place. But right now, we have great focus and emphasis on cloud and recurring revenue. It's been received well. We've shifted a lot of our business to ACV models. We've done really quite a bit in a short period of time. So the only way we can do that is if the teams allow us to do it, and they've been open to it. And so it's not just on the comp side. It's on recognition as well. And we pointed our recognition in the direction of ARR, of cloud, of the right kinds of revenue and the right products for our customers. So we feel like we're in a really -- we're off to a good start, let's put it that way. But we're never not monitoring where we are.



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Operator

Your next question comes from Tom Roderick with Stifel.

Thomas Michael Roderick - Stifel, Nicolaus & Company, Incorporated, Research Division - MD

So maybe I could start with just a follow up on the ACI question, and I know it's a bit early, but we saw a great demo at the Analyst Day, and I think a lot of us kind of came away from that wondering what the plan is from here, how you sort of monetize that and how it plays out? So you've got a few pilot customers under your belt. I was wondering if you could talk a little bit more to us about the business model looks like as you move into those customers. And I guess the specific questions I have is, in thinking about how hospitals can start to adopt this, how do you think about what the multiplier effect is on the number of lines processed or transcribed for documentation? Seemingly, there's a bigger opportunity to get into more rooms, more doctors, kind of an expansion on that front. And then from the business model itself, how do we think about -- is there a hardware upfront fee for the listening device that goes into the rooms? What are the opt-in opportunities for both patients and doctors? Can you just talk a little bit more about some of the nuances involved in that, no pun intended?

Mark D. Benjamin - Nuance Communications, Inc. - CEO & Director

Tom, it's Mark. So I'll do my best. And by the way, we'll be at HIMSS in March, as I mentioned, really, even with the next generation of ACI. And the demo experience will show an even more interactive solution so you'll get an even better feel for how the technology is emerging. But certainly, we are designing the exam room of the future with the solution with both the physician and the patient experience in mind relative to satisfaction, relative to productivity, relative to certainly coding and quality measures. So there's a number of aspects to the solution. It's not trying to solve one thing alone.

The early adopters have really -- we will roll this solution out by specialty. Understanding that the solution is an ML-based solution. So it gets smarter as you put more through it, and we're intentionally starting with a number of specialties that provide high-revenue transactions, catalogs of medical ontology and complexity that I think will build the solution well for the follow-on specialties. We mentioned we'd be out the door with 5 at GA this quarter. We'll follow on with probably 1 to 2 a month throughout the course of the year on top of that.

As far as the financial modeling and how we turn that in -- how do we monetize, which I think was part of your question, we don't really compare it to the transcription lines per se. At least we haven't. It's an interesting mathematical equation, but probably not the way to think about it. I think you have to look at this as a multiple of what Dragon has historically been pegged out in the market. Obviously, it's a very different solution, doing a lot more. So think of it -- think of ACI in its mature form, which it's only a handful of specialties today. Think of that as a subscription with the potential to have some variable cost based on exam volumes. And they could all really differ by specialty because the hospitals are very different, not just by specialty, but by many different factors of volumes and revenues per patient and what have you. So I think that's how you should be thinking about it.

The hardware itself -- our goal with hardware has really been to keep the cost of that technology in the wall to a minimum, meaning not something that's going to be a sticker shock type of solution, and we're well on our way to accomplishing that. So I would think of the hardware as something that we bundle into the subscription and the service.

Thomas Michael Roderick - Stifel, Nicolaus & Company, Incorporated, Research Division - MD

Outstanding. Really helpful. Quick follow-on. I know we've -- understand we've spent a lot of time and enthusiasm talking about health care. Pivoting to Enterprise just a little bit. Going back to your Analyst Day, you kind of talked about 50% penetration of intelligent engagement solutions in your top 1 50, but only 25% engagement in -- or penetration on the broader 1,400-plus customers you have there on the Enterprise side. Can you just talk a little bit more about the go-to-market and how you're working with the sales force to push deeper intelligent engagement solutions into the Enterprise and what that's doing for prices or ACV in that marketplace?



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Robert Dahdah - Nuance Communications, Inc. - Executive VP & Chief Revenue Officer

Yes. This is Rob. So a couple of things. First off, there's -- we've done a number of things internally as well as externally. Internally, we've had to really kind of give them the right tools and equipment to go out and make these sales. So we've hosted a series of internal learning sessions where we really were able to ramp the teams up. They've been very well received, different way that we've deployed in the past. We've been kind of elbow to elbow with each other doing kind of real-time role playing of these, so we can get out in front of the reps and in front of the prospects in a real way as opposed to just calling in air cover from a solution engineer. The reps are more and more able to go speak the language right in front of the customer. And so that's been a really good first step for us. We've given certainly marketing air cover to that. We have customer shows in-flight as we speak that will be -- we'll be able to get out again in front of our customers and prospects to really show them more of what we can do, more future-looking or future-proofing some of their solutions, as we call it. And so that's another thing that we've been doing.

In terms of pricing, when you look at a full stack solution like we're able to offer, it's very difficult for a competitor to compete across that whole suite. We definitely have niche players that try to play in there. But as these -- as our customers look to do more consolidation of their suppliers and their partners, we -- it starts to narrow down the field, and it puts us in a really good position to be able to deliver what they want in a way that they want it. And so we feel like this type of dynamic is playing well for us.

Operator

There are no further questions at this time. I will now turn the call back over to Mark Benjamin for closing remarks.

Mark D. Benjamin - Nuance Communications, Inc. - CEO & Director

Okay. So I just want to thank everyone for joining us tonight, and we'll see you in 90 days. Thanks very much.

Operator

This concludes today's conference call. You may now disconnect.

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