CONTANGO OIL & GAS CO
Form 10-K
August 29, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K
(Mark One)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2012

[ ] 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 001-16317

CONTANGO OIL & GAS COMPANY
(Exact name of registrant as specified in its charter)

Delaware	95-4079863
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

3700 Buffalo Speedway, Suite 960
Houston, Texas 77098
(Address of principal executive offices)
(713) 960-1901
(Registrant's telephone number, including area code)

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

Common Stock, Par Value $0.04 per share	NYSE MKT

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [ ] No [X]

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes [ ] No [X]

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 [X] No [ ]

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

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

Large accelerated filer [X] Accelerated filer [ ] Non-accelerated filer [ ] Smaller reporting company [ ]
(Do not check if smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

At December 31, 2011, the aggregate market value of the registrant's common stock held by non-affiliates (based upon the closing sale price of shares of such common stock as reported on the NYSE MKT was $745,499,902. As of August 24, 2012, there were 15,292,448 shares of the registrant's common stock outstanding.

Documents Incorporated by Reference

Items 10, 11, 12, 13 and 14 of Part III have been omitted from this report since registrant will file with the Securities and Exchange Commission, not later than 120 days after the close of its fiscal year, a definitive proxy statement, pursuant to Regulation 14A. The information required by Items 10, 11, 12, 13 and 14 of this report, which will appear in the definitive proxy statement, is incorporated by reference into this Form 10-K.

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CONTANGO OIL & GAS COMPANY AND SUBSIDIARIES
ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED JUNE 30, 2012
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CAUTIONARY STATEMENT ABOUT FORWARD-LOOKING STATEMENTS

Some of the statements made in this report may contain “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934, as amended. The words and phrases “should be”, “will be”, “believe”, “expect”, “anticipate”, “estimate”, “forecast”, “goal” and similar expressi identify forward-looking statements and express our expectations about future events. These include such matters as:

- Our financial position
- Business strategy, including outsourcing
- Meeting our forecasts and budgets
- Anticipated capital expenditures
- Drilling of wells
- Natural gas and oil production and reserves
- Timing and amount of future discoveries (if any) and production of natural gas and oil
- Operating costs and other expenses
- Cash flow and anticipated liquidity
- Prospect development
- Property acquisitions and sales
- New governmental laws and regulations
- Expectations regarding oil and gas markets in the United States

Although we believe the expectations reflected in such forward-looking statements are reasonable, such expectations may not occur. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from actual future results expressed or implied by the forward-looking statements. These factors include among others:

- Low and/or declining prices for natural gas and oil
- Natural gas and oil price volatility
- Operational constraints, start-up delays and production shut-ins at both operated and non-operated production platforms, pipelines and gas processing facilities
- The risks associated with acting as the operator in drilling deep high pressure and temperature wells in the Gulf of Mexico, including well blowouts and explosions
- The risks associated with exploration, including cost overruns and the drilling of non-economic wells or dry holes, especially in prospects in which the Company has made a large capital commitment relative to the size of the Company’s capitalization structure
- The timing and successful drilling and completion of natural gas and oil wells
- Availability of capital and the ability to repay indebtedness when due
- Availability of rigs and other operating equipment
- Ability to receive Bureau of Safety and Environmental Enforcement permits on a time schedule that permits the Company to operate efficiently
- Ability to raise capital to fund capital expenditures
- Timely and full receipt of sale proceeds from the sale of our production
- The ability to find, acquire, market, develop and produce new natural gas and oil properties
- Interest rate volatility
- Zero or near-zero interest rates
- Uncertainties in the estimation of proved reserves and in the projection of future rates of production and timing of development expenditures
- Operating hazards attendant to the natural gas and oil business
- Downhole drilling and completion risks that are generally not recoverable from third parties or insurance

- Potential mechanical failure or under-performance of significant wells, production facilities, processing plants or pipeline mishaps
- Weather
- Availability and cost of material and equipment
- Delays in anticipated start-up dates
- Actions or inactions of third-party operators of our properties
- Actions or inactions of third-party operators of pipelines or processing facilities
- The ability to find and retain skilled personnel
- Strength and financial resources of competitors
- Federal and state regulatory developments and approvals
- Environmental risks
- Worldwide economic conditions
- The ability to construct and operate offshore infrastructure, including pipeline and production facilities
- The continued compliance by the Company with various pipeline and gas processing plant specifications for the gas and condensate produced by the Company
- Drilling and operating costs, production rates and ultimate reserve recoveries in our Eugene Island 10 (“Dutch”) and state of Louisiana (“Mary Rose”) acreage
- Restrictions on permitting activities
- Expanded rigorous monitoring and testing requirements
- Legislation that may regulate drilling activities and increase or remove liability caps for claims of damages from oil spills
- Ability to obtain insurance coverage on commercially reasonable terms
- Accidental spills, blowouts and pipeline ruptures
- Impact of new and potential legislative and regulatory changes on Gulf of Mexico operating and safety standards

You should not unduly rely on these forward-looking statements in this report, as they speak only as of the date of this report. Except as required by law, we undertake no obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances occurring after the date of this report or to reflect the occurrence of unanticipated events. See the information under the heading “Risk Factors” referred to on page 13 of this report for some of the important factors that could affect our financial performance or could cause actual results to differ materially from estimates contained in forward-looking statements.

All references in this Form 10-K to the “Company”, “Contango”, “we”, “us” or “our” are to Contango Oil & Gas Company and wholly-owned Subsidiaries. Unless otherwise noted, all information in this Form 10-K relating to natural gas and oil reserves and the estimated future net cash flows attributable to those reserves are based on estimates prepared by independent engineers and are net to our interest.

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PART I
Item 1. Business
Overview
Contango is a Houston-based, independent natural gas and oil company. The Company’s core business is to explore, develop, produce and acquire natural gas and oil properties onshore and offshore in the Gulf of Mexico in water-depths of less than 300 feet. Contango Operators, Inc. (“COI”), our wholly-owned subsidiary, acts as operator on our properties.
Our Strategy
Our exploration strategy is predicated upon two core beliefs: (1) that the only competitive advantage in the commodity-based natural gas and oil business is to be among the lowest cost producers and (2) that virtually all the exploration and production industry’s value creation occurs through the drilling of successful exploratory wells. As a result, our business strategy includes the following elements:
Funding exploration prospects generated by Juneau Exploration, L.P., our alliance partner. We depend primarily upon our alliance partner, Juneau Exploration, L.P. (“JEX”), for prospect generation expertise. JEX is experienced and has a successful track record in exploration.
Using our limited capital availability to increase our reward/risk potential on selective prospects. We have concentrated our risk investment capital in the exploration of i) offshore Gulf of Mexico prospects and ii) conventional and unconventional onshore plays. Exploration prospects are inherently risky as they require large amounts of capital with no guarantee of success. COI drills and operates our prospects. Should we be successful in any of our offshore prospects, we will have the opportunity to spend significantly more capital to complete development and bring the discovery to producing status.
Sale of proved properties. From time-to-time as part of our business strategy, we have sold and in the future expect to continue to sell some or a substantial portion of our proved reserves and assets to capture current value, using the sales proceeds to further our offshore exploration activities. Since its inception, the Company has sold approximately $524 million worth of natural gas and oil properties, and views periodic reserve sales as an opportunity to capture value, reduce reserve and price risk, and as a source of funds for potentially higher rate of return natural gas and oil exploration opportunities.
Controlling general and administrative and geological and geophysical costs. Our goal is to be among the most efficient in the industry in revenue and profit per employee and among the lowest in general and administrative costs. We have ten employees. We plan to continue outsourcing our geological, geophysical, and reservoir engineering and land functions, and partnering with cost efficient operators.
Structuring incentives to drive behavior. We believe that equity ownership aligns the interests of our employees and stockholders. Our directors and executive officers beneficially own or have voting control over approximately 17% of our common stock.

Exploration Alliance with JEX
JEX is a private company formed for the purpose of generating offshore and onshore domestic natural gas and oil prospects. Additionally, JEX can generate offshore prospects through our 32.3% owned affiliated company, Republic Exploration LLC ("REX"). In addition to generating new prospects, JEX occasionally evaluates offshore and onshore exploration prospects generated by third-party independent companies for us to purchase. Once we have purchased a prospect from JEX, REX or a third-party, we have historically entered into participation agreements and joint operating agreements, which specify each participant’s working interest, net revenue interest, and describe when such interests are earned, as well as allocate an overriding royalty interest of up to 3.33% to benefit employees of JEX. See Note 13 - Related Party Transactions for a detailed description of our transactions with JEX and REX.
On April 10, 2012, the Company announced that Mr. Brad Juneau, the sole manager of the general partner of JEX, had joined the Company’s board of directors and that the Company had entered into an advisory agreement with JEX (the "Advisory Agreement"), whereby in addition to generating and evaluating offshore and onshore exploration prospects for the Company, JEX will direct Contango’s staff on operational matters including drilling, completions and

production. Pursuant to the Advisory Agreement, JEX will be paid an annual fee of $2 million and JEX, or employees of JEX, will continue to be eligible to receive overriding royalty interests, carried interests and certain back-in rights.

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Offshore Gulf of Mexico Activities

Contango, through its wholly-owned subsidiary, COI and its partially-owned affiliate, REX, conducts exploration activities in the Gulf of Mexico. COI drills, and operates our wells in the Gulf of Mexico, as well as attends lease sales and acquires leasehold acreage. Additionally, COI may acquire significant working interests in offshore exploration and development opportunities in the Gulf of Mexico, under farm-out agreements, or similar agreements, with REX, JEX and/or other third parties.

As of August 24, 2012, the Company's offshore production was approximately 83.5 million cubic feet equivalent per day ("Mmcfed"), net to Contango, which consists mainly of seven federal and five state of Louisiana wells in the shallow waters of the Gulf of Mexico. These 12 operated wells produce via the following four platforms:

Eugene Island 24 Platform

This third-party owned and operated production platform at Eugene Island 24 was designed with a capacity of 100 million cubic feet per day ("Mmcfd") and 3,000 barrels of oil per day ("bopd"). This platform services production from the Company’s Dutch #1, #2 and #3 federal wells. From this platform, the gas flows through an American Midstream pipeline into a third-party owned and operated on-shore processing facility at Burns Point, Louisiana, and the condensate flows via an ExxonMobil pipeline to on-shore markets and multiple refineries. As of August 24, 2012, we were producing approximately 22.5 Mmcfed, net to Contango, from this platform.

The Company recently finished laying 6" auxiliary flowlines from the Dutch #1, #2, and #3 wells to our Eugene Island 11 Platform (see below) and is in the process of redirecting production from the Eugene Island 24 Platform to the Eugene Island 11 Platform. Our cost estimate for the installation of these three flowlines is $2.5 million, net to Contango. As of June 30, 2012, the Company had incurred approximately $0.8 million to install these flowlines.

Eugene Island 11 Platform

Our Company-owned and operated platform at Eugene Island 11 was designed with a capacity of 500 Mmcfd and 6,000 bopd. In September 2010 the Company installed a companion platform and two pipelines adjacent to the Eugene Island 11 platform to be able to access alternate markets. These platforms service production from the Company’s five Mary Rose wells which are all located in state of Louisiana waters, as well as our Dutch #4 and Dutch #5 wells which are both located in federal waters. From these platforms, we can flow our gas to an American Midstream pipeline via our 8” pipeline and from there to a third-party owned and operated on-shore processing facility at Burns Point, Louisiana. We can flow our condensate via an ExxonMobil pipeline to on-shore markets and multiple refineries.

Alternatively, our gas and condensate can flow to our Eugene Island 63 auxiliary platform via our 20” pipeline, which has been designed with a capacity of 330 Mmcfd and 6,000 bopd, and from there to third-party owned and operated on-shore processing facilities near Patterson, Louisiana, via an ANR pipeline. As of August 24, 2012, we were producing approximately 44.6 Mmcfed, net to Contango, from this platform.

Based on production and decline rates, the Company has recently determined the need to place its Dutch and Mary Rose wells on compression in 2013. The Company is in the process of designing and building a large turbine type compressor for the platform at an estimated cost of $6.8 million, net to Contango. This compressor will be of sufficient capacity to service all ten of the Company's Dutch and Mary Rose wells. As of June 30, 2012, the Company had incurred approximately $2.3 million to design and build the compressor, which is expected to be installed in June 2013.

Ship Shoal 263 Platform

Our Company-owned and operated platform at Ship Shoal 263 was designed with a capacity of 40 Mmcfd and 5,000 bopd. This platform services natural gas and condensate production from our Nautilus well, which flows via the Transcontinental Gas Pipeline to onshore processing plants. As of August 24, 2012, we were producing approximately 3.0 Mmcfed, net to Contango, from this platform.

Effective October 1, 2010, the Company purchased an additional 7.5% working interest and 6.0% net revenue interest in Ship Shoal 263 for approximately $7.5 million from JEX. The Company now owns a 100% working interest and

80% net revenue interest in this well and platform.

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Vermilion 170 Platform

Our Company-owned and operated platform at Vermilion 170 was designed with a capacity of 60 Mmcfd and 2,000 bopd. This platform services natural gas and condensate production from our Swimmy well, which flows via the Sea Robin Pipeline to onshore processing plants. As of August 24, 2012, we were producing approximately 13.4 Mmcfed, net to Contango, from this platform.

Based on current production and decline rates, the Company has determined the need to place its Vermilion 170 well on compression in 2013, at a cost of $1.4 million, net to Contango. As of June 30, 2012, the Company had incurred approximately $0.4 million to design and build a compressor to service its Swimmy well, which is expected to be completed in late 2012.

Other Activities

On July 10, 2012 we spud our South Timbalier 75 prospect ("Fang") with the Spartan 303 rig. The Company farmed-in this prospect in August 2011 from an independent third party. We have a 100% working interest in this wildcat exploration prospect, subject to back-ins if successful, and have budgeted to invest approximately $28.0 million to drill this well. As of June 30, 2012, the Company had invested approximately $0.4 million in Fang, which includes leasehold costs.

On July 3, 2012, we spud our Ship Shoal 134 prospect ("Eagle") with the Hercules 205 rig. The Company purchased the deep mineral rights on Ship Shoal 134 from an independent third-party effective February 24, 2011. We have a 100% working interest in this wildcat exploration prospect, subject to back-ins if successful, and have budgeted approximately $25.0 million to drill this well. As of June 30, 2012, the Company had invested approximately $6.5 million in Eagle, which includes leasehold costs. We expect to know the drilling results of both the Eagle and Fang wells by November 2012.

On June 20, 2012, the Company was the apparent high bidder on six lease blocks at the Central Gulf of Mexico Lease Sale 216/222. The Company bid an aggregate amount of approximately $11 million on the following six blocks:

- East Cameron 124
- Eugene Island 31
- Eugene Island 260
- Ship Shoal 83
- Ship Shoal 255
- South Timbalier 110

An apparent high bid (“AHB”) is subject to Outer Continental Shelf (“OCS”) Bid Adequacy Review. The Bureau of Ocean Energy Management (“BOEM”) (formerly the Minerals Management Service) may reject all bids for a given tract. The BOEM review process can take up to 90 days. Upon approval from the BOEM, our plan is to promptly obtain permits to drill these prospects and to drill them in 2013 and 2014. The Company will have a 100% working interest in these prospects, subject to back-ins if successful. In August 2012, the Company was notified that it had been awarded East Cameron 124, Eugene Island 31, Ship Shoal 83 and South Timbalier 110 effective September 1, 2012.

On March 1, 2012, the Company was awarded Brazos Area 543 by the BOEM, which was bid on at the Western Gulf of Mexico Lease Sale No. 218 held on December 14, 2011. As of June 30, 2012, the Company had invested approximately $0.4 million in Brazos Area 543, which includes leasehold costs.

In June 2011, we completed a workover of our Eloise North well at a cost of approximately $1.8 million, net to Contango, which enabled us to continue producing from the lower Rob-L sands. In October 2011, we commenced a workover of our Eloise North well to recomplete the well in the upper Rob-L sands. During the workover, the Company experienced difficulties and unexpected delays due to malfunctioning production tree valves, coiled tubing equipment failures, weather delays, and stuck equipment in the tubing. As a result, the Company plugged the Rob-L sands in January 2012 and recompleted uphole in the Cib-Op sands as our Mary Rose #5 well, at a cost of approximately $0.5 million, net to Contango, based on the new higher ownership percentage and inclusive of a required well cost adjustment. The Mary Rose #5 well began producing on January 26, 2012 and by mid-March 2012 had stopped again. We are currently flowing the well intermittently until we can install compression in 2013.

On December 21, 2011, the Company purchased an additional 3.66% working interest (2.67% net revenue interest) in Mary Rose #5 (previously Eloise North) for approximately $0.2 million from an existing partner. This purchase brings the Company’s working interest and net revenue interest in Mary Rose #5 to 37.80% and 27.59%, respectively.

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In July 2011, we recompleted our Eloise South well uphole in the Cib-Op sands as our Dutch #5 well, at a cost of approximately $5.7 million, net to Contango. The Company has a 47.05% working interest (38.1% net revenue interest) in Dutch #5. In addition to this $5.7 million, the Dutch #5 well owners purchased the Eloise South well bore from the Eloise South well owners (the “Well Cost Adjustment”). The Company invested a net of approximately $2.3 million related to this Well Cost Adjustment.

In September 2010, we drilled our Galveston Area 277L prospect (“His Dudeness”), a wildcat exploration well in the Gulf of Mexico, and determined it was a dry hole. The Company invested approximately $9.5 million, including leasehold costs, to drill, plug and abandon this well.

During the fiscal year ended June 30, 2010, we drilled two dry holes in the Gulf of Mexico. The first was on a farm-in we obtained on block Vermillion 155 (“Paisano”). This well had a dry hole cost of approximately $5.3 million. The second was our Matagorda Island 617 well (“Dude”), with a dry hole cost of approximately $14.9 million. The Company had a 100% working interest in both of these wells.

Republic Exploration LLC

In his capacity as sole manager of the general partner of JEX, Mr. Juneau also controls the activities of REX, an entity owned 34.4% by JEX, 32.3% by Contango, and 33.3% by a third party which contributed other assets to REX. REX generates and evaluates offshore exploration prospects and has historically participated with the Company in the drilling and development of certain prospects through participation agreements and joint operating agreements, which specify each participant’s working interest, net revenue interest, and describe when such interests are earned, as well as allocate an overriding royalty interest ("ORRI") of up to 3.33% to benefit the employees of JEX. The Company proportionately consolidates the results of REX in its consolidated financial statements.

West Delta 36, a REX prospect, is operated by a third party. The Company depends on a third-party operator for the operation and maintenance of this production platform. As of August 24, 2012, the well was in the process of being recompleted uphole, at a cost of approximately $0.1 million, net to Contango. REX has a 25.0% working interest (“WI”), and a 20.0% net revenue interest (“NRI”), in this well.

Contango Offshore Exploration LLC

Prior to its dissolution on June 1, 2010, in his capacity as sole manager of the general partner of JEX, Mr. Juneau controlled the activities of Contango Offshore Exploration LLC ("COE"), an entity then owned 65.63% by Contango and 34.37% by JEX. COE generated and evaluated offshore exploration prospects and had historically participated with the Company in the drilling and development of certain prospects through participation agreements and joint operating agreements, which specified each participant’s working interest, net revenue interest, and described when such interests were earned, as well as allocate an overriding royalty interest ("ORRI") of up to 3.33% to benefit the employees of JEX. The Company proportionately consolidated the results of COE in its consolidated financial statements.

Immediately prior to its dissolution, COE owed the Company $5.9 million in principal and interest under a promissory note (the “COE Note”) payable on demand. In connection with the dissolution, the Company assumed its 65.6% share of the obligation under the COE Note, while JEX assumed the remaining 34.4%, or approximately $2 million. This $2 million was paid back to the Company during the fiscal year ended June 30, 2011.

Offshore Properties

During the fiscal year ended June 30, 2012, State Lease 19396 expired and was returned to the state of Louisiana. During the fiscal year ended June 30, 2011, the Company relinquished 12 lease blocks to the BOEM, and allowed two additional lease blocks to expire in accordance with their terms.

Producing Properties. The following table sets forth the interests owned by Contango through its affiliated entities in the Gulf of Mexico which were capable of producing natural gas or oil as of August 24, 2012:

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Area/Block	WI	NRI	Status
Eugene Island 10 #D-1 (Dutch #1)	47.05%	38.1%	Producing
Eugene Island 10 #E-1 (Dutch #2)	47.05%	38.1%	Producing
Eugene Island 10 #F-1 (Dutch #3)	47.05%	38.1%	Producing
Eugene Island 10 #G-1 (Dutch #4)	47.05%	38.1%	Producing
Eugene Island 10 #I-1 (Dutch #5)	47.05%	38.1%	Producing
S-L 18640 #1 (Mary Rose #1)	53.21%	40.5%	Producing
S-L 19266 #1 (Mary Rose #2)	53.21%	38.7%	Producing
S-L 19266 #2 (Mary Rose #3)	53.21%	38.7%	Producing
S-L 18860 #1 (Mary Rose #4)	34.58%	25.5%	Producing
S-L 19266 #3 and S-L 19261 (Mary Rose #5)	37.80%	27.6%	Intermittent
Ship Shoal 263 (Nautilus)	100.00%	80.0%	Producing
Vermilion 170 (Swimmy)	87.24%	68.0%	Producing
West Delta 36 (via REX)	8.1%	6.5%	Producing

Leases. The following table sets forth the interests owned by Contango through its related entities in leases in the Gulf of Mexico as of August 24, 2012:

Area/Block	WI	Lease Date	Expiration Date
Eugene Island 11	53.21%	Dec 07	Dec-12
East Breaks 369 (1)	(2)	Dec-03	Dec-13
South Timbalier 97 (via REX)	32.30%	Jun-09	Jun-14
Ship Shoal 121	100.00%	Jul-10	Jul-15
Ship Shoal 122	100.00%	Jul-10	Jul-15
Brazos Area 543	100.00%	Mar-12	Mar-17
Ship Shoal 134	100.00%	(3)	(3)
South Timbalier 75	100.00%	(4)	(4)

(1) Dry Hole
(2) Farm-out. COI retains a 2.41% ORRI
(3) Purchased deep rights. Currently drilling
(4) Farm-in. Currently drilling. Will earn lease once production begins (if successful)

Onshore Exploration and Properties

Alta Investments

On April 12, 2011, the Company announced a commitment to invest up to $20 million over two years in Alta Energy Canada Partnership (“Alta Energy”), a venture that will acquire, explore, develop and operate onshore unconventional oil and natural gas shale assets. As of August 24, 2012, we had invested approximately $12.3 million in Alta Energy to purchase over 60,000 acres in the Kaybob Duvernay, a liquids rich shale play in Alberta, Canada. Alta Energy has built one of the largest acreage blocks in the core of the play. Alta Energy drilled and cored its first vertical well in 17 days which is highly competitive with offset operators. Alta Energy has drilled three vertical test wells and has taken whole cores on two of those.

Offsetting activity in the Kaybob Duvernay continues to provide encouraging early results. With four horizontal well results available, initial production began with 508 barrels of oil equivalent per day ("Boed") for the first well and continuously improved to 2,123 Boed for the fourth well which tested 7.7 MMcfd and 839 Bbls per day. Condensate yields continue to rise to close to 100 bbls/MMcf plus encouraging amounts of NGL's. We expect an active summer of offsetting activity with additional information being slowly provided by competitors to the market. Alta Energy began its summer drilling program which included spudding Alta's first horizontal well. Contango has a 2% interest in Alta Energy and a 5% interest in the Kaybob Duvernay project.

Exaro Energy III LLC

On April 9, 2012, the Company announced that through its wholly-owned subsidiary, Contaro Company, it had entered into a Limited Liability Company Agreement (the “LLC Agreement”) to form Exaro Energy III LLC (“Exaro”). Pursuant to the LLC Agreement, the Company has committed to invest up to $82.5 million in cash in Exaro over the next five years together with other parties for an aggregate commitment of $182.5 million. The Company owns approximately a 45% interest in Exaro, subject to terms allowing another party to acquire up to $15 million of the Company’s commitment, which would decrease the Company’s interest in Exaro to approximately 37%.

As of June 30, 2012, the Company had invested approximately $41.3 million in Exaro. Exaro has entered into an Earning and Development Agreement (the “EDA Agreement”) with Encana Oil & Gas (USA) Inc. (“Encana”) to provide funding of up to $380 million to continue the development drilling program in a defined area of Encana’s Jonah field asset located in Sublette County, Wyoming. This funding will be comprised of the $182.5 million investment detailed above, debt, and cash flow from operations. Encana will continue to be the operator of the field and upon investing the full amount of the $380 million, Exaro will have earned 32.5% of Encana’s working interest in a defined joint venture area that comprises approximately 5,760 gross acres.

The Exaro-Encana venture currently has three rigs drilling, has completed five wells to date and achieved first production during mid-June 2012. The drilling project is progressing on schedule. As of June 30, 2012, there were no material natural gas or oil reserves associated with our investment in Exaro. During the period from inception to June 30, 2012, Exaro incurred a loss of approximately $1.5 million, of which approximately $0.5 million was recognized in the Company's consolidated statement of operations (net of $0.2 million in taxes) for the fiscal year ended June 30, 2012.

Tuscaloosa Marine Shale

As of August 24, 2012, the Company had invested approximately $8.7 million to lease approximately 25,000 acres in the Tuscaloosa Marine Shale ("TMS"), a shale play in central Louisiana and Mississippi. The TMS is an oil focused play and we intend to watch the play develop before we commit to drilling any exploratory wells. We do, however, plan to participate in outside operated wells with a small working interest prior to initiating an operated, high interest drilling program.

Jim Hogg County, Texas

We have entered into a letter agreement with a large south Texas mineral owner outlining the general terms and conditions of an exploration program involving acreage in Jim Hogg County, Texas. As of August 24, 2012, we had paid approximately $1.2 million into this exploration program.

Discontinued Operations

Joint Venture Assets

In October 2009, the Company entered into a joint venture with Patara Oil & Gas LLC ("Patara") to develop proved undeveloped Cotton Valley gas reserves in Panola County, Texas. B.A. Berilgen, a member of the Company’s board of directors, is the Chief Executive Officer of Patara. On May 13, 2011, the Company sold to Patara its 90% interest and 5% overriding royalty interest in the 21 wells drilled under this joint venture for approximately $36.2 million and recognized a pre-tax loss of approximately $0.7 million. These 21 wells had proved reserves of approximately 16.7 Bcfe, net to Contango. The Company accounted for this sale as discontinued operations as of June 30, 2011 and has included the results of the joint venture operations in discontinued operations for all periods presented.

Rexer Assets

On May 13, 2011, the Company sold to Patara 100% of its interest in Rexer #1 and 75% of its interest in Rexer-Tusa #2 for approximately $2.5 million and recognized a pre-tax loss of approximately $0.3 million. Rexer #1 was a wildcat exploration well that was spud in June 2010 and began producing in October 2010. This well had proved

reserves of approximately 0.5 Bcfe, net to Contango.
The remaining 25% working interest in Rexer-Tusa #2 was sold to Patara in October 2011 for $10,000. Rexer-Tusa #2 was a wildcat exploration well that was spud in May 2011. This well had no proved reserves at the time of sale. The Company has accounted for the sale of Rexer #1 and Rexer-Tusa #2 as discontinued operations as of December 31, 2011 and has included the results of these operations in discontinued operations for all periods presented.
Contango Mining Company
Contango Mining Company (“Contango Mining”), a wholly-owned subsidiary of the Company and the predecessor to Contango ORE, Inc. (“CORE”), was initially formed on October 15, 2009 as a Delaware corporation registered to do business

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in Alaska for the purpose of engaging in exploration in the State of Alaska for (i) gold and associated minerals and (ii) rare earth elements. Contango Mining held leasehold interests in approximately 675,000 acres from the Tetlin Village Council, the council formed by the governing body for the Native Village of Tetlin, an Alaska Native Tribe, as well as additional acres in unpatented Federal and State of Alaska mining claims for the exploration of gold deposits and associated minerals and rare earth elements (collectively, the "Properties").

On November 29, 2010, CORE, then another wholly-owned subsidiary of the Company, acquired the assets and assumed the obligations of Contango Mining, including the Properties, in exchange for its common stock which was subsequently distributed to the Company's stockholders of record as of October 15, 2010 on the basis of one share of common stock for each ten shares of the Company's common stock then outstanding. No fractional shares were issued, but a cash payment was made to shareholders with less than ten shares based upon the value established for CORE. The Company also contributed $3.5 million in cash to CORE immediately prior to the distribution. The Company no longer has an ownership in CORE and has included its results of operations and gain on disposition in discontinued operations for all periods presented.

Marketing and Pricing

The Company currently derives its revenue principally from the sale of natural gas and oil. As a result, the Company's revenues are determined, to a large degree, by prevailing natural gas and oil prices. The Company currently sells its natural gas and oil on the open market at prevailing market prices. Major purchasers of our natural gas, oil and natural gas liquids for the fiscal year ended June 30, 2012 were Shell Trading US Company (25%), NJR Energy Services (13%), ConocoPhillips Company (22%), Exxon Mobil Oil Corporation (11%), Enterprise Products Operating LLC (14%), and TransLouisiana Gas Pipeline Inc. (8%). Market prices are dictated by supply and demand, and the Company cannot predict or control the price it receives for its natural gas and oil. The Company has outsourced the marketing of its offshore natural gas and oil production volume to a privately-held third party marketing firm.

Price decreases would adversely affect our revenues, profits and the value of our proved reserves. Historically, the prices received for natural gas and oil have fluctuated widely. Among the factors that can cause these fluctuations are:

- The domestic and foreign supply of natural gas and oil
- Overall economic conditions
- The level of consumer product demand
- Adverse weather conditions and natural disasters
- The price and availability of competitive fuels such as heating oil and coal
- Political conditions in the Middle East and other natural gas and oil producing regions
- The level of LNG imports
- Domestic and foreign governmental regulations
- Special taxes on production
- The loss of tax credits and deductions

Competition

The Company competes with numerous other companies in all facets of its business. Our competitors in the exploration, development, acquisition and production business include major integrated oil and gas companies as well as numerous independents, including many that have significantly greater financial resources and in-house technical expertise.

Governmental Regulations

Federal Income Tax. Federal income tax laws significantly affect the Company's operations. The principal provisions affecting the Company are those that permit the Company, subject to certain limitations, to deduct as incurred, rather than to capitalize and amortize, its domestic "intangible drilling and development costs" and to claim depletion on a portion of its domestic natural gas and oil properties and to claim a manufacturing deduction based on qualified production activities.

Environmental Matters. Domestic natural gas and oil operations are subject to extensive federal regulation and, with respect to federal leases, to interruption or termination by governmental authorities on account of environmental and other considerations such as the Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") also known as the "Super Fund Law". The trend towards stricter standards in environmental legislation and regulation could increase costs to the Company and others in the industry. Natural gas and oil lessees are subject to liability for the costs of clean-up of pollution resulting from a lessee's operations, and may also be subject to liability for pollution damages. The Company maintains insurance against costs of clean-up operations, but is not fully insured against all such risks. A serious incident of pollution may also result in the Department of the Interior requiring lessees under federal leases to suspend or cease operation in the affected area.

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The Oil Pollution Act of 1990 (the "OPA") and regulations thereunder impose a variety of regulations on "responsible parties" related to the prevention of oil spills and liability for damages resulting from such spills in U.S. waters. The OPA assigns liability to each responsible party for oil removal costs and a variety of public and private damages. While liability limits apply in some circumstances, a party cannot take advantage of liability limits if the spill was caused by gross negligence or willful misconduct or resulted from violation of federal safety, construction or operating regulations. Few defenses exist to the liability imposed by the OPA. In addition, to the extent the Company's offshore lease operations affect state waters, the Company may be subject to additional state and local clean-up requirements or incur liability under state and local laws. The OPA also imposes ongoing requirements on responsible parties, including proof of financial responsibility to cover at least some costs in a potential spill. The Company believes that it currently has established adequate proof of financial responsibility for its offshore facilities. However, the Company cannot predict whether financial responsibility requirements under any OPA amendments will result in the imposition of substantial additional annual costs to the Company in the future or otherwise materially adversely affect the Company. The impact, however, should not be any more adverse to the Company than it will be to other similarly situated or less capitalized owners or operators in the Gulf of Mexico.

The Company's operations are subject to numerous federal, state and local laws and regulations controlling the discharge of materials into the environment or otherwise relating to the protection of the environment. Such laws and regulations, among other things, impose absolute liability on the lessee for the cost of clean-up of pollution resulting from a lessee's operations, subject the lessee to liability for pollution damages, may require suspension or cessation of operations in affected areas, and impose restrictions on the injection of liquids into subsurface aquifers that may contaminate groundwater. Such laws could have a significant impact on the operating costs of the Company, as well as the natural gas and oil industry in general. Federal, state and local initiatives to further regulate the disposal of natural gas and oil wastes are also pending in certain jurisdictions, and these initiatives could have a similar impact on the Company. The Company's operations are also subject to additional federal, state and local laws and regulations relating to protection of human health, natural resources, and the environment pursuant to which the Company may incur compliance costs or other liabilities.

Impact of Deepwater Horizon Incident. In April 2010, the deepwater Gulf of Mexico drilling rig Deepwater Horizon, engaged in drilling operations for another operator, sank after an apparent blowout and fire. The accident resulted in the loss of life and a significant oil spill and highlighted the dangers associated with exploration and production activities.

The legislative and regulatory response to the Deepwater Horizon Incident is ongoing. In 2010, the US Department of the Interior issued new rules designed to improve drilling and workplace safety, and various Congressional committees began pursuing legislation to greater regulate drilling activities and increase liability. In January 2011, the President's National Commission on the Deepwater Horizon Oil Spill and Offshore Drilling released its report, recommending that the federal government require additional regulation and an increase in liability caps.

Additional regulatory review, slower permitting processes and increased oversight have resulted in longer development cycle time for our Gulf of Mexico projects. Cycle time is the length of time it takes for a project to progress from developing a prospect to beginning production, and longer development cycle times could result in lower rates of return on our investments.

Increased regulation impacting our activities in the Gulf of Mexico could result in extensive efforts to ensure compliance and incremental compliance costs. A significant delay or cancellation of our planned Gulf of Mexico exploratory activities will reduce our longer term ability to replace reserves, resulting in a negative impact on production over time. To the extent current exploration activities are significantly delayed, a gap could occur in our long-term production profile with a negative impact on our operating results and cash flows.

Additional legislation or regulation is being discussed which could require each company doing business in the Gulf of Mexico to establish and maintain a higher level of financial responsibility under its Certificate of Financial Responsibility ("COFR"), a certificate required under the Oil Pollution Act of 1990 which evidences a company’s financial ability to pay for cleanup and damages caused by oil spills. There have also been discussions regarding the establishment of a new industry mutual fund in which companies would be required to participate and which would be available to pay for consequential damages arising from an oil spill. These and/or other legislative or regulatory changes could require us to maintain a certain level of financial strength and may reduce our financial flexibility.

Future legislation or regulation is also likely to result in substantial increases in civil or criminal fines or sanctions. Such fines or sanctions could well exceed the actual cost of containment and cleanup associated with a well incident or spill. We are monitoring legislative and regulatory developments; however, the full legislative and regulatory response to the Deepwater Horizon Incident is not yet fully known.

Other Laws and Regulations. Various laws and regulations often require permits for drilling wells and also cover spacing of wells, the prevention of waste of natural gas and oil including maintenance of certain gas/oil ratios, rates of production and other matters. The effect of these laws and regulations, as well as other regulations that could be promulgated by the jurisdictions in which the Company has production, could be to limit the number of wells that could be drilled on the Company's properties and to limit the allowable production from the successful wells completed on the Company's properties, thereby limiting the Company's revenues.

The BOEM administers the natural gas and oil leases held by the Company on federal onshore lands and offshore tracts in the Outer Continental Shelf. The BOEM holds a royalty interest in these federal leases on behalf of the federal government. While the royalty interest percentage is fixed at the time that the lease is entered into, from time to time the BOEM changes or reinterprets the applicable regulations governing its royalty interests, and such action can indirectly affect the actual royalty obligation that the Company is required to pay. However, the Company believes that the regulations generally do not impact the Company to any greater extent than other similarly situated producers. At the end of lease operations, oil and gas lessees must plug and abandon wells, remove platforms and other facilities, and clear the lease site sea floor. The BOEM requires companies operating on the Outer Continental Shelf to obtain surety bonds to ensure performance of these obligations. As an operator, the Company is required to obtain surety bonds of $200,000 per lease for exploration and $500,000 per lease for developmental activities.

The Federal Energy Regulatory Commission (the "FERC") has embarked on wide-ranging regulatory initiatives relating to natural gas transportation rates and services, including the availability of market-based and other alternative rate mechanisms to pipelines for transmission and storage services. In addition, the FERC has announced and implemented a policy allowing pipelines and transportation customers to negotiate rates above the otherwise applicable maximum lawful cost-based rates on the condition that the pipelines alternatively offer so-called recourse rates equal to the maximum lawful cost-based rates. With respect to gathering services, the FERC has issued orders declaring that certain facilities owned by interstate pipelines primarily perform a gathering function, and may be transferred to affiliated and non-affiliated entities that are not subject to the FERC's rate jurisdiction. The Company cannot predict the ultimate outcome of these developments, or the effect of these developments on transportation rates. Inasmuch as the rates for these pipeline services can affect the natural gas prices received by the Company for the sale of its production, the FERC's actions may have an impact on the Company. However, the impact should not be substantially different for the Company than it would be for other similarly situated natural gas producers and sellers.

Risk and Insurance Program

In accordance with industry practice, we maintain insurance against many, but not all, potential perils confronting our operations and in coverage amounts and deductible levels that we believe to be economic. Consistent with that profile, our insurance program is structured to provide us financial protection from significant losses resulting from damages to, or the loss of, physical assets or loss of human life, and liability claims of third parties, including such occurrences as well blowouts and weather events that result in oil spills and damage to our wells and/or platforms. Our goal is to balance the cost of insurance with our assessment of the potential risk of an adverse event. We maintain insurance at levels that we believe are appropriate and consistent with industry practice and we regularly review our risks of loss and the cost and availability of insurance and revise our insurance program accordingly.

We expect the future availability and cost of insurance to be impacted by the Deepwater Horizon Incident. Impacts could include: tighter underwriting standards, limitations on scope and amount of coverage, and higher premiums, and will depend, in part, on future changes in laws and regulations regarding exploration and production activities in the Gulf of Mexico, including possible increases in liability caps for claims of damages from oil spills. We will continue to monitor the expected regulatory and legislative response and its impact on the insurance market and our overall risk profile, and adjust our risk and insurance program to provide protection at a level that we can afford considering the cost of insurance, against the potential and magnitude of disruption to our operations and cash flows.

We carry insurance protection for our net share of any potential financial losses occurring as a result of events such as the Deepwater Horizon Incident. As a result of the incident, we have increased our well control coverage from $75 million to $100 million on certain wells, which covers control of well, pollution cleanup and consequential damages. We have increased our general liability coverage from $100 million to $150 million, which covers pollution cleanup, consequential damages coverage, and third party personal injury and death. And we have increased our Oil Spill Financial Responsibility coverage from $35 million to $150 million, which covers additional pollution cleanup and third party claims coverage.

Health, Safety and Environmental Program. The Company’s Health, Safety and Environmental (“HS&E”) Program is supervised by an operating committee of senior management to insure compliance with all state and federal regulations. In addition, to support the operating committee, we have contracted with J. Connors Consulting (“JCC”) to manage our regulatory

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process. JCC is a regulatory consulting firm specializing in the offshore Gulf of Mexico regulatory process, preparation of incident response plans, safety and environmental services and facilitation of comprehensive oil spill response training and drills to oil and gas companies and pipeline operators.

For our Gulf of Mexico operations, we have a Regional Oil Spill Plan in place with the BOEM. Our response team is trained annually and is tested through annual spill drills given by the BOEM. In addition, we have in place a contract with O'Brien's Response Management ("O'Brien's"). O'Brien's maintains a 24/7 manned incident command center located in Slidell, LA. Upon the occurrence of an oil spill, the Company's spill program is initiated by notifying O'Brien's that we have an emergency. While the Company would focus on source control of the spill, O'Brien's would handle all communication with state and federal agencies as well as U.S. Coast Guard notifications.

If a spill were to occur, we have contracted with Clean Gulf Associates ("CGA") to assist with equipment and personnel needs. CGA specializes in onsite control and cleanup and is on 24 hour alert with equipment currently stored at six bases (Ingleside and Galveston, TX and Lake Charles, Houma, Venice and Pascagoula, LA), and is opening new sites in Leeville, Morgan City and Harvey, LA. The CGA equipment stockpile is available to serve member oil spill response needs including blowouts; open seas, near shore and shallow water skimming; open seas and shoreline booming; communications; dispersants; boat spray systems to apply dispersants; wildlife rehabilitation; and a forward command center. CGA has retainers with an aerial dispersant company and a company that provides mechanical recovery equipment for spill responses. CGA equipment includes:

- HOSS Barge: the largest purpose-built skimming barge in the United States with 4,000 barrels of storage capacity.
- Fast Response System (FRU): a self-contained skimming system for use on vessels of opportunity. CGA has nine of these units.
- Fast Response Vessels (FRV): four 46 foot FRVs with cruise speeds of 20-25 knots that have built-in skimming troughs and cargo tanks, outrigger skimming arms, navigation and communication equipment.

In addition to being a member of CGA, the Company has contracted with Wild Well Control for source control at the wellhead, if required. Wild Well Control is one of the world's leading providers of firefighting, well control, engineering, and training services.

Safety and Environmental Management System. The Company has developed and implemented a Safety and Environmental Management System ("SEMS") to address oil and gas operations in the Outer Continental Shelf ("OCS"), as required by the Bureau of Safety and Environmental Enforcement ("BSEE"). Full implementation of the following thirteen mandatory elements of the American Petroleum Institute's Recommended Practice 75 (API RP 75) was required on or before November 15, 2011:

- General provisions
- Safety and environmental information
- Hazards analyses
- Management of change
- Operating procedures
- Safe work practices
- Training
- Mechanical integrity
- Pre-startup review
- Emergency response and control
- Investigation of accidents
- Audits
- Records and documentation

Our SEMS program identifies, addresses, and manages safety, environmental hazards, and its impacts during the design, construction, start-up, operation, inspection, and maintenance of all new and existing facilities. The Company has established goals, performance measures, training, accountability for its implementation, and provides necessary resources for an effective SEMS, as well as reviews the adequacy and effectiveness of the SEMS program. Facilities must be designed, constructed, maintained, monitored, and operated in a manner compatible with industry codes, consensus standards, and all applicable governmental regulations. We have contracted with Island Technologies Inc. to manage our SEMS program for production operations.

The BSEE will enforce the SEMS requirements through audits. We must have our SEMS program audited by either an independent third-party or our designated and qualified personnel within 2 years of the initial implementation and at least once

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every 3 years thereafter. Failure of an audit may force us to shut-in our Gulf of Mexico operations.

Employees

We have ten employees, all of whom are full time. The Company outsources its human resources function to Insperity, Inc. and all of the Company’s employees are co-employees of Insperity, Inc. In addition to our employees, we use the services of independent consultants and contractors to perform various professional services, including reservoir engineering, land, legal, environmental and tax services. We are dependent on JEX for prospect generation, evaluation and prospect leasing. As a working interest owner, we rely on outside operators to drill, produce and market our natural gas and oil for our onshore prospects and certain offshore prospects where we are a non-operator. In the offshore prospects where we are the operator, we currently rely on a turn-key contractor to drill and rely on independent contractors to produce and market our natural gas and oil. In addition, we utilize the services of independent contractors to perform field and on-site drilling and production operation services and independent third party engineering firms to calculate our reserves.

Directors and Executive Officers

The following table sets forth the names, ages and positions of our directors and executive officers:

Name	Age	Position
Kenneth R. Peak	67	Chairman and Director
Brad Juneau	52	President, Acting Chief Executive Officer and Director
Sergio Castro	43	Vice President, Chief Financial Officer, Treasurer and Secretary
Yaroslava Makalskaya	43	Vice President, Controller and Chief Accounting Officer
Marc L. Duncan	59	Vice Chairman of Operating Committee; Safety, Environmental and Regulatory Compliance Officer (SEARCO)
Charles A. Cambron	45	Vice President - Drilling
Michael J. Autin	53	Vice President - Production
B.A. Berilgen	64	Director
Jay D. Brehmer	47	Director
Charles M. Reimer	67	Director
Steven L. Schoonover	67	Director

Kenneth R. Peak. Mr. Peak is the founder of the Company and has been Chairman and Chief Executive Officer since its formation in September 1999. In August 2012, Mr. Peak received a medical leave of absence from the Company for up to six months and Mr. Juneau was elected President and Acting Chief Executive Officer. Mr. Peak entered the energy industry in 1973 as a commercial banker and held a variety of financial and executive positions in the oil and gas industry prior to starting Contango in 1999. Mr. Peak served as an officer in the U.S. Navy from 1968 to 1971. Mr. Peak received a BS in physics from Ohio University in 1967, and an MBA from Columbia University in 1972. He currently serves as a director of Patterson-UTI Energy, Inc., a provider of onshore contract drilling services to exploration and production companies in North America, and Contango ORE, Inc., an exploration stage company involved in the exploration of gold and associated minerals and rare earth elements in the state of Alaska.

Brad Juneau. Mr. Juneau was elected a director of Contango in April 2012 and President and Acting Chief Executive Officer in August 2012. Mr. Juneau is the sole manager of the general partner of JEX, a company involved in the generation of natural gas and oil prospects. Prior to forming Juneau Exploration in 1998, Mr. Juneau served as senior vice president of exploration for Zilkha Energy Company from 1987 to 1998. Prior to joining Zilkha Energy Company, Mr. Juneau served as staff petroleum engineer with Texas International Company for three years, where his principal responsibilities included reservoir engineering, as well as acquisitions and evaluations. Prior to that, he was a production engineer with Enserch Corporation in Oklahoma City. Mr. Juneau holds a BS degree in petroleum engineering from Louisiana State University. Mr. Juneau was also elected President, Acting Chief Executive Officer and director of Contango ORE, Inc. in August 2012.

Sergio Castro. Mr. Castro joined Contango in March 2006 as Treasurer and was appointed Vice President, Treasurer and Secretary in April 2006 and Chief Financial Officer in June 2010. Prior to joining Contango, Mr. Castro spent two years (April 2004 to March 2006) as a consultant for UHY Advisors TX, LP. From January 2001 to April 2004, Mr. Castro was a lead credit analyst for Dynegy Inc. From August 1997 to January 2001, Mr. Castro worked as an auditor for Arthur Andersen LLP, where he specialized in energy companies. Mr. Castro was honorably discharged from the U.S. Navy in 1993 as an E-6, where he served onboard a nuclear powered submarine. Mr. Castro received a BBA in Accounting in 1997 from the University of Houston, graduating summa cum laude. Mr. Castro is a CPA and a Certified Fraud Examiner.

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Yaroslava Makalskaya. Ms. Makalskaya joined Contango in March 2010 and was appointed Vice President, Controller and Chief Accounting Officer in June 2010. Ms. Makalskaya has approximately 20 years of experience in accounting and finance, including 13 years in public accounting. Prior to joining Contango, Ms. Makalskaya was a director in the Transaction Services practice at PricewaterhouseCoopers, where she assisted clients with M&A transactions as well as advised clients with complex accounting and financial reporting issues. Prior to July 2008 Ms. Makalskaya was a Senior Manager in the audit practices of PricewaterhouseCoopers and Arthur Andersen, where her clients included many US and international companies in energy, utilities, mining and other sectors. Ms. Makalskaya holds a MS degree in Economics from Novosibirsk State University in Russia. Ms. Makalskaya is a CPA.

Marc L. Duncan. Mr. Duncan joined Contango in June 2005 as President and Chief Operating Officer of Contango Operators, Inc. and was appointed President and Chief Operating Officer of Contango Oil & Gas Company in October 2006 until December 2010. In December 2010 Mr. Duncan was appointed as the Company's Safety, Environmental and Regulatory Compliance Officer ("SEARCO") and Vice Chairman of the Operating Committee. Mr. Duncan has over 38 years of experience in the energy industry and has held a variety of domestic and international engineering and senior-level operations management positions relating to natural gas and oil exploration, project development, and drilling and production operations. Prior to joining Contango, Mr. Duncan served as Chief Operating Officer of USENCO International, Inc. and its subsidiaries and affiliates in China and Ukraine from February 2000 to July 2004 and as a senior project and drilling engineer for Hunt Oil Company from July 2004 to June 2005. He holds an MBA in Engineering Management from the University of Dallas, an MEd from the University of North Texas and a BS in Science and Education from Stephen F. Austin University.

Charles A. Cambron. Mr. Cambron joined Contango in August 2010 as Vice President of Drilling. Mr. Cambron has over 20 years of experience in the Gulf of Mexico oil and gas industry. Most recently he was employed by Applied Drilling Technology, Inc. (ADTI) as an Operations Manager from August 1995 until August 2010. He also held various positions in engineering and offshore supervision over a 15 year period. Prior to ADTI, Mr. Cambron began his career with Rowan Petroleum, Inc. as a Drilling Engineer working in both the Gulf of Mexico and North Sea. Mr. Cambron received a BS degree in Petroleum Engineering from the University of Oklahoma in 1991.

Michael J. Autin. Mr. Autin joined Contango in May 2012 as Vice President of Production in August 2012. Mr. Autin has over 33 years of experience in the petroleum industry including the Gulf of Mexico and U.S onshore shale. He has held various positions including Production Manager, HSE Manager and Offshore Installation Manager. Prior to joining Contango, Mr. Autin was employed by BHP Billiton since October 2000, where most recently he was Gulf of Mexico Operations Manager, Field Manager and Operations Advisor. Mr. Autin attended Nicholls State University where he studied petroleum, safety and business. He received a BS degree in 1986.

B.A. Berilgen. Mr. Berilgen was appointed a director of Contango in July 2007. Mr. Berilgen has served in a variety of senior positions during his 40 year career. Most recently, he became Chief Executive Officer of Patara Oil & Gas LLC in April 2008. Prior to that he was Chairman, Chief Executive Officer and President of Rosetta Resources Inc., a company he founded in June 2005, until his resignation in July 2007, and then he was an independent consultant from July 2007 through April 2008. Mr. Berilgen was also previously the Executive Vice President of Calpine Corp. and President of Calpine Natural Gas L.P. from October 1999 through June 2005. In June 1997, Mr. Berilgen joined Sheridan Energy, a public oil and gas company, as its President and Chief Executive Officer. Mr. Berilgen attended the University of Oklahoma, receiving a BS in Petroleum Engineering in 1970 and a MS in Industrial Engineering / Management Science.

Jay D. Brehmer. Mr. Brehmer has been a director of Contango since October 2000. Mr. Brehmer is a co-founding partner of Southplace, LLC, a provider of private-company middle-market corporate finance advisory services. Mr. Brehmer founded Southplace, LLC in November 2002. In August 2004, Mr. Brehmer became Managing Director of Houston Capital Advisors LP, a boutique financial advisory, merger and acquisition investment bank, while still retaining his membership in Southplace, LLC. Mr. Brehmer resigned from Houston Capital Advisors LP in January 2008 and is currently associated with Southplace, LLC in a full-time capacity. From May 1998 until November 2002, Mr. Brehmer was responsible for structured-finance energy related transactions at Aquila Energy Capital Corporation. Prior to joining Aquila, Mr. Brehmer founded Capital Financial Services, which provided mid-cap companies with strategic merger and acquisition advice coupled with prudent financial capitalization structures. Mr. Brehmer holds a BBA from Drake University in Des Moines, Iowa.

Charles M. Reimer. Mr. Reimer was elected a director of Contango in November 2005. Mr. Reimer is President of Freeport LNG Development, L.P., and has experience in exploration, production, liquefied natural gas (“LNG”) and business development ventures, both domestically and abroad. From 1986 until 1998, Mr. Reimer served as the senior executive responsible for the VICO joint venture that operated in Indonesia, and provided LNG technical support to P. T. Badak. Additionally, during these years he served, along with Pertamina executives, on the board of directors of the P.T. Badak LNG plant in Bontang, Indonesia. Mr. Reimer began his career with Exxon Company USA in 1967 and held various professional and management positions in Texas and Louisiana. Mr. Reimer was named President of Phoenix Resources Company in 1985 and

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relocated to Cairo, Egypt, to begin eight years of international assignments in both Egypt and Indonesia. Prior to joining Freeport LNG Development, L.P. in December 2002, Mr. Reimer was President and Chief Executive Officer of Cheniere Energy, Inc.

Steven L. Schoonover. Mr. Schoonover was elected a director of Contango in November 2005. Mr. Schoonover was most recently Chief Executive Officer of Cellxion, L.L.C., a company he founded in September 1996 and sold in September 2007, which specialized in construction and installation of telecommunication buildings and towers, as well as the installation of high-tech telecommunication equipment. Since the sale in September 2007, Mr. Schoonover continues to serve as a consultant to the current management team of Cellxion, L.L.C. From 1990 until its sale in November 1997 to Telephone Data Systems, Inc., Mr. Schoonover served as President of Blue Ridge Cellular, Inc., a full-service cellular telephone company he co-founded. From 1983 to 1996, he served in various positions, including President and Chief Executive Officer, with Fibrebond Corporation, a construction firm involved in cellular telecommunications buildings, site development and tower construction. Mr. Schoonover has been awarded, on two occasions with two different companies, Entrepreneur of the Year, sponsored by Ernst & Young, Inc Magazine and USA Today.

Directors of Contango serve as members of the board of directors until the next annual stockholders meeting, until successors are elected and qualified or until their earlier resignation or removal. Officers of Contango are elected by the board of directors and hold office until their successors are chosen and qualified, until their death or until they resign or have been removed from office. All corporate officers serve at the discretion of the board of directors.

Beginning December 1, 2011, each non-employee director of the Company received a quarterly retainer of $28,000 payable in cash, with no stock option or common stock grants. There were no additional payments for meetings attended or being chairman of a committee. During fiscal year 2011 and 2010, each outside director of the Company received a quarterly retainer of $20,000 payable in cash, with no stock option or common stock grants. There were no additional payments for meetings attended or being chairman of a committee. There are no family relationships between any of our directors or executive officers.

Corporate Offices

We lease our corporate offices at 3700 Buffalo Speedway, Suite 960, Houston, Texas 77098. In November 2010, the Company expanded its office space and extended its office lease agreement through December 31, 2015.

Code of Ethics

We adopted a Code of Ethics for senior management in December 2002, which was updated and adopted by the Company's Board of Directors in May 2012. A copy of our Code of Ethics is filed as an exhibit to this Form 10-K and is also available on our website at www.contango.com.

Available Information

You may read and copy all or any portion of this annual report on Form 10-K, our quarterly reports on Form 10-Q and current reports on Form 8-K, as well as any amendments and exhibits to those reports, without charge at the office of the Securities and Exchange Commission (the “SEC”) in Public Reference Room, 100 F Street NE, Washington, DC, 20549. Information regarding the operation of the public reference rooms may be obtained by calling the SEC at 1-800-SEC-0330. In addition, filings made with the SEC electronically are publicly available through the SEC's website at http://www.sec.gov, and at our website at http://www.contango.com. This annual report on Form 10-K, including all exhibits and amendments, has been filed electronically with the SEC.

Item 1A. Risk Factors

In addition to the other information set forth elsewhere in this Form 10-K, you should carefully consider the following factors when evaluating the Company. An investment in the Company is subject to risks inherent in our business. The trading price of the shares of the Company is affected by the performance of our business relative to, among other things, competition, market conditions and general economic and industry conditions. The value of an investment in the Company may decrease, resulting in a loss.

We have no ability to control the market price for natural gas and oil. Natural gas and oil prices fluctuate widely, and a substantial or extended decline in natural gas and oil prices would adversely affect our revenues, profitability and growth and could have a material adverse effect on the business, the results of operations and financial condition of the Company.

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Our revenues, profitability and future growth depend significantly on natural gas and crude oil prices. Prices received affect the amount of future cash flow available for capital expenditures and repayment of indebtedness and our ability to raise additional capital. We do not expect to hedge our production to protect against price decreases. Lower prices may also affect the amount of natural gas and oil that we can economically produce. Factors that can cause price fluctuations include:

• Overall economic conditions.
• The domestic and foreign supply of natural gas and oil.
• The level of consumer product demand.
• Adverse weather conditions and natural disasters.
• The price and availability of competitive fuels such as LNG, heating oil and coal.
• Political conditions in the Middle East and other natural gas and oil producing regions.
• The level of LNG imports and any LNG exports.
• Domestic and foreign governmental regulations.
• Special taxes on production.
• Access to pipelines and gas processing plants.
• The loss of tax credits and deductions.

A substantial or extended decline in natural gas and oil prices could have a material adverse effect on our access to capital and the quantities of natural gas and oil that may be economically produced by us. A significant decrease in price levels for an extended period would negatively affect us.

We depend on the services of our Chairman and implementation of our business plan could be seriously harmed if we lost his services.

We depend heavily on the services of Mr. Kenneth R. Peak, our Chairman, who received a medical leave of absence from the Company for up to six months in August 2012. The proceeds from a $10.0 million “key person” life insurance policy on Mr. Peak may not be adequate to cover our losses in the event of Mr. Peak’s death.

We are highly dependent on the technical services provided by JEX and could be seriously harmed if JEX terminated its services with us or became otherwise unavailable.

Because we employ no geoscientists, we are dependent upon JEX for the success of our natural gas and oil exploration projects and expect to remain so for the foreseeable future. We have entered into an Advisory Agreement with JEX, whereby in addition to generating and evaluating offshore and onshore exploration prospects for the Company, JEX will direct Contango’s staff on operational matters including drilling, completions and production. The Advisory Agreement is effective for a term of two years from April 1, 2012, and continues on a month-to-month basis thereafter. In August 2012, Mr. Brad Juneau was elected President and Acting Chief Executive Officer during Mr. Peak's medical leave of absence. Highly qualified explorationists and engineers are difficult to attract and retain. As a result, the loss of the services of JEX could have a material adverse effect on us and could prevent us from pursuing our business plan. Additionally, the loss by JEX of certain explorationists could have a material adverse effect on our operations as well.

Our ability to successfully execute our business plan is dependent on our ability to obtain adequate financing.

Our business plan, which includes participation in 3-D seismic shoots, lease acquisitions, the drilling of exploration prospects and producing property acquisitions, has required and is expected to continue to require substantial capital expenditures. We may require additional financing to fund our planned growth. Our ability to raise additional capital will depend on the results of our operations and the status of various capital and industry markets at the time we seek such capital. Accordingly, additional financing may not be available to us on acceptable terms, if at all. In the event additional capital resources are unavailable, we may be required to curtail our exploration and development activities or be forced to sell some of our assets in an untimely fashion or on less than favorable terms.

It is difficult to quantify the amount of financing we may need to fund our planned growth. The amount of funding we may need in the future depends on various factors such as:

• Our financial condition.
• The prevailing market price of natural gas and oil.
• The type of projects in which we are engaging.
• The lead time required to bring any discoveries to production.

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We frequently obtain capital through the sale of our producing properties.

The Company, since its inception in September 1999, has raised approximately $524 million from various property sales. These sales bring forward future revenues and cash flows, but our longer term liquidity could be impaired to the extent our exploration efforts are not successful in generating new discoveries, production, revenues and cash flows. Additionally, our longer term liquidity could be impaired due to the decrease in our inventory of producing properties that could be sold in future periods. Further, as a result of these property sales the Company's ability to collateralize bank borrowings is reduced which increases our dependence on more expensive mezzanine debt and potential equity sales. The availability of such funds will depend upon prevailing market conditions and other factors over which we have no control, as well as our financial condition and results of operations.

We assume additional risk as operator in drilling high pressure and high temperature wells in the Gulf of Mexico.

COI, a wholly-owned subsidiary of the Company, was formed for the purpose of drilling and operating exploration wells in the Gulf of Mexico. Drilling activities are subject to numerous risks, including the significant risk that no commercially productive hydrocarbon reserves will be encountered. The cost of drilling, completing and operating wells and of installing production facilities and pipelines is often uncertain. Drilling costs could be significantly higher if we encounter difficulty in drilling offshore exploration wells. The Company's drilling operations may be curtailed, delayed, canceled or negatively impacted as a result of numerous factors, including title problems, weather conditions, compliance with governmental requirements and shortages or delays in the delivery or availability of material, equipment and fabrication yards. In periods of increased drilling activity resulting from high commodity prices, demand exceeds availability for drilling rigs,
drilling vessels, supply boats and personnel experienced in the oil and gas industry in general, and the offshore oil and gas industry in particular. This may lead to difficulty and delays in consistently obtaining certain services and equipment from vendors, obtaining drilling rigs and other equipment at favorable rates and scheduling equipment fabrication at factories and fabrication yards. This, in turn, may lead to projects being delayed or experiencing increased costs. The cost of drilling, completing, and operating wells is often uncertain, and new wells may not be productive or we may not recover all or any of our investment. The risk of significant cost overruns, curtailments, delays, inability to reach our target reservoir and other factors detrimental to drilling and completion operations may be higher due to our inexperience as an operator.

Additionally, we use turnkey contracts that may cost more than non-turnkey drilling contracts at daily rates. Should our contracts come off turnkey or should such turnkey contracts be terminated by the turnkey drilling contractor, our drilling costs could be significantly higher.

We rely on third-party operators to operate and maintain some of our production platforms, pipelines and processing facilities and, as a result, we have limited control over the operations of such facilities. The interests of an operator may differ from our interests.

We depend upon the services of third-party operators to operate production platforms, pipelines, gas processing facilities and the infrastructure required to produce and market our natural gas, condensate and oil. We have limited influence over the conduct of operations by third-party operators. As a result, we have little control over how frequently and how long our production is shut-in when production problems, weather and other production shut-ins occur. Poor performance on the part of, or errors or accidents attributable to, the operator of a project in which we participate may have an adverse effect on our results of operations and financial condition. Also, the interest of an operator may differ from our interests.

Repeated production shut-ins can possibly damage our well bores.

Our well bores are required to be shut-in from time to time due to a variety of issues, including a combination of weather, mechanical problems, sand production, bottom sediment, water and paraffin associated with our condensate production at our Eugene Island 11 platform, as well as downstream third-party facility and pipeline shut-ins. In addition, shut-ins are necessary from time to time to upgrade and improve the production handling capacity at related downstream platform, gas processing and pipeline infrastructure. In addition to negatively impacting our near term revenues and cash flow, repeated production shut-ins may damage our well bores if repeated excessively or not executed properly. The loss of a well bore due to damage could require us to drill additional wells.

Concentrating our capital investment in the Gulf of Mexico increases our exposure to risk.

The vast majority of our capital investments is primarily focused in offshore Gulf of Mexico exploration prospects, which may result in a total loss of our investment. Furthermore, even our productive wells may not result in profitable operations. Gulf of Mexico exploration efforts have been undertaken for over 60 years and remaining prospects are at deeper

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horizons that are more expensive to drill and often in much deeper water depths. Accordingly, as a result, a number of companies have shifted their focus to onshore “shale plays.” The Company’s continuing focus on the Gulf of Mexico will result in significant dry hole costs, perhaps in excess of $30 million for one well, which significantly concentrates and increases our risk profile.

Natural gas and oil reserves are depleting assets and the failure to replace our reserves would adversely affect our production and cash flows.

Our future natural gas and oil production depends on our success in finding or acquiring new reserves. If we fail to replace reserves, our level of production and cash flows will be adversely impacted. Production from natural gas and oil properties decline as reserves are depleted, with the rate of decline depending on reservoir characteristics. Our total proved reserves will decline as reserves are produced unless we conduct other successful exploration and development activities or acquire properties containing proved reserves, or both. Further, the majority of our reserves are proved developed producing. Accordingly, we do not have significant opportunities to increase our production from our existing proved reserves. Our ability to make the necessary capital investment to maintain or expand our asset base of natural gas and oil reserves would be impaired to the extent cash flow from operations is reduced and external sources of capital become limited or unavailable. We may not be successful in exploring for, developing or acquiring additional reserves. If we are not successful, our future production and revenues will be adversely affected.

Reserve estimates depend on many assumptions that may turn out to be inaccurate. Any material inaccuracies in these reserve estimates or underlying assumptions could materially affect the quantities of our reserves.

There are numerous uncertainties in estimating crude oil and natural gas reserves and their value, including many factors that are beyond our control. It requires interpretations of available technical data and various assumptions, including assumptions relating to economic factors. Any significant inaccuracies in these interpretations or assumptions could materially affect the estimated quantities of reserves shown in this report.

In order to prepare these estimates, our independent third-party petroleum engineers must project production rates and timing of development expenditures as well as analyze available geological, geophysical, production and engineering data, and the extent, quality and reliability of this data can vary. The process also requires economic assumptions relating to matters such as natural gas and oil prices, drilling and operating expenses, capital expenditures, taxes and availability of funds.

Actual future production, natural gas and oil prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable natural gas and oil reserves most likely will vary from our estimates. Any significant variance could materially affect the estimated quantities and pre-tax net present value of reserves shown in a reserve report. In addition, estimates of our proved reserves may be adjusted to reflect production history, results of exploration and development, prevailing natural gas and oil prices and other factors, many of which are beyond our control and may prove to be incorrect over time. As a result, our estimates may require substantial upward or downward revisions if subsequent drilling, testing and production reveal different results. Furthermore, some of the producing wells included in our reserve report have produced for a relatively short period of time. Accordingly, some of our reserve estimates are not based on a multi-year production decline curve and are calculated using a reservoir simulation model together with volumetric analysis. Any downward adjustment could indicate lower future production and thus adversely affect our financial condition, future prospects and market value.

The Company’s reserves and revenues are primarily concentrated in one field.

Approximately 82% of our reserves are assigned to our Dutch and Mary Rose discoveries which have ten producing well bores concentrated in one reservoir on one field, and are producing through two production platforms. Reserve assessments based on only ten well bores in one reservoir are subject to significantly greater risk of being shut-in for a variety of weather, platform and pipeline difficulties. In addition, the risk of a downward revision in our reserve estimates is also greater.

We rely on the accuracy of the estimates in the reservoir engineering reports provided to us by our outside engineer.

We have no in house reservoir engineering capability, and therefore rely on the accuracy of the periodic reservoir reports provided to us by our independent third-party reservoir engineer. If those reports prove to be inaccurate, our financial reports could have material misstatements. Further, we use the reports of our independent reservoir engineer in our financial planning. If the reports of the outside reservoir engineer prove to be inaccurate, we may make misjudgments in our financial planning.

Exploration is a high risk activity, and our participation in drilling activities may not be successful.

Our future success largely depends on the success of our exploration drilling program. Participation in exploration drilling activities involves numerous risks, including the significant risk that no commercially productive natural gas or oil reservoirs will be discovered. The cost of drilling, completing and operating wells is uncertain, and drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including:

- Unexpected drilling conditions.
- Blowouts, fires or explosions with resultant injury, death or environmental damage.
- Pressure, temperature or other irregularities in formations.
- Equipment failures and/or accidents caused by human error.
- Tropical storms, hurricanes and other adverse weather conditions.
- Compliance with governmental requirements and laws, present and future.
- Shortages or delays in the availability of drilling rigs and the delivery of equipment.
- Our turnkey drilling contracts reverting to a day rate contract or our turnkey contractor electing to terminate the turnkey contract would significantly increase the cost and risk to the Company.
- Problems at third-party operated platforms, pipelines and gas processing facilities over which we have no control.

Even when properly used and interpreted, 3-D seismic data and visualization techniques are only tools used to assist geoscientists in identifying subsurface structures and hydrocarbon indicators. They do not allow the interpreter to know conclusively if hydrocarbons are present or economically producible. Poor results from our drilling activities would materially and adversely affect our future cash flows and results of operations. In addition, as a “successful efforts” company, we choose to account for unsuccessful exploration efforts (the drilling of “dry holes”) and seismic costs as a current expense of operations, which immediately impacts our earnings. Significant expensed exploration charges in any period would materially adversely affect our earnings for that period and cause our earnings to be volatile from period to period.

Production activities in the Gulf of Mexico increase our susceptibility to pollution and natural resource damage.

A blowout, rupture or spill of any magnitude would present serious operational and financial challenges. All of the Company’s operations in the Gulf of Mexico shelf are in water depths of less than 200 feet and less than 50 miles from the coast. Such proximity to the shore-line increases the probability of a biological impact or damaging the fragile eco-system in the event of released condensate.

Possible regulation related to global warming and climate change could have an adverse effect on our operations and demand for oil and natural gas.

Studies over recent years have indicated that emissions of certain gases may be contributing to warming of the Earth’s atmosphere. In response to these studies, governments have begun adopting domestic and international climate change regulations that require reporting and reductions in the emission of greenhouse gases. Methane, a primary component of natural gas, and carbon dioxide, a byproduct of the burning of oil, natural gas and refined petroleum products, are considered greenhouse gases. Internationally, the United Nations Framework Convention on Climate Change, and the Kyoto Protocol address greenhouse gas emissions, and several countries including countries in the European Union have established greenhouse gas regulatory systems. In the United States, at the state level, many states, either individually or through multi-state regional initiatives, have begun implementing legal measures to reduce emissions of greenhouse gases, primarily through the planned development of emission inventories or regional greenhouse gas cap and trade programs or have begun considering adopting greenhouse gas regulatory programs.

The Environmental Protection Agency (the "EPA") has issued greenhouse gas monitoring and reporting regulations that went into effect January 1, 2010, and require reporting by regulated facilities by March 2011 and annually thereafter. In November 2010, the EPA issued a final rule requiring companies to report certain greenhouse gas emissions from oil and natural gas facilities. Beyond measuring and reporting, the EPA issued an "Endangerment Finding" under section 202(a) of the Clean Air Act, concluding greenhouse gas pollution threatens the public health and welfare of current and future generations. The finding serves as a first step to issuing regulations that would require permits for and reductions in greenhouse gas emissions for certain facilities. EPA has proposed such greenhouse gas regulations and may issue final rules at a subsequent date.

Several decisions have been issued by courts that may increase the risk of claims being filed by governments and private parties against companies that have significant greenhouse gas emissions. Such cases may seek to challenge air emissions permits that greenhouse gas emitters apply for and seek to force emitters to reduce their emissions or seek damages

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for alleged climate change impacts to the environment, people, and property.

Any laws or regulations that may be adopted to restrict or reduce emissions of greenhouse gases could require us to incur increased operating and compliance costs, and could have an adverse effect on demand for the natural gas and condensate that we produce.

The natural gas and oil business involves many operating risks that can cause substantial losses and our insurance coverage may not be sufficient to cover some liabilities or losses that we may incur.

The natural gas and oil business involves a variety of operating risks, including:

• Blowouts, fires and explosions.
• Surface cratering.
• Uncontrollable flows of underground natural gas, oil or formation water.
• Natural disasters.
• Pipe and cement failures.
• Casing collapses.
• Stuck drilling and service tools.
• Reservoir compaction.
• Abnormal pressure formations.
• Environmental hazards such as natural gas leaks, oil spills, pipeline ruptures or discharges of toxic gases.
• Capacity constraints, equipment malfunctions and other problems at third-party operated platforms, pipelines and gas processing plants over which we have no control.
• Repeated shut-ins of our well bores could significantly damage our well bores.
• Required workovers of existing wells that may not be successful.

If any of the above events occur, we could incur substantial losses as a result of:

• Injury or loss of life.
• Reservoir damage.
• Severe damage to and destruction of property or equipment.
• Pollution and other environmental damage.
• Clean-up responsibilities.
• Regulatory investigations and penalties.
• Suspension of our operations or repairs necessary to resume operations.

Offshore operations are subject to a variety of operating risks peculiar to the marine environment, such as capsizing and collisions. In addition, offshore operations, and in some instances, operations along the Gulf Coast, are subject to damage or loss from hurricanes or other adverse weather conditions. These conditions can cause substantial damage to facilities and interrupt production. As a result, we could incur substantial liabilities that could reduce the funds available for exploration, development or leasehold acquisitions, or result in loss of properties.

If we were to experience any of these problems, it could affect well bores, platforms, gathering systems and processing facilities, any one of which could adversely affect our ability to conduct operations. In accordance with customary industry practices, we maintain insurance against some, but not all, of these risks. Losses could occur for uninsurable or uninsured risks or in amounts in excess of existing insurance coverage. We may not be able to maintain adequate insurance in the future at rates we consider reasonable, and particular types of coverage may not be available. An event that is not fully covered by insurance could have a material adverse effect on our financial position and results of operations.

Not hedging our production may result in losses.

Due to the significant volatility in natural gas prices and the potential risk of significant hedging losses if our production should be shut-in during a period when NYMEX natural gas prices increase, our policy is to hedge only through the purchase of puts. By not hedging our production, we may be more adversely affected by declines in natural gas and oil prices than our competitors who engage in hedging arrangements.

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Our ability to market our natural gas and oil may be impaired by capacity constraints and equipment malfunctions on the platforms, gathering systems, pipelines and gas plants that transport and process our natural gas and oil.

All of our natural gas and oil is transported through gathering systems, pipelines and processing plants. Transportation capacity on gathering system pipelines and platforms is occasionally limited and at times unavailable due to repairs or improvements being made to these facilities or due to capacity being utilized by other natural gas or oil shippers that may have priority transportation agreements. If the gathering systems, processing plants, platforms or our transportation capacity is materially restricted or is unavailable in the future, our ability to market our natural gas or oil could be impaired and cash flow from the affected properties could be reduced, which could have a material adverse effect on our financial condition and results of operations. Further, repeated shut-ins of our wells could result in damage to our well bores that would impair our ability to produce from these wells and could result in additional wells being required to produce our reserves.

We may not have title to our leased interests and if any lease is later rendered invalid, we may not be able to proceed with our exploration and development of the lease site.

Our practice in acquiring exploration leases or undivided interests in natural gas and oil leases is to not incur the expense of retaining title lawyers to examine the title to the mineral interest prior to executing the lease. Instead, we rely upon the judgment of JEX and others to perform the field work in examining records in the appropriate governmental, county or parish clerk's office before leasing a specific mineral interest. This practice is widely followed in the industry. Prior to the drilling of an exploration well the operator of the well will typically obtain a preliminary title review of the drillsite lease and/or spacing unit within which the proposed well is to be drilled to identify any obvious deficiencies in title to the well and, if there are deficiencies, to identify measures necessary to cure those defects to the extent reasonably possible. However, such deficiencies may not have been cured by the operator of such wells. It does happen, from time to time, that the examination made by title lawyers reveals that the lease or leases are invalid, having been purchased in error from a person who is not the rightful owner of the mineral interest desired. In these circumstances, we may not be able to proceed with our exploration and development of the lease site or may incur costs to remedy a defect. It may also happen, from time to time, that the operator may elect to proceed with a well despite defects to the title identified in the preliminary title opinion.

Competition in the natural gas and oil industry is intense, and we are smaller and have a more limited operating history than many of our competitors.

We compete with a broad range of natural gas and oil companies in our exploration and property acquisition activities. We also compete for the equipment and labor required to operate and to develop these properties. Many of our competitors have substantially greater financial resources than we do. These competitors may be able to pay more for exploratory prospects and productive natural gas and oil properties. Further, they may be able to evaluate, bid for and purchase a greater number of properties and prospects than we can. Our ability to explore for natural gas and oil and to acquire additional properties in the future depends on our ability to evaluate and select suitable properties and to consummate transactions in this highly competitive environment. In addition, many of our competitors have been operating for a much longer time than we have and have substantially larger staffs. We may not be able to compete effectively with these companies or in such a highly competitive environment.

Proposed United States federal budgets and pending legislation contain certain provisions that, if passed as originally submitted, will have an adverse effect on our financial position, results of operations, and cash flows.

In February 2009, the US federal administration released its budget proposals for 2010, which included numerous proposed tax changes. In April 2009, legislation was introduced to further these objectives and in February 2010, the federal administration released similar budget proposals for 2011. The proposed budgets and legislation would repeal many tax incentives and deductions that are currently used by oil and gas companies in the United States and impose new taxes. Among others, the provisions include: elimination of the ability to fully deduct intangible drilling costs in the year incurred; repeal of the percentage depletion deduction for oil and gas properties; repeal of the manufacturing tax deduction for oil and gas companies; increase in the geological and geophysical amortization period for independent producers; and implementation of a fee on non-producing leases located on federal lands. Should some or all of these provisions become law, taxes on the E&P industry would increase, which could have a negative impact on our results of operations and cash flows. Although these proposals initially were made in 2009, none have become law. It is still, however, the federal administration's stated intention to enact legislation to repeal tax incentives and deductions and impose new taxes on oil and gas companies.

We are subject to complex laws and regulations, including environmental regulations that can adversely affect the cost, manner or feasibility of doing business.

Our operations are subject to numerous laws and regulations governing the operation and maintenance of our facilities and the discharge of materials into the environment. Failure to comply with such rules and regulations could result in substantial penalties and have an adverse effect on us. These laws and regulations:

• Require that we obtain permits before commencing drilling.
• Restrict the substances that can be released into the environment in connection with drilling and production activities.
• Limit or prohibit drilling activities on protected areas, such as wetlands or wilderness areas.
• Require remedial measures to mitigate pollution from former operations, such as plugging abandoned wells.

Under these laws and regulations, we could be liable for personal injury and clean-up costs and other environmental and property damages, as well as administrative, civil and criminal penalties. We maintain only limited insurance coverage for sudden and accidental environmental damages. Accordingly, we may be subject to liability, or we may be required to cease production from properties in the event of environmental damages. These laws and regulations have been changed frequently in the past. In general, these changes have imposed more stringent requirements that increase operating costs or require capital expenditures in order to remain in compliance. It is also possible that unanticipated developments could cause us to make environmental expenditures that are significantly different from those we currently expect. Existing laws and regulations could be changed and any such changes could have an adverse effect on our business and results of operations.

Our operations in the Gulf of Mexico have been and may continue to be adversely affected by changes in laws and regulations which have occurred and are expected to continue to occur as a result of the Deepwater Horizon Incident.

In April 2010, the deepwater Gulf of Mexico drilling rig Deepwater Horizon was engaged in drilling operations for another operator and sank after an apparent blowout and fire. The accident resulted in the loss of life and a significant oil spill. As a result, the Department of the Interior issued additional safety and performance standards as well as rigorous monitoring and testing requirements for offshore drilling. In addition, various Congressional committees began pursuing legislation to regulate drilling activities, establish safety requirements and increase liability for oil spills.

We continue to monitor legislative and regulatory developments, including the Drilling Safety Rule and the Workforce Safety Rule issued by the Department of the Interior. However, the full legislative and regulatory response to the incident is not fully known. An expansion of safety and performance regulations or an increase in liability for drilling activities will have one or more of the following impacts on our business:

• Increase the costs of drilling exploratory and development wells.
• Cause delays in, or preclude, the development of projects in the Gulf of Mexico.
• Result in longer time periods to obtain permits.
• Result in higher operating costs.
• Increase or remove liability caps for claims of damages from oil spills.
• Limit our ability to obtain additional insurance coverage on commercially reasonable terms to protect against any increase in liability.

Any of the above factors may result in a reduction of our cash flows, profitability, and the fair value of our properties.

New regulatory requirements and permitting procedures have significantly delayed our ability to obtain permits to drill new wells in offshore waters.

Subsequent to the Deepwater Horizon Incident in the Gulf of Mexico, a series of Notices to Lessees ("NTLs") were issued which imposed new regulatory requirements and permitting procedures for new wells to be drilled in federal waters of the OCS. These new regulatory requirements include the following:

- The Environmental NTL, which imposes new and more stringent requirements for documenting the environmental impacts potentially associated with the drilling of a new offshore well and significantly increases oil spill response requirements.
- The Compliance and Review NTL, which imposes requirements for operators to secure independent reviews of well design, construction and flow intervention processes, and also requires certifications of compliance from senior corporate officers.

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- The Drilling Safety Rule, which prescribes tighter cementing and casing practices, imposes standards for the use of drilling fluids to maintain well bore integrity, and stiffens oversight requirements relating to blowout preventers and their components, including shear and pipe rams.
- The Workplace Safety Rule, which requires operators to have a comprehensive SEMS in order to reduce human and
- organizational errors as root causes of work-related accidents and offshore spills.

Since the adoption of these new regulatory requirements, BOEM has been taking much longer periods of time to review and approve permits for new wells. Due to the extremely slow pace of permit review and approval, the BOEM may now take four months or longer to approve applications for drilling permits that were previously approved in less than 30 days. The new rules also increase the cost of preparing each permit application and will increase the cost of each new well.

The BSEE has implemented much more stringent controls and reporting requirements that if not followed, could result in significant monetary penalties or a shut-in of all or a portion of our Gulf of Mexico operations.

The BSEE is the federal agency responsible for overseeing the safe and environmentally responsible development of energy and mineral resources on the OCS. They are responsible for leading the most aggressive and comprehensive reforms to offshore oil and gas regulation and oversight in U.S. history. Their reforms have tightened requirements for everything from well design and workplace safety to corporate accountability. One of the many reforms includes implementing a SEMS program. This program requires operators to identify, address, and manage safety and environmental hazards during the design, construction, start-up, operation, inspection, and maintenance of all new and existing facilities. Facilities must be designed, constructed, maintained, monitored, and operated in a manner compatible with industry codes, consensus standards, and all applicable governmental regulations. Failure to comply with the SEMS program may force us to cease operations in the Gulf of Mexico.

Additionally, the OCS Lands Act authorizes and requires the BSEE to provide for both an annual scheduled inspection and a periodic unscheduled (unannounced) inspection of all oil and gas operations on the OCS. In addition to examining all safety equipment designed to prevent blowouts, fires, spills, or other major accidents, the inspections focus on pollution, drilling operations, completions, workovers, production, and pipeline safety. Upon detecting a violation, the inspector issues an Incident of Noncompliance ("INC") to the operator and uses one of two main enforcement actions (warning or shut-in), depending on the severity of the violation. If the violation is not severe or threatening, a warning INC is issued. The warning INC must be corrected within a reasonable amount of time specified on the INC. The shut-in INC may be for a single component (a portion of the facility) or the entire facility. The violation must be corrected before the operator is allowed to resume the activity in question.

In addition to the enforcement actions specified above, the BSEE can assess a civil penalty of up to $35,000 per violation per day if: 1) the operator fails to correct the violation in the reasonable amount of time specified on the INC; or 2) the violation resulted in a threat of serious harm or damage to human life or the environment. Operators with excessive INCs may be required to cease operations in the Gulf of Mexico.

Federal and state legislative and regulatory initiatives relating to hydraulic fracturing could result in increased costs and additional operating restrictions or delays.

It is customary in our industry to recover natural gas and oil from shale and other formations through the use of horizontal drilling combined with hydraulic fracturing. Hydraulic fracturing is the process of creating or expanding cracks, or fractures, in formations using water, sand and other additives pumped under high pressure into the formation. We intend to use hydraulic fracturing as a means to increase the productivity of the onshore wells that we drill and complete.

The hydraulic fracturing process is typically regulated by state oil and natural gas commissions. Several states, including Pennsylvania, Texas, Colorado, Montana, New Mexico and Wyoming, have adopted, and other states are considering adopting, regulations that could impose more stringent permitting, public disclosure, and/or well construction requirements on hydraulic fracturing operations. In addition to state laws, some local municipalities have adopted or are considering adopting land use restrictions, such as city ordinances, that may restrict or prohibit the performance of well drilling in general and/or hydraulic fracturing in particular.

Additionally, the EPA has asserted federal regulatory authority over hydraulic fracturing activities involving diesel fuel (specifically, when diesel fuel is utilized in the stimulation fluid) under the Safe Drinking Water Act and is completing the process of drafting guidance documents related to this newly asserted regulatory authority. There are also certain governmental reviews either underway or being proposed that focus on shale and other formation completion and production practices, including hydraulic fracturing. Depending on the outcome of these studies, federal and state legislatures and agencies may seek

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to further regulate such activities. The EPA has published proposed New Source Performance Standards ("NSPS") and National Emissions Standards for Hazardous Air Pollutants ("NESHAP") that, if adopted as proposed, would amend existing NSPS and NESHAP standards for oil and gas facilities as well as create new NSPS standards for oil and gas production, transmission
and distribution facilities. The EPA has also proposed regulations focused on reducing emissions of certain air pollutants by the oil and gas industry, including volatile organic compounds, sulfur dioxide and certain air toxics.

Certain environmental and other groups have suggested that additional federal, state and local laws and regulations may be needed to more closely regulate the hydraulic fracturing process. We cannot predict whether additional federal, state or local laws or regulations will be enacted in the future and, if so, what actions any such laws or regulations would require or prohibit. If additional levels of regulation or permitting requirements were imposed through the adoption of new laws and regulations, our business and operations could be subject to delays, increased operating and compliance costs and process prohibitions.

We do not control the activities on properties we do not operate.

Other companies may from time to time drill, complete and operate properties in which we have an interest. As a result, we have a limited ability to exercise influence over operations for these properties or their associated costs. Our dependence on the operator and other working interest owners for these projects and our limited ability to influence operations and associated costs could materially adversely affect the realization of our targeted returns on capital in drilling or acquisition activities. The success and timing of our drilling and development activities on properties operated by others therefore depend upon a number of factors that are outside of our control, including:

• Timing and amount of capital expenditures.
• The operator’s expertise and financial resources.
• Approval of other participants in drilling wells.
• Selection of technology.

We are highly dependent on our management team, JEX, our exploration partners and third-party consultants and engineers, and any failure to retain the services of such parties could adversely affect our ability to effectively manage our overall operations or successfully execute current or future business strategies.

The successful implementation of our business strategy and handling of other issues integral to the fulfillment of our business strategy is highly dependent on our management team, as well as certain key geoscientists, geologists, engineers and other professionals engaged by us. We are highly dependent on the services provided by JEX. The loss of key members of our management team, JEX or other highly qualified technical professionals could adversely affect our ability to effectively manage our overall operations or successfully execute current or future business strategies which may have a material adverse effect on our business, financial condition and operating results.

Acquisition prospects are difficult to assess and may pose additional risks to our operations.

We expect to evaluate and, where appropriate, pursue acquisition opportunities on terms our management considers favorable. The successful acquisition of natural gas and oil properties requires an assessment of:

• Recoverable reserves.
• Exploration potential.
• Future natural gas and oil prices.
• Operating costs.

• Potential environmental and other liabilities and other factors.
• Permitting and other environmental authorizations required for our operations.

In connection with such an assessment, we would expect to perform a review of the subject properties that we believe to be generally consistent with industry practices. Nonetheless, the resulting conclusions are necessarily inexact and their accuracy inherently uncertain and such an assessment may not reveal all existing or potential problems, nor will it necessarily permit a buyer to become sufficiently familiar with the properties to fully assess their merits and deficiencies. Inspections may not always be performed on every platform or well, and structural and environmental problems are not necessarily observable even when an inspection is undertaken. Future acquisitions could pose additional risks to our operations and financial results, including:

• Problems integrating the purchased operations, personnel or technologies.

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• Unanticipated costs.
• Diversion of resources and management attention from our exploration business.
• Entry into regions or markets in which we have limited or no prior experience.
• Potential loss of key employees of the acquired organization.

Low interest rates put us at a competitive disadvantage compared to our peers.

As of June 30, 2012, we had approximately $130 million in cash and no debt. The overnight T-bill investment rate for the fiscal year ended June 30, 2012 averaged approximately 0.035%, which would only generate investment income for the year of approximately $45,500. We therefore keep all of our cash in non-interest bearing accounts which are guaranteed by the U.S. Government. Competitive companies which borrow money are able to do so at extremely low rates and thereby may benefit from today's low level of interest rates.

Anti-takeover provisions of our certificate of incorporation, bylaws and Delaware law could adversely affect a potential acquisition by third-parties that may ultimately be in the financial interests of our stockholders.

Our Certificate of Incorporation, Bylaws and the Delaware General Corporation Law contain provisions that may discourage unsolicited takeover proposals. These provisions could have the effect of inhibiting fluctuations in the market price of our common stock that could result from actual or rumored takeover attempts, preventing changes in our management or limiting the price that investors may be willing to pay for shares of common stock.

Item 1B. Unresolved Staff Comments
None

Item 2. Properties

Development, Exploration and Acquisition Expenditures
The following table presents information regarding our net costs incurred in the purchase of proved and unproved properties and in exploration and development activities for the periods indicated:

	Year Ended June 30,		
	2012	2011	2010
Property acquisition costs:		(thousands)	
Unproved	$5,404	$2,802	$11,319
Proved	381	10,135	2,009
Exploration costs	1,154	14,016	52,805
Development costs	10,350	39,211	40,902
Total costs	$17,289	$66,164	$107,035

Drilling Activity
The following table shows our drilling activity for the periods indicated. The Company did not drill any wells during the fiscal year ended June 30, 2012. In the table, “gross” wells refer to wells in which we have a working interest, and “net” wells refer to gross wells multiplied by our working interest in such wells.

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	Year Ended June 30, 2012		2011		2010	
	Gross	Net	Gross	Net	Gross	Net
Exploratory Wells:						
Productive (onshore)	—	—	9	7.5	14	14.0
Productive (offshore)	—	—	1	1.0	2	1.3
Non-productive (onshore)	—	—	—	—	—	—
Non-productive (offshore)	—	—	1	1.0	2	2.0
Total	—	—	11	9.5	18	17.3

For the fiscal year ended June 30, 2011, of the nine productive onshore wells listed above, one relates to the Rexer-Tusa #2 well and eight relate to our Conterra Company wells. For the fiscal year ended June 30, 2010, of the 14 productive onshore wells listed above, one relates to our Rexer #1 well and 13 relate to our Conterra Company wells. The Rexer #1 well and Conterra Company wells were sold on May 13, 2011 while the sale of the Rexer-Tusa #2 was completed in October 2011. These wells are classified as discontinued operations in our financial statements for all periods presented.

Exploration and Development Acreage

Our principal natural gas and oil properties consist of natural gas and oil leases. The following table indicates our interests in developed and undeveloped acreage as of June 30, 2012:

	Developed Acreage (1)(2)		Undeveloped Acreage (1)(3)	
	Gross (4)	Net (5)	Gross (4)	Net (5)
Onshore (TMS)	—	—	13,848	13,848
Offshore Gulf of Mexico	21,949	13,242	26,283	22,653
Total	21,949	13,242	40,131	36,501

(1) Excludes any interest in acreage in which we have no working interest before payout or before initial production.
(2) Developed acreage consists of acres spaced or assignable to productive wells.
(3) Undeveloped acreage is considered to be those leased acres on which wells have not been drilled or completed to a point that would permit the production of commercial quantities of oil and gas, regardless of whether or not such acreage contains proved reserves.
(4) Gross acres refer to the number of acres in which we own a working interest.
(5) Net acres represent the number of acres attributable to an owner's proportionate working interest in a lease (e.g., a 50% working interest in a lease covering 320 acres is equivalent to 160 net acres).

Included in the Offshore Gulf of Mexico acres shown in the table above are the beneficial interests Contango has in the offshore acreage owned by REX. The above table includes our 32.3% interest in REX's 1,788 net developed acres and 5,000 net undeveloped acres.

Productive Wells

The following table sets forth the number of gross and net productive natural gas and oil wells in which we owned an interest as of June 30, 2012:

	Total Productive Wells (1)	
	Gross (2)	Net (3)
Natural gas (onshore)	—	—

Natural gas (offshore)	13	6.6
Oil	—	—
Total	13	6.6

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(1) Productive wells are producing wells and wells capable of producing commercial quantities. Completed but marginally producing wells are not considered here as a "productive" well.
(2) A gross well is a well in which we own an interest.
(3) The number of net wells is the sum of our fractional working interests owned in gross wells.

Natural Gas and Oil Reserves

The following table presents our estimated net proved natural gas and oil reserves and the pre-tax net present value of our reserves at June 30, 2012, based on reserve reports generated by William M. Cobb & Associates, Inc. ("Cobb"). The Company believes that having an independent and well respected third-party engineering firm prepare its reserve report enhances the credibility of its reported reserve estimates. Management is responsible for the reserve estimate disclosures in this filing, and meets regularly with our independent third-party engineer to review these reserve estimates. The qualifications of the technical person at Cobb responsible for overseeing the preparation of our reserve estimates are set forth below.

- Over 30 years of practical experience in the estimation and evaluation of reserves
- A registered professional engineer in the state of Texas
- Bachelor of Science Degree in Petroleum Engineering
- Member in good standing of the Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers

Cobb has informed us that the technical person primarily responsible for the reserve estimates meets or exceeds the education, training, and experience requirements set forth in the standards pertaining to the Estimating and Auditing of Oil and Gas Reserves Information promulgated by the Society of Petroleum Engineers and is proficient in the application of industry standard practices to engineering evaluations as well as the application of SEC and other industry definitions and guidelines.

We maintain adequate and effective internal controls over the underlying data upon which reserves estimates are based. The primary inputs to the reserve estimation process are comprised of technical information, financial data, ownership interests and production data. All field and reservoir technical information, which is communicated to our reservoir engineers quarterly, is confirmed when our third-party reservoir engineers hold technical meetings with geologists, operations and land personnel to discuss field performance and to validate future development plans. Current revenue and expense information is obtained from our accounting records, which are subject to external quarterly reviews, annual audits and our own set of internal controls over financial reporting. Internal controls over financial reporting are assessed for effectiveness annually using criteria set forth in Internal Controls – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. All data such as commodity prices, lease operating expenses, production taxes, field level commodity price differentials, ownership percentages, and well production data are updated in the reserve database by our third-party reservoir engineers and then analyzed by management to ensure that they have been entered accurately and that all updates are complete. Once the reserve database has been entirely updated with current information, and all relevant technical support material has been assembled, our independent engineering firms prepare their independent reserve estimates and final report.

The following table sets forth our offshore proved reserves as of June 30, 2012:

	Developed	Undeveloped	Total
Natural gas (MMcf)	196,268	5,111	201,379
Oil and condensate (MBbls)	3,353	(41)	3,312
Natural gas liquids (MBbls)	5,664	222	5,886
Total proved reserves (MMcfe)	250,370	6,197	256,567

Pre-tax net present value, discounted at 10% (in thousands)	$686,900	$43,322	$730,222

Prior Year Reserves

Our estimated net proved natural gas, oil and natural gas liquids reserves as of June 30, 2009, 2010, 2011 and 2012 are disclosed on page F-24 and were based on reserve reports generated by William M. Cobb & Associates, Inc. ("Cobb"). The reserve estimates as of June 30, 2010 also include the reserves associated with the Joint Venture Assets which were prepared exclusively by Lonquist & Co. LLC ("Lonquist"). These Joint Venture Asset reserves account for approximately 8% of our total reserves as of June 30, 2010 and were sold on May 13, 2011. The technical person at Lonquist responsible for overseeing the preparation of our Joint Venture Asset reserve estimates had over 23 years of practical experience in the estimation and evaluation of reserves, is a registered professional engineer in the state of Texas, has a BS in Petroleum Engineering, and is a member in good standing of the Society of Petroleum Engineers and the Society of Petroleum Evaluation Engineers. This individual meets or exceeds the education, training, and experience requirements set forth in the standards pertaining to the Estimating and Auditing of Oil and Gas Reserves Information promulgated by the Society of Petroleum Engineers and is proficient in the application of industry standard practices to engineering evaluations as well as the application of SEC and other industry definitions and guidelines.

Proved Undeveloped Reserves

The Company annually reviews any proved undeveloped reserves ("PUDs") to ensure their development within five years or less. As of June 30, 2012, the Company had approximately 6.2 Bcfe of PUDs related to Mary Rose #6, an acceleration well on state of Louisiana acreage. Our plan is to develop our PUD reserves prior to June 30, 2017. As of June 30, 2011, the Company had approximately 39 Bcfe of PUDs. Of this amount, approximately 37.5 Bcfes were attributable to our discovery at Vermilion 170 which began producing in fiscal year 2012. At June 30, 2010 the Company had approximately 19.8 Bcfe of PUDs mainly related to Cotton Valley and Travis Peak gas reserves in Panola County, Texas under our joint venture with Patara. These PUDs were sold on May 13, 2011 and the transaction is classified as discontinued operations in our financial statements.

Modernization of Oil and Gas Reporting

Effective June 30, 2010, we implemented the SEC's final rules related to the modernization of oil and gas reporting (SEC's reserves rules). Although the SEC's reserves rules allow probable and possible reserves to be disclosed separately, we have elected not to disclose probable and possible reserves in this report. See Item 8. Financial Statements and Supplementary Data – Supplemental Oil and Gas Information (Unaudited) for a description of the most significant revisions to oil and gas reporting disclosures. The SEC's reserve rules does not allow prior-year reserve information to be restated, so all information related to periods prior to June 30, 2010 is presented consistent with prior SEC rules for the estimation of proved reserves.

The line item "Pre-tax net present value, discounted at 10%" in the table above, is not intended to represent the current market value of the estimated natural gas and oil reserves we own. The pre-tax net present value of future cash flows attributable to our proved reserves as of June 30, 2012 was based on $3.13 per million British thermal units ("MMbtu") for natural gas at the NYMEX, $96.07 per barrel of oil at the West Texas Intermediate Posting, and $59.39 per barrel of NGLs, in each case before adjusting for basis, transportation costs and British thermal unit ("BTU") content. The pre-tax net present value is a non-GAAP financial measure as defined in Item 10(e) of Regulation S-K. The table below reconciles our calculation of pre-tax net present value to the standardized measure of discounted future net cash flows, which is the most directly comparable GAAP financial measure. Management believes that pre-tax net present value is an important non-GAAP financial measure used by analysts, investors and independent oil and gas producers for evaluating the relative value of oil and natural gas properties and acquisitions because the tax characteristics of comparable companies can differ materially. The reconciliation of the pre-tax net present value to the standardized measure of discounted future net cash flows relating to our proved oil and natural gas reserves at June 30, 2012 is as follows (in thousands):

	June 30, 2012
Pre-tax net present value, discounted at 10%	$730,222
Future income taxes, discounted at 10%	(216,290)
Standardized measure of discounted future net cash flows	$513,932

While we are reasonably certain of recovering our calculated reserves, the process of estimating natural gas and oil reserves is complex. It requires various assumptions, including natural gas and oil prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. Our third party engineers must project production rates, estimate timing and amount of development expenditures, analyze available geological, geophysical, production and engineering data, and the extent, quality and reliability of all of this data may vary. Actual future production, natural gas and oil prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable natural gas and oil reserves most likely will vary from estimates. Any significant variance could materially affect the estimated quantities and net present value of reserves. In addition, estimates of proved reserves may be adjusted to reflect production history, results of exploration and development, prevailing natural gas and oil prices and other factors, many of which are beyond our control.

Item 3. Legal Proceedings

From time to time, we are party to litigation or other legal and administrative proceedings that we consider to be a part of the ordinary course of business. As of the date of this Form 10-K, we are not a party to any material legal proceedings and

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we are not aware of any material proceedings contemplated against us, that could individually or in the aggregate, reasonably be expected to have a material adverse effect on our financial condition, cash flows or results of operations.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

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

Our common stock was listed on the NYSE MKT (previously the American Stock Exchange) in January 2001 under the symbol "MCF". The table below shows the high and low closing prices of our common stock for the periods indicated.

	High	Low
Fiscal Year 2011:		
Quarter ended September 30, 2010	$51.28	$41.40
Quarter ended December 31, 2010	$59.91	$50.30
Quarter ended March 31, 2011	$63.24	$55.02
Quarter ended June 30, 2011	$64.19	$55.12
Fiscal Year 2012:		
Quarter ended September 30, 2011	$66.29	$53.40
Quarter ended December 31, 2011	$68.74	$52.89
Quarter ended March 31, 2012	$64.66	$57.66
Quarter ended June 30, 2012	$59.92	$51.82

On August 24, 2012, the closing price of our common stock on the NYSE MKT was $57.74 per share, and there were 15,292,448 shares of Contango common stock outstanding.

We have not declared any cash dividends on our shares of common stock. Any future decision to pay dividends on our common stock will be at the discretion of our board and will depend upon our financial condition, results of operations, capital requirements, and other factors our board may deem relevant.

The following table sets forth information about our equity compensation plans at June 30, 2012:

Plan Category	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (b))
1999 Stock Incentive Plan - approved by security holders	—	$—	—
2009 Equity Compensation Plan - approved by security holders	—	$—	1,475,000
Equity compensation plans not approved by security holders	—	$—	—

The Company's 1999 Stock Incentive Plan (the "1999 Plan") expired in August 2009. The final remaining outstanding options were net-settled with the Company in February 2012 and no options remain outstanding.

On September 15, 2009, the Company's Board of Directors (the "Board") adopted the Contango Oil & Gas Company Equity Compensation Plan (the "2009 Plan"), which was approved by shareholders on November 19, 2009. Under the 2009 Plan, the Board may grant restricted stock and option awards to officers, directors, employees or consultants of the Company. Awards made under the 2009 Plan are subject to such restrictions, terms and conditions, including forfeitures, if any, as may be determined by the Board. As of August 24, 2012, all options issued under the 2009 Plan had been exercised. The Company has not issued any restricted stock under the 2009 Plan.

During the fiscal year ended June 30, 2012, the Company net-settled 45,000 stock options from two employees for a total of approximately $465,000. During the fiscal year ended June 30, 2011, the Company purchased 172,544 shares of its common stock. Of this amount, 152,544 shares were purchased from three officers of the Company, one member of the Board, one employee, and one consultant for a total of approximately $8.9 million. During the fiscal year ended June 30, 2010, the Company purchased 115,454 shares of its common stock from three officers of the Company and two members of the Board

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for a total of approximately $6.4 million. All purchases were approved by the Board under the Company's share repurchase programs described below and were completed at the closing price of the Company's common stock on the date of purchase.

Share Repurchase Programs

$100 Million Share Repurchase Program

In September 2008, the Company's board of directors approved a $100 million share repurchase program which concluded in October 2011. All shares were purchased in the open market or through privately negotiated transactions. The purchases were made subject to market conditions and certain volume, pricing and timing restrictions to minimize the impact of the purchases upon the market. Repurchased shares of common stock became authorized but unissued shares, and may be issued in the future for general corporate and other purposes. During the fiscal year ended June 30, 2012, the Company purchased the below listed shares under its $100 million share repurchase program:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that may yet be Purchased Under Program
August 22 - 23, 2011	36,700	$54.91	1,922,141	$13.0 million
September 21 - 30, 2011	207,000	$55.64	2,129,141	$1.5 million
October 3, 2011	28,137	$54.09	2,157,278	—

$50 Million Share Repurchase Program

On September 28, 2011, the Company's Board of Directors approved the adoption of a $50 million share repurchase program, effective upon completion of purchases under the Company's $100 million share repurchase program. The repurchases will be subject to the same terms and conditions as repurchases made under the $100 million share repurchase program. During the fiscal year ended June 30, 2012, the Company purchased the below listed shares under its $50 million share repurchase program:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that may yet be Purchased Under Program
October 3 - 7, 2011	33,163	$54.38	33,163	$48.2 million
December 14, 2011	2,500	$57.21	35,663	$48.1 million
May 9 - 31, 2012	36,098	$53.56	71,761	$46.1 million
June 1 - 4, 2012	28,620	$51.92	100,381	$44.6 million

In addition to the above, in February 2012 the Company net-settled 45,000 stock options from two employees for a total of approximately $465,000. In total, under both share repurchase programs combined as of August 24, 2012, the Company had invested approximately $105.8 million to purchase 2,257,659 shares of its common stock at an average cost per share of $46.67, and 45,000 stock options. As of August 24, 2012, the Company had 15,292,448 shares of common stock outstanding and no options. Since inception, the Company has purchased approximately 5.0 million shares of stock and options at an average cost of $23.82 per share.

The following graph compares the yearly percentage change from June 30, 2007 until June 30, 2012 in the cumulative total stockholder return on our common stock to the cumulative total return on the S&P Smallcap 600 Index and a peer group of five independent oil and gas exploration companies selected by us. The companies in our selected peer group are ATP Oil & Gas Corp., Callon Petroleum, Energy XXI (Bermuda) Limited, McMoRan Exploration Company, and W&T Offshore, Inc. Our common stock began trading on the NYSE MKT (previously American Stock Exchange) on January 19, 2001 and before that had traded on the Nasdaq over-the-counter Bulletin Board. The graph assumes that a $100 investment was made in our common stock and each index on June 30, 2007, adjusted for stock splits and dividends. The stock performance for our common stock is not necessarily indicative of future performance.

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	6/30/2007	6/30/2008	6/30/2009	6/30/2010	6/30/2011	6/30/2012
Peer Group Composite	100	137	20	40	75	50
S&P 600	100	84	62	76	103	103
Contango Oil & Gas Co.	100	256	117	123	161	163

Item 6. Selected Financial Data

The selected consolidated financial data (not including proved reserve information) set forth below is for continuing operations and should be read in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and with the consolidated financial statements and notes to those consolidated financial statements included elsewhere in this Form 10-K.

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	Year Ended June 30,				
	2012	2011	2010	2009	2008
Financial Data:	(Dollar amounts in thousands, except per share amounts)				
Revenues:					
Natural gas and oil sales	$179,272	$201,721	$159,010	$190,656	$116,498
Total revenues	$179,272	$201,721	$159,010	$190,656	$116,498
Income from continuing operations	$59,213	$64,459	$50,166	$55,861	$83,221
Discontinued operations, net of income taxes	(824)	574	(480)	—	173,685
Net income	$58,389	$65,033	$49,686	$55,861	$256,906
Preferred stock dividends	—	—	—	—	1,548
Net income attributable to common stock	$58,389	$65,033	$49,686	$55,861	$255,358
Net income (loss) per share:					
Basic					
Continuing operations	$3.84	$4.11	$3.17	$3.41	$5.05
Discontinued operations	(0.05)	0.04	(0.03)	—	10.73
Total	$3.79	$4.15	$3.14	$3.41	$15.78
Diluted					
Continuing operations	$3.84	$4.10	$3.11	$3.35	$4.82
Discontinued operations	(0.05)	0.04	(0.03)	—	10.06
Total	$3.79	$4.14	$3.08	$3.35	$14.88
Weighted average shares outstanding:					
Basic	15,423	15,665	15,831	16,363	16,185
Diluted	15,425	15,713	16,157	16,690	17,263

				million	
Exercisable at June 30, 2014	3,749,438	$13.45	2.5 years	$20.0	million
Exercisable at June 30, 2013	4,593,210	$12.62	2.9 years	$26.6	million

(a) The aggregate intrinsic value in this table was calculated based on the positive difference, if any, between the closing market value of our common stock on June 30, 2014 ($18.77) and the exercise price of the underlying options.

The weighted-average intrinsic value of stock options exercised during the nine months ended June 30, 2014 and 2013 was $3.1 million and $20.2 million, respectively.

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

Restricted Units

Restricted Units are not included in issued and outstanding common stock until the shares are vested and released. The purchase price for vested Restricted Units is $0.001 per share. The table below summarizes activity relating to Restricted Units for the nine months ended June 30, 2014:

	Number of Shares Underlying Restricted Units — Contingent Awards	Number of Shares Underlying Restricted Units — Time-Based Awards
Outstanding at September 30, 2013	5,587,181	9,095,424
Granted	2,952,869	6,795,172
Earned/released	(782,689)	(4,715,473)
Forfeited	(1,914,529)	(1,122,886)
Outstanding at June 30, 2014	5,842,832	10,052,237
Weighted average remaining recognition period of outstanding Restricted Units	1.7 years	1.8 years
Unearned stock-based compensation expense of outstanding Restricted Units	$80.1 million	$122.2 million
Aggregate intrinsic value of outstanding Restricted Units(a)	$109.7 million	$188.8 million

(a) The aggregate intrinsic value in this table was calculated based on the positive difference between the closing market value of our common stock on June 30, 2014 ($18.77) and the purchase price of the underlying Restricted Units.

A summary of weighted-average grant-date fair value for awards granted and intrinsic value of all Restricted Units vested during the periods noted is as follows:

	Nine Months Ended June 30,	
	2014	2013
Weighted-average grant-date fair value per share	$15.39	$21.79
Total intrinsic value of shares vested (in millions)	$82.7	$129.4

Restricted Stock Awards

Restricted Stock Awards are included in the issued and outstanding common stock at the date of grant. The table below summarizes activity related to Restricted Stock Awards for the nine months ended June 30, 2014:

	Number of Shares Underlying Restricted Stock	Weighted Average Grant Date Fair Value
Outstanding at September 30, 2013	1,000,000	$24.06
Granted	250,000	$15.71
Vested	(250,000)	$25.80
Outstanding at June 30, 2014	1,000,000	$21.54
Weighted average remaining recognition period of outstanding Restricted Awards	1.1 years	
Unearned stock-based compensation expense of outstanding Restricted Awards	$12.6 million	
Aggregate intrinsic value of outstanding Restricted Awards	$18.8 million	

A summary of weighted-average grant-date fair value for awards granted and intrinsic value of all Restricted Stock Awards vested during the periods noted is as follows:

	Nine Months Ended June 30,	
	2014	2013
Weighted-average grant-date fair value per share	$15.71	$22.32

Total intrinsic value of shares vested (in millions)	$3.9	$5.3

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15. Income Taxes

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

	Three months Ended June 30,		Nine Months Ended June 30,	
	2014	2013	2014	2013
Domestic	$4,710	$25,712	$8,505	$8,136
Foreign	2,249	1,278	7,826	10,967
Provision for income taxes	$6,959	$26,990	$16,331	$19,103
Effective tax rate	(14.7)%	(338.1)%	(12.3)%	(29.9)%

The effective income tax rate was (14.7)% and (12.3)% for the three and nine months ended June 30, 2014, respectively. Our current effective tax rate differs from the U.S. federal statutory rate of 35% primarily due to earnings in foreign operations which are subject to a significantly lower tax rate than the U.S. statutory tax rate, driven primarily by our subsidiaries in Ireland. The effective tax rate for the three and nine months ended June 30, 2014 included the impact of $1.0 million and ($2.8) million, respectively, in adjustments to the domestic valuation allowance as a result of acquisitions.

The effective income tax rate was (338.1)% and (29.9)% for the three and nine months ended June 30, 2013, respectively. The difference in the effective tax rate in fiscal 2013 as compared to the U.S. federal statutory rate of 35% was primarily driven by the establishment of a valuation allowance related to our net domestic deferred tax assets for which we concluded that the recoverability of the net assets was not more likely than not during the third quarter of fiscal 2013.

Our effective income tax rate is based upon the income for the year, the composition of income in different countries, changes relating to valuation allowances for certain countries if and as necessary, 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.

At June 30, 2014 and September 30, 2013, the liability for income taxes associated with uncertain tax positions was $21.1 million and $19.6 million, respectively, and is included in other long term liabilities. If these benefits were recognized, they would favorably impact the effective tax rate. We do not expect a significant change in the amount of unrecognized tax benefits within the next twelve months.

16. Commitments and Contingencies

Litigation and Other Claims

Like many companies in the software industry, we have, from time to time, been notified of claims that we may be infringing on, or contributing to the infringement of, the intellectual property rights of others. These claims have been referred to counsel, and they are in various stages of evaluation and negotiation. If it appears necessary or desirable, we may seek licenses for these intellectual property rights. There is no assurance that licenses will be offered by all claimants, that the terms of any offered licenses will be acceptable to us or that in all cases the dispute will be resolved without litigation, which may be time consuming and expensive, and may result in injunctive relief or the payment of damages by us.

We do not believe that the resolution of any such claim or litigation will have a material adverse effect on our financial position and results of operations. However, resolution of any such claim or litigation could require significant management time and adversely impact our operating results, financial position and cash flows.

Guarantees and Other

We include indemnification provisions in the contracts we enter into 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.

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

We indemnify our directors and officers to the fullest extent permitted by law. These agreements, among other things, indemnify 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 have 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 periods. To the extent that we do not purchase a director and officer insurance policy for the full period of any contractual indemnification, we would be required to pay for costs incurred, if any, as described above.

17. Segment and Geographic Information

We operate in, and report financial information for, the following four reportable segments: Healthcare, Mobile and Consumer, Enterprise and Imaging. Segment profit is an important measure used for evaluating performance and for decision-making purposes and reflects the direct controllable costs of each segment together with an allocation of sales and corporate marketing expenses, and certain research and development project costs that benefit multiple product offerings. Segment profit represents income from operations excluding stock-based compensation, amortization of intangible assets, acquisition-related costs (income), net, restructuring and other charges, net, costs associated with intellectual property collaboration agreements, other income (expense), net and certain unallocated corporate expenses.

We do not track our assets by operating segment; consequently, it is not practical to show assets or depreciation by operating segment. The following table presents segment results along with a reconciliation of segment profit to loss before income taxes (dollars in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2014	2013	2014	2013
Segment revenues(a):				
Healthcare	$240,099	$238,168	$704,382	$684,939
Mobile and Consumer	109,161	110,991	334,205	358,895
Enterprise	85,103	78,866	261,505	237,048
Imaging	52,451	62,769	166,740	186,359
Total segment revenues	486,814	490,794	1,466,832	1,467,241
Acquisition-related revenues	(11,310)	(21,025)	(45,695)	(84,205)
Total consolidated revenues	475,504	469,769	1,421,137	1,383,036
Segment profit:				
Healthcare	84,916	94,779	254,853	273,540
Mobile and Consumer	20,522	32,153	51,812	108,634
Enterprise	17,501	20,026	55,714	55,094
Imaging	16,887	24,990	60,271	75,614
Total segment profit	139,826	171,948	422,650	512,882
Corporate expenses and other, net	(25,292)	(40,361)	(86,624)	(96,670)
Acquisition-related revenues and cost of revenues adjustment	(10,450)	(19,334)	(42,319)	(77,439)
Stock-based compensation	(55,382)	(39,195)	(147,541)	(114,108)
Amortization of intangible assets	(42,293)	(42,490)	(126,872)	(126,837)
Acquisition-related (costs) income, net	(9,110)	8,458	(18,710)	(22,723)
Restructuring and other charges, net	(8,622)	(7,940)	(17,178)	(14,669)
Costs associated with IP collaboration agreements	(4,937)	(4,937)	(14,811)	(15,645)
Other expense, net	(31,028)	(34,133)	(101,151)	(108,606)

Loss before income taxes	$(47,288)	$(7,984)	$(132,556)	$(63,815)

(a) Segment revenues differ from reported revenues due to certain revenue adjustments related to acquisitions that would otherwise have been recognized but for the purchase accounting treatment of the business combinations. Segment revenues

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also include revenue that the business would have otherwise recognized had we not acquired intellectual property and other assets from the same customer. These revenues are included to allow for more complete comparisons to the financial results of historical operations and in evaluating management performance.

No country outside of the United States provided greater than 10% of our total revenue. Revenue, classified by the major geographic areas in which our customers are located, was as follows (dollars in thousands):

	Three months ended June 30,		Nine months ended June 30,	
	2014	2013	2014	2013
United States	$350,363	$338,432	$1,040,135	$1,003,024
International	125,141	131,337	381,002	380,012
Total revenues	$475,504	$469,769	$1,421,137	$1,383,036

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations
The following Management's Discussion and Analysis is intended to help the reader understand the results of operations and financial condition of our business. Management's Discussion and Analysis is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying notes to the condensed consolidated financial statements.
CAUTIONARY NOTE CONCERNING FORWARD-LOOKING STATEMENTS
This Quarterly Report on Form 10-Q including the sections entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Quantitative and Qualitative Disclosure About Market Risk" under Items 2 and 3, respectively, of Part I of this report, and the sections entitled "Legal Proceedings" and "Risk Factors," under Items 1 and 1A, respectively, of Part II of this report, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve risks, uncertainties and assumptions that, if they never materialize or if they prove incorrect, could cause our consolidated results to differ materially from those expressed or implied by such forward-looking statements. These forward-looking statements include predictions regarding:

- our future bookings, revenues, cost of revenues, research and development expenses, selling, general and administrative expenses, amortization of intangible assets and gross margin;
- our strategy relating to our segments;
- market trends;
- technological advancements;
- the potential of future product releases;
- our product development plans and the timing, amount and impact of investments in research and development;
- future acquisitions, and anticipated benefits from acquisitions;
- international operations and localized versions of our products; and
- the conduct, timing and outcome of legal proceedings and litigation matters.

You can identify these and other forward-looking statements by the use of words such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "intends," "potential," "continue" or the negative of such terms, or o comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks described in Item 1A — "Risk Factors" and elsewhere in this Quarterly Report on Form 10-Q.
You should not place undue reliance on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document.
OVERVIEW
Business Overview
We are a leading provider of voice and language solutions for businesses and consumers around the world. Our solutions are used in the healthcare, mobile, consumer, enterprise customer service, and imaging markets. We are seeing several trends in our markets, including (i) the growing adoption of cloud-based, connected services and highly interactive mobile applications, (ii) deeper integration of virtual assistant capabilities and services, and (iii) the continued expansion of our core technology portfolio from speech recognition to natural language understanding, semantic processing, domain-specific reasoning and dialog management capabilities.

- Healthcare. Trends in our healthcare business include continuing customer preference for hosted solutions and other time-based licenses, and increasing interest in the use of mobile devices to access healthcare systems and records. We continue to see strong demand for transactions which involve the sale and delivery of both software and non-software related services or products, as well as transactions which involve the sale of multiple solutions, such as both hosted transcription services and Dragon Medical licenses. Although the volume processed in our hosted transcription services has steadily increased due to the expanding customer base, we have experienced some erosion in lines processed when customers adopt electronic medical record (EMR) systems, and when in some cases customers use our licensed Dragon Medical product to support input into the EMR. We believe an important trend in the healthcare market is the desire to

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improve efficiency in the coding and revenue cycle management process. Our solutions reduce costs by increasing automation of this important workflow, and also enable hospitals to improve documentation used to support billings. In addition to improved efficiency, there is an impending change in the industry coding standard from ICD-9 to ICD-10, which will significantly increase the number of possible codes, and therefore, increase the complexity of this process, which in turn reinforces our customers' desire for improved efficiency. We are investing to expand our product set to address the various healthcare opportunities, including deeper integration with our clinical documentation solutions, as well as expand our international capabilities, and reduce our time from contract signing to initiation of billable services.

- Mobile and Consumer. Trends in our mobile and consumer segment include device manufacturers requiring custom applications to deliver unique and differentiated products such as virtual assistants, broadening keyboard technologies to take advantage of touch screens, increasing hands-free capabilities on cell phones and in automobiles, the adoption of our technology on a broadening scope of devices, such as televisions, set-top boxes, e-book readers, tablet and laptop computers, cameras and third-party applications and away from consumer software. The more powerful capabilities of mobile devices require us to supply a broader set of technologies to support the increasing scope and complexity of the solutions. These technologies include cloud-based speech recognition, natural language understanding, dialog management, text-to-speech and enhanced text input, where the complexity of the technologies allow us to charge a higher price. Within given levels of our technology set, we have seen pricing pressures from our OEM partners in our mobile handset business. We continue to see strong demand involving the sale and delivery of both software and non-software related services, as well as products to help customers define, design and implement increasingly robust and complex custom solutions such as virtual assistants. We continue to see an increasing proportion of revenue from on-demand and transactional arrangements as opposed to traditional upfront licensing of our mobile products and solutions. Although this has a negative impact on near-term revenue, we believe this model will build stronger and more predictable revenues over time. We are investing to increase our capabilities and capacity to help device manufacturers build custom applications, to increase the capacity of our data centers, to increase the number, kinds and capacity of network services, to enable developers to access our technology, and to expand both awareness and channels for our direct-to-consumer products.

- Enterprise. Trends in our enterprise business include increasing interest in the use of mobile applications and web sites to access customer care systems and records, voice-based authentication of users, increasing interest in coordinating actions and data across customer care channels, and the ability of a broader set of hardware providers and systems integrators to serve the market. We are investing to expand our product set to address these opportunities, to increase efficiency of our hosted applications, expand our capabilities and capacity to help customers build custom applications, and broaden our relationships with new hardware and systems integrator partners serving the market.

- Imaging. The imaging market is evolving to include more networked solutions, mobile access to networked solutions, multi-function devices, and away from packaged software. We expect to expand our traditional packaged software sales with subscription versions. We are investing to improve mobile access to our networked products, expand our distribution channels and embedding relationships, and expand our language coverage.

Confronted by dramatic increases in electronic information, consumers, business personnel and healthcare professionals must use a variety of resources to retrieve information, transcribe patient records, conduct transactions and perform other job-related functions. We believe that the power of our solutions can transform the way people use the Internet, telecommunications systems, electronic medical records, wireless and mobile networks and related corporate infrastructure to conduct business.

Strategy

During fiscal 2014, we continued to focus on growth by providing market-leading, value-added solutions for our customers and partners through a broad set of technologies, service offerings and channel capabilities. We have increased our focus on operating efficiencies, expense and hiring discipline and acquisition synergies to improve gross margins and operating margins. We intend to continue to pursue growth through the following key elements of our strategy:

- Extend Technology Leadership. Our solutions are recognized as among the best in their respective categories. We intend to leverage our global research and development organization, and our broad portfolio of technologies, applications and intellectual property to foster technological innovation and to maintain customer preference for our solutions. We also intend to invest further in our engineering resources and to seek new technological advancements that further expand the addressable markets for our solutions.

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- Broaden Expertise in Vertical Markets. Businesses are increasingly turning to us for comprehensive solutions rather than for a single technology product. We intend to broaden our expertise and capabilities to continue to deliver targeted solutions for a range of industries including mobile device manufacturers, healthcare, telecommunications, financial services and government administration. We also intend to expand our global sales and professional services capabilities to help our customers and partners design, integrate and deploy innovative solutions.
- Increase Subscription and Transaction Based Recurring Revenue. We intend to increase our subscription and transaction based offerings in all of our segments. This will enable us to deliver applications that our customers use, and pay for, on a repeat basis, providing us with the opportunity to enjoy the benefits of recurring revenue streams.
- Expand Global Presence. We intend to further expand our international resources to better serve our global customers and partners and to leverage opportunities in established markets such as Europe, and also emerging markets within Asia and Latin America. We continue to add regional executives and sales employees across geographic regions to better address demand for voice and language based solutions and services.
- Pursue Strategic Acquisitions and Partnerships. We have selectively pursued strategic acquisitions to expand our technology, solutions and resources, and to complement our organic growth. We use these acquisitions to deliver enhanced value to our customers, partners, employees and shareholders. We intend to continue to pursue acquisitions that enhance our solutions, serve specific vertical markets and strengthen our technology portfolio. We have, however, recently slowed the pace and reduced the size of acquisitions to focus our resources more on driving organic growth. We also have formed key partnerships with other important companies in our markets of interest, and intend to continue to do so in the future where it will enhance the value of our business.

Key Metrics

In evaluating the financial condition and operating performance of our business, management focuses on revenues, net income, gross margins, operating margins and cash flow from operations. A summary of these key financial metrics for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, is as follows:

- Total revenues increased by $38.1 million to $1,421.1 million;
- Net loss increased by $66.0 million to a loss of $148.9 million;
- Gross margins decreased by 3.5 percentage points to 55.4%;
- Operating margins decreased by 5.4 percentage points to (2.2)%; and
- Cash provided by operating activities decreased by $39.3 million to $262.2 million.

In addition to the above key financial metrics, we also focus on certain operating metrics. A summary of these key operating metrics as of June 30, 2014, as compared to June 30, 2013, is as follows:

- Annualized line run-rate in our on-demand healthcare solutions increased 6% from one year ago to approximately 5.5 billion lines per year. The annualized line run-rate is determined using billed equivalent line counts in a given quarter, multiplied by four;
- Bookings increased 17% from one year ago to $547.0 million. Bookings growth was led by our Mobile Auto, voicemail-to-text, and Enterprise on-demand offerings, offset by lower bookings in our Imaging MFP, Mobile Handset and Dragon Consumer products. Bookings represent the estimated gross revenue value of transactions at the time of contract execution, except for maintenance and support offerings. For fixed price contracts, the bookings value represents the gross total contract value. For contracts where revenue is based on transaction volume, the bookings value represents the contract price multiplied by the estimated future transaction volume during the contract term, whether or not such transaction volumes are guaranteed under a minimum commitment clause. Actual results could be different than our initial estimate. The maintenance and support bookings value represents the amounts billed in the period the customer is invoiced. Because of the inherent estimates required to determine bookings and the fact that the actual resultant revenue may differ from our initial bookings estimates, we consider bookings one indicator of potential future revenue and not as an arithmetic measure of backlog; and
- Estimated three-year value of on-demand contracts increased 8% from one year ago to approximately $2.3 billion. We expect that an increasing portion of our revenue will come from on-demand services. We determine this value as of the end of the period reported, by using our best estimate of three years of anticipated future revenue streams under signed on-demand contracts then in place, whether or not they are guaranteed through

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a minimum commitment clause. Our best estimate is based on estimates used in evaluating the contracts and determining sales compensation, adjusted for changes in estimated launch dates, actual volumes achieved and other factors deemed relevant. For contracts with an expiration date beyond three years, we include only the value expected within three years. For other contracts, we assume renewal consistent with historic renewal rates unless there is a known cancellation. Contracts are generally priced by volume of usage and typically have no or low minimum commitments. Actual revenue could vary from our estimates due to factors such as cancellations, non-renewals or volume fluctuations.

RESULTS OF OPERATIONS

Total Revenues

The following tables show total revenues by product type and by geographic location, based on the location of our customers, in dollars and percentage change (dollars in millions):

	Three months ended June 30, 2014	Three months ended June 30, 2013	Dollar Change	Percent Change	Nine months ended June 30, 2014	Nine months ended June 30, 2013	Dollar Change	Percent Change
Product and licensing	$168.2	$191.6	$(23.4)	(12.2)%	$521.5	$561.3	$(39.8)	(7.1)%
Professional services and hosting	231.7	210.4	21.3	10.1%	677.3	624.0	53.3	8.5%
Maintenance and support	75.6	67.8	7.8	11.5%	222.3	197.7	24.6	12.4%
Total Revenues	$475.5	$469.8	$5.7	1.2%	$1,421.1	$1,383.0	$38.1	2.8%
United States	$350.4	$338.4	$12.0	3.5%	$1,040.1	$1,003.0	$37.1	3.7%
International	125.1	131.4	(6.3)	(4.8)%	381.0	380.0	1.0	0.3%
Total Revenues	$475.5	$469.8	$5.7	1.2%	$1,421.1	$1,383.0	$38.1	2.8%

The geographic split for the three months ended June 30, 2014, was 74% of total revenues in the United States and 26% internationally, compared to 72% of total revenues in the United States and 28% internationally for the same period last year. The geographic split for the nine months ended June 30, 2014, was essentially flat as compared to the same period last year with 73% of total revenues in the United States and 27% internationally.

Product and Licensing Revenue

Product and licensing revenue primarily consists of sales and licenses of our technology. The following table shows product and licensing revenue, in dollars and as a percentage of total revenues (dollars in millions):

	Three months ended June 30, 2014	Three months ended June 30, 2013	Dollar Change	Percent Change	Nine months ended June 30, 2014	Nine months ended June 30, 2013	Dollar Change	Percent Change
Product and licensing revenue	$168.2	$191.6	$(23.4)	(12.2)%	$521.5	$561.3	$(39.8)	(7.1)%
As a percentage of total revenue	35.4%	40.8%			36.7%	40.6%		

The decrease in product and licensing revenue for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, consisted of an $8.1 million decrease in Imaging, a $7.2 million decrease in Enterprise, and a $6.1 million decrease in Mobile and Consumer. The decrease in Imaging revenue was due to lower sales of our multi-functional peripheral products as well as reduced demand for packaged software. The decrease in Enterprise revenue was primarily driven by lower sales of on-premise solutions. The decrease in Mobile and Consumer includes the impact of lower sales in Dragon desktop consumer products in advance of the July 2014 launch of Dragon NaturallySpeaking 13.

The decrease in product and licensing revenue for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, consisted of a $34.7 million decrease in Mobile and Consumer revenue, and a $16.4 million decrease in Enterprise revenue. The decrease in Mobile and Consumer revenue was driven by a $17.5 million decrease in sales of our embedded licenses, resulting from a continuing shift toward on-demand and ratable pricing models, together with a decrease of $16.8 million in Dragon desktop consumer products in advance of the July 2014 launch of Dragon NaturallySpeaking13 and an overall weakness in desktop software sales. The decrease in Enterprise revenues was primarily driven by lower sales of on-premise solutions. These decreases were offset by a $14.8 million increase in Healthcare revenue, including an $11.6 million increase in sales of our Clintegrity solutions, together with a $5.9 million increase in sales of Dragon Medical licenses.

As a percentage of total revenue, product and licensing revenue decreased from 40.6% to 36.7% for the nine months ended June 30, 2014. This decrease was driven by lower sales of embedded licenses in our Mobile and Consumer segment, resulting

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from a continuing shift toward on-demand and hosting services. Within product and licensing revenue, we are also seeing more term-based, subscription and transactional pricing models, which are recognized over time. In addition, the decrease includes the impact of our recent acquisitions, which have a higher proportion of on-demand hosting revenue. We expect this trend to continue through the remainder of fiscal 2014.

Professional Services and Hosting Revenue

Professional services revenue primarily consists of consulting, implementation and training services for customers. Hosting revenue primarily relates to delivering on-demand hosted services, such as medical transcription, automated customer care applications, voice message transcription, and mobile infotainment, search and transcription, over a specified term. The following table shows professional services and hosting revenue, in dollars and as a percentage of total revenues (dollars in millions):

	Three months ended June 30,		Dollar Change	Percent Change	Nine months ended June 30,		Dollar Change	Percent Change
	2014	2013			2014	2013		
Professional services and hosting revenue	$231.7	$210.4	$21.3	10.1 %	$677.3	$624.0	$53.3	8.5%
As a percentage of total revenue	48.7 %	44.8 %			47.7 %	45.1 %		

The increase in professional services and hosting revenue for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, consisted of an $11.4 million increase in our Enterprise revenue and a $5.3 million increase in our Healthcare revenue primarily driven by our recent acquisitions. Mobile and Consumer revenue increased $4.4 million resulting from a continuing shift toward on-demand and hosting services.

The increase in professional services and hosting revenue for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, included a $32.0 million increase in Enterprise revenue primarily driven by our recent acquisitions. Healthcare revenue increased $12.7 million driven by a $7.4 million increase in revenues from our Clintegrity product line and a $5.3 million increase in revenues from our Clinical Documentation Solutions. The revenue increase in our Clinical Documentation Solutions included $19.7 million of revenues from acquisitions, partially offset by the negative impact from the continued erosion resulting from customers' migration to electronic medical records.

As a percentage of total revenue, professional services and hosting revenue increased from 45.1% to 47.7% for the nine months ended June 30, 2014. This increase was driven by our recent Healthcare and Enterprise acquisitions, which have a higher proportion of professional services and hosting revenue. The increase also includes the continuing shift toward on-demand and hosting services in our Mobile and Consumer segment. We expect this revenue mix shift to continue through the remainder of fiscal 2014.

Maintenance and Support Revenue

Maintenance and support revenue primarily consists of technical support and maintenance services. The following table shows maintenance and support revenue, in dollars and as a percentage of total revenues (dollars in millions):

	Three months ended June 30,		Dollar Change	Percent Change	Nine months ended June 30,		Dollar Change	Percent Change
	2014	2013			2014	2013		
Maintenance and support revenue	$75.6	$67.8	$7.8	11.5 %	$222.3	$197.7	$24.6	12.4%
As a percentage of total revenue	15.9 %	14.4 %			15.6 %	14.3 %		

The increase in maintenance and support revenue for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, resulted from strong maintenance renewals, including a $3.7 million increase in Imaging, together with an increase of $2.9 million in Healthcare revenue driven by sales of our Dragon Medical solutions.

The increase in maintenance and support revenue for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, resulted from strong maintenance renewals in all of our segments, including an $8.9

million increase in Healthcare revenue driven by sales of Dragon Medical solutions, together with an increase of $8.5 million in Imaging revenues.

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Costs and Expenses

Cost of Product and Licensing Revenue

Cost of product and licensing revenue primarily consists of material and fulfillment costs, manufacturing and operations costs and third-party royalty expenses. The following table shows the cost of product and licensing revenue, in dollars and as a percentage of product and licensing revenue (dollars in millions):

	Three months ended June 30, 2014	2013	Dollar Change	Percent Change	Nine months ended June 30, 2014	2013	Dollar Change	Percent Change
Cost of product and licensing revenue	$23.9	$25.8	$(1.9)	(7.4)%	$74.6	$75.1	$(0.5)	(0.7)%
As a percentage of product and licensing revenue	14.2 %	13.5 %			14.3 %	13.4 %		

The decrease in cost of product and licensing revenue for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, consisted of a $3.0 million decrease in Imaging costs primarily driven by lower Imaging revenue. Gross margins decreased 0.7 percentage points primarily driven by lower revenues from higher margin license products in our Enterprise business.

The decrease in cost of product and licensing revenue for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, consisted of a $2.5 million reduction in Imaging costs due to lower revenue and a $2.1 million reduction in Mobile and Consumer costs, primarily driven by lower sales of our Dragon desktop consumer products. The decrease in expense was offset by a $2.5 million increase in Healthcare costs primarily driven by higher sales of our Dragon Medical products and Clintegrity solutions. Gross margins decreased 0.9 percentage points, primarily driven by lower revenues from higher margin license products in our Enterprise and Mobile and Consumer businesses.

Cost of Professional Services and Hosting Revenue

Cost of professional services and hosting revenue primarily consists of compensation for services personnel, outside consultants and overhead, as well as the hardware, infrastructure and communications fees that support our hosting solutions. The following table shows the cost of professional services and hosting revenue, in dollars and as a percentage of professional services and hosting revenue (dollars in millions):

	Three months ended June 30, 2014	2013	Dollar Change	Percent Change	Nine months ended June 30, 2014	2013	Dollar Change	Percent Change
Cost of professional services and hosting revenue	$163.6	$140.4	$23.2	16.5 %	$475.6	$404.1	$71.5	17.7%
As a percentage of professional services and hosting revenue	70.6 %	66.7 %			70.2 %	64.8 %		

The increase in the cost of professional services and hosting revenue for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, was due to a $7.3 million increase in Enterprise costs driven by our recent acquisitions. Healthcare costs increased $6.1 million as a result of recent acquisitions and higher transcription related costs. Mobile and Consumer costs increased $5.6 million driven by investment in our connected services infrastructure, as we continue to fund an increasing volume of large-scale engagements in our mobile business where the demand for advanced, cloud-based services continues to grow. In addition, stock-based compensation expense increased $5.1 million over the prior period. Performance-based awards and annual bonuses were lower in the prior period as a result of weaker than planned operating results. Gross margins decreased 3.9 percentage points primarily driven by growth in transcription related costs in our Healthcare segment as well as investment in our connected services infrastructure in our Mobile business. In addition, increased stock-based compensation expense impacted gross margins by 2.2 percentage points.

The increase in the cost of professional services and hosting revenue for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, was due to a $22.7 million increase in Healthcare costs as a result of recent acquisitions and higher transcription related costs. Mobile and Consumer costs increased $22.6 million driven by investment in our connected services infrastructure, as we continue to fund an increasing volume of large-scale engagements in our Mobile business, where the demand for advanced, cloud-based services continues to grow. Our Enterprise costs also increased $13.6 million driven by our recent acquisitions. In addition, stock-based compensation expense increased $12.0 million over the prior period. Performance-based awards and annual bonuses were lower in the prior period as a result of weaker than planned operating results. Gross margins

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decreased 5.4 percentage points primarily driven by investment in our connected services infrastructure in our Mobile business, as well as growth in transcription related costs in our Healthcare segment. We expect this trend to continue through the remainder of fiscal 2014. In addition, increased stock-based compensation expense reduced gross margins by 1.8 percentage points.

Cost of Maintenance and Support Revenue

Cost of maintenance and support revenue primarily consists of compensation for product support personnel and overhead. The following table shows the cost of maintenance and support revenue, in dollars and as a percentage of maintenance and support revenue (dollars in millions):

	Three months ended June 30, 2014	2013	Dollar Change	Percent Change	Nine months ended June 30, 2014	2013	Dollar Change	Percent Change
Cost of maintenance and support revenue	$13.6	$12.6	$1.0	7.9 %	$38.5	$40.5	$(2.0)	(4.9)%
As a percentage of maintenance and support revenue	18.0 %	18.6 %			17.3 %	20.5 %		

The increase in the cost of maintenance and support revenue for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, was primarily due to a $0.7 million increase in stock-based compensation, together with a $0.4 million increase in Imaging costs driven by higher sales. Gross margins increased 0.6 percentage points.

The decrease in the cost of maintenance and support revenue for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, was primarily due to a $1.1 million decrease in Imaging costs together with a reduction in Healthcare costs of $0.6 million. Gross margins increased 3.2 percentage points driven by cost improvements in all of our businesses.

Research and Development Expense

Research and development expense primarily consists of salaries, benefits, and overhead relating to engineering staff as well as third party engineering costs. The following table shows research and development expense, in dollars and as a percentage of total revenues (dollars in millions):

	Three months ended June 30, 2014	2013	Dollar Change	Percent Change	Nine months ended June 30, 2014	2013	Dollar Change	Percent Change
Research and development expense	$87.1	$73.1	$14.0	19.2 %	$252.2	$211.5	$40.7	19.2%
As a percentage of total revenue	18.3 %	15.6 %			17.7 %	15.3 %		

The increase in research and development expense for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, was primarily attributable to a $10.7 million increase in compensation expense, driven by headcount growth, including additional headcount from our recent acquisitions, together with a $4.3 million increase in stock-based compensation expense. Performance-based awards and annual bonuses were lower in the prior period as a result of weaker than planned operating results.

The increase in research and development expense for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, was primarily attributable to a $28.4 million increase in compensation expense, driven by headcount growth, including additional headcount from our recent acquisitions, together with an $11.2 million increase in stock-based compensation expense. Performance-based awards and annual bonuses were lower in the prior year as a result of weaker than planned operating results. We have increased investment in research and development expense to fund cloud-based speech systems and natural language understanding advancements to extend our technology capabilities.

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Sales and Marketing Expense

Sales and marketing expense includes salaries and benefits, commissions, advertising, direct mail, public relations, tradeshow costs and other costs of marketing programs, travel expenses associated with our sales organization and overhead. The following table shows sales and marketing expense, in dollars and as a percentage of total revenues (dollars in millions):

	Three months ended June 30,		Dollar Change	Percent Change	Nine months ended June 30,		Dollar Change	Percent Change
	2014	2013			2014	2013		
Sales and marketing expense	$99.8	$98.9	$0.9	0.9 %	$317.0	$313.9	$3.1	1.0 %
As a percentage of total revenue	21.0 %	21.1 %			22.3 %	22.7 %		

The increase in sales and marketing expense for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, was primarily attributable to a $2.3 million increase in compensation expense, including commission expense. The increase in compensation expense was driven primarily by headcount growth, including additional headcount from our recent acquisitions. The increase was offset by a reduction of $1.7 million in travel expenses.

The increase in sales and marketing expense for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, was primarily attributable to a $10.6 million increase in compensation expense, including commission expense. The increase in compensation expense was driven primarily by headcount growth, including additional headcount from our recent acquisitions. The increase was offset by a decrease of $3.0 million in stock-based compensation expense, a decrease of $2.9 million in marketing and channel program spending and a decrease of $1.8 million in travel expenses.

General and Administrative Expense

General and administrative expense primarily consists of personnel costs for administration, finance, human resources, general management, fees for external professional advisers including accountants and attorneys, and provisions for doubtful accounts. The following table shows general and administrative expense, in dollars and as a percentage of total revenues (dollars in millions):

	Three months ended June 30,		Dollar Change	Percent Change	Nine months ended June 30,		Dollar Change	Percent Change
	2014	2013			2014	2013		
General and administrative expense	$43.7	$50.8	$(7.1)	(14.0)%	$131.9	$128.9	$3.0	2.3%
As a percentage of total revenue	9.2 %	10.8 %			9.3 %	9.3 %		

The decrease in general and administrative expense for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, was primarily attributable to a $6.3 million decrease in our outside professional services expense and a $4.6 million decrease in contribution expense. The decrease in expense was offset by a $5.6 million increase in stock-based compensation expense. Performance-based awards and annual bonuses were lower in the prior period as a result of weaker than planned operating results.

The increase in general and administrative expense for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, was primarily attributable to a $13.2 million increase in stock-based compensation expense. Performance-based awards and annual bonuses were lower in the prior year as a result of weaker than planned operating results. The increase in expense was offset by a $4.6 million decrease in contribution expense and a $3.6 million decrease in outside professional services expense.

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Amortization of Intangible Assets

Amortization of acquired patents and core and completed technology are included in cost of revenue and the amortization of acquired customer and contractual relationships, non-compete agreements, acquired trade names and trademarks, and other intangibles are included in operating expenses. Customer relationships are amortized on an accelerated basis based upon the pattern in which the economic benefits of the customer relationships are being realized. Other identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives. Amortization expense was recorded as follows (dollars in millions):

	Three months ended June 30,		Dollar Change	Percent Change	Nine months ended June 30,		Dollar Change	Percent Change
	2014	2013			2014	2013		
Cost of revenue	$15.0	$15.2	$(0.2)	(1.3)%	$45.5	$48.1	$(2.6)	(5.4)%
Operating expenses	27.3	27.3	—	—%	81.3	78.7	2.6	3.3%
Total amortization expense	$42.3	$42.5	$(0.2)	(0.5)%	$126.8	$126.8	$—	—%
As a percentage of total revenue	8.9%	9.0%			8.9%	9.2%		

The increase in amortization of intangible assets in our operating expenses for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, was primarily attributable to the amortization of acquired intangible assets from our acquisitions during the period that have higher relative allocations of fair value to customer relationships. The decrease in amortization of intangible assets in our cost of revenue for the three and nine months ended June 30, 2014 was primarily attributable to certain intangible assets becoming fully amortized in the period.

Acquisition-Related Costs, Net

Acquisition-related costs include those costs related to business and other acquisitions, including potential acquisitions. These costs consist of (i) transition and integration costs, including retention payments, transitional employee costs and earn-out payments treated as compensation expense, as well as the costs of integration-related services provided by third-parties; (ii) professional service fees, including third-party costs related to the acquisition, and legal and other professional service fees associated with disputes and regulatory matters related to acquired entities; and (iii) adjustments to acquisition-related items that are required to be marked to fair value each reporting period, such as contingent consideration, and other items related to acquisitions for which the measurement period has ended. Acquisition-related costs were recorded as follows (dollars in millions):

	Three months ended June 30,		Dollar Change	Percent Change	Nine months ended June 30,		Dollar Change	Percent Change
	2014	2013			2014	2013		
Transition and integration costs	$5.6	$6.0	$(0.4)	(6.7)%	$14.0	$23.9	$(9.9)	(41.4)%
Professional service fees	3.4	3.4	—	—%	9.1	16.7	(7.6)	(45.5)%
Acquisition-related adjustments	0.1	(17.9)	18.0	(100.6)%	(4.4)	(17.9)	13.5	(75.4)%
Total acquisition-related costs, net	$9.1	$(8.5)	$17.6	(207.1)%	$18.7	$22.7	$(4.0)	(17.6)%
As a percentage of total revenue	1.9%	(1.8)%			1.3%	1.6%		

For the nine months ended June 30, 2014, transition and integration costs decreased $9.9 million and professional service fees decreased $7.6 million as compared to the nine months ended June 30, 2013, as a result of our strategy to slow the pace and reduce the size of acquisitions in fiscal 2014.

Included in acquisition-related adjustments for the nine months ended June 30, 2014 and 2013, is income of $7.7 million and $17.8 million related to the elimination of contingent liabilities established in the original allocation of purchase price for acquisitions closed in fiscal 2008 and 2007, respectively, following the expiration of the applicable statute of limitations. As a result, we have eliminated these contingent liabilities, and included the adjustment in acquisition-related costs, net in our consolidated statements of operations in the applicable period.

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Restructuring and Other Charges, Net

Restructuring and other charges, net include restructuring expenses together with other expenses that are unusual in nature and are the result of unplanned events, and arise outside of the ordinary course of continuing operations. Restructuring expenses consist of employee severance costs and may also include charges for duplicate facilities and other contract termination costs to improve our cost structure prospectively. Other amounts may include gains or losses on sales of non-strategic assets or product lines. The following table sets forth the activity relating to the restructuring accruals included in restructuring and other charges, net for the nine months ended June 30, 2014 (dollars in millions):

	Personnel	Facilities	Total
Balance at September 30, 2013	$4.2	$1.2	$5.4
Restructuring charges	10.9	3.2	14.1
Non-cash adjustments	—	0.8	0.8
Cash payments	(7.0)	(2.6)	(9.6)
Balance at June 30, 2014	$8.1	$2.6	$10.7

For the nine months ended June 30, 2014, we recorded net restructuring charges of $14.1 million, which included a $10.9 million severance charge related to the elimination of approximately 200 personnel across multiple functions including the impact of eliminating duplicative positions resulting from acquisitions, and $3.2 million primarily resulting from the restructuring of facilities that will no longer be utilized.

In addition to the restructuring charges, we have recorded certain other charges (credits) that are the result of unplanned events, and arose outside of the ordinary course of continuing operations, including litigation contingency reserves and the disposition of certain non-core product lines. For the three and nine months ended June 30, 2014, other charges totaled $0.1 million and $3.1 million, respectively. For the nine months ended June 30, 2013, other charges (credits) totaled ($0.8) million.

Other Income (Expense)

Other income (expense) consists of interest income, interest expense, gain (loss) from security price guarantee derivatives, gain (loss) from foreign exchange, and gain (loss) from other non-operating activities. The following table shows other income (expense), in dollars and as a percentage of total revenues (dollars in millions):

	Three months ended June 30,		Dollar Change	Percent Change	Nine months ended June 30,		Dollar Change	Percent Change
	2014	2013			2014	2013		
Interest income	$0.5	$0.4	$0.1	25.0%	$1.7	$1.3	$0.4	30.8%
Interest expense	(31.9)	(34.1)	2.2	(6.5)%	(99.9)	(102.1)	2.2	(2.2)%
Other income (expense), net	0.4	(0.4)	0.8	(200.0)%	(3.0)	(7.9)	4.9	(62.0)%
Total other expense, net	$(31.0)	$(34.1)	$3.1	(9.1)%	$(101.2)	$(108.7)	$7.5	(6.9)%
As a percentage of total revenue	6.5%	7.3%			7.1%	7.9%		

For the nine months ended June 30, 2014, other expense decreased $4.9 million primarily driven by a reduction in loss related to our security price guarantees as compared to the same period last year.

Provision for Income Taxes

The following table shows the provision for income taxes and the effective income tax rate (dollars in millions):

	Three months ended June 30,		Dollar Change	Percent Change	Nine months ended June 30,		Dollar Change	Percent Change
	2014	2013			2014	2013		
Provision for income taxes	$7.0	$27.0	$(20.0)	(74.1)%	$16.3	$19.1	$(2.8)	(14.7)%
Effective income tax rate	(14.7)%	(338.1)%			(12.3)%	(29.9)%		

The effective income tax rate was (14.7)% and (12.3)% for the three and nine months ended June 30, 2014, respectively. Our current effective tax rate differs from the U.S. federal statutory rate of 35% primarily due to earnings in foreign operations, which are subject to a significantly lower tax rate than the U.S. statutory tax rate, driven primarily by our subsidiaries in Ireland.

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The effective tax rate for the three and nine months ended June 30, 2014 included the impact of $1.0 million and $(2.8) million, respectively, in adjustments to the domestic valuation allowance as a result of acquisitions.
The effective income tax rate was (338.1)% and (29.9)% for the three and nine months ended June 30, 2013, respectively. The difference in the effective tax rate in fiscal 2013 as compared to the U.S. federal statutory rate of 35% was primarily driven by the establishment of a valuation allowance related to our net domestic deferred tax assets, which we concluded that the recoverability of the net assets was not more likely than not during the third quarter of fiscal 2013.
Our effective income tax rate is based upon the income for the year, the composition of income in different countries, changes relating to valuation allowances for certain countries if, and as necessary, 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.

SEGMENT ANALYSIS

We operate in, and report financial information for, the following four reportable segments: Healthcare, Mobile and Consumer, Enterprise and Imaging.
Segment revenues include certain revenue adjustments related to acquisitions that would otherwise have been recognized but for the purchase accounting treatment of the business combinations. Segment revenues also include revenue that we would have otherwise recognized had we not acquired intellectual property and other assets from the same customer. We include these revenues and the related cost of revenues to allow for more complete comparisons to the financial results of historical operations, forward-looking guidance and the financial results of peer companies and in evaluating management performance.

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Segment profit is an important measure used for evaluating performance and for decision-making purposes. Segment profit reflects the direct controllable costs of each segment together with an allocation of sales and corporate marketing expenses, and certain research and development project costs that benefit multiple product offerings. Segment profit represents income from operations excluding stock-based compensation, amortization of intangible assets, acquisition-related costs, net, restructuring and other charges, net, costs associated with intellectual property collaboration agreements, other income (expense), net and certain unallocated corporate expenses. The following table presents segment results (dollars in millions):

	Three months ended June 30, 2014	2013	Change	Percent Change	Nine months ended June 30, 2014	2013	Change	Percent Change
Segment Revenues								
Healthcare	$240.1	$238.1	$2.0	0.8 %	$704.4	$684.9	$19.5	2.8 %
Mobile and Consumer	109.2	111.0	(1.8)	(1.6)%	334.2	358.9	(24.7)	(6.9)%
Enterprise	85.1	78.9	6.2	7.9 %	261.5	237.0	24.5	10.3 %
Imaging	52.4	62.8	(10.4)	(16.6)%	166.7	186.4	(19.7)	(10.6)%
Total segment revenues	$486.8	$490.8	$(4.0)	(0.8)%	$1,466.8	$1,467.2	$(0.4)	— %
Acquisition-related revenues adjustments	(11.3)	(21.0)	9.7	(46.2)%	(45.7)	(84.2)	38.5	(45.7)%
Total revenues	$475.5	$469.8	$5.7	1.2 %	$1,421.1	$1,383.0	$38.1	2.8 %
Segment Profit								
Healthcare	$84.9	$94.8	$(9.9)	(10.4)%	$254.9	$273.5	$(18.6)	(6.8)%
Mobile and Consumer	20.5	32.2	(11.7)	(36.3)%	51.8	108.6	(56.8)	(52.3)%
Enterprise	17.5	20.0	(2.5)	(12.5)%	55.7	55.1	0.6	1.1 %
Imaging	16.9	25.0	(8.1)	(32.4)%	60.3	75.6	(15.3)	(20.2)%
Total segment profit	$139.8	$172.0	$(32.2)	(18.7)%	$422.7	$512.8	$(90.1)	(17.6)%
Segment Profit Margin								
Healthcare	35.4 %	39.8 %	(4.4)		36.2 %	39.9 %	(3.7)	
Mobile and Consumer	18.8 %	29.0 %	(10.2)		15.5 %	30.3 %	(14.8)	
Enterprise	20.6 %	25.3 %	(4.7)		21.3 %	23.2 %	(1.9)	
Imaging	32.3 %	39.8 %	(7.5)		36.2 %	40.6 %	(4.4)	
Total segment profit margin	28.7 %	35.0 %	(6.3)		28.8 %	35.0 %	(6.2)	

Segment Revenue

Three months ended June 30, 2014

- Healthcare segment revenue increased $2.0 million for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013. Product and licensing revenue decreased $4.1 million driven by lower sales in Dragon Medical licenses. Professional services and hosting revenue increased $3.1 million due to $6.6 million of additional revenue from our recent acquisitions offset by the negative impact from the continued EMR erosion. Maintenance and support revenue increased $2.9 million driven by strong renewals related to our Dragon Medical licenses.

- Mobile and Consumer segment revenue decreased $1.8 million for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013. Product and licensing revenue decreased $6.5 million, driven primarily by decreased sales of our Dragon desktop consumer products in advance of the July 2014 launch of Dragon NaturallySpeaking13. Professional services and hosting revenue increased $4.7 million, which included $2.2 million from our recent acquisitions. The combination of our recent acquisitions and the shift toward on-demand and hosting services resulted in a 4.8 percentage point increase in on-demand revenue as a percentage of Mobile and Consumer segment revenue during the period.

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Enterprise segment revenue increased $6.2 million for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013. Professional services and hosting revenue increased $12.2 million primarily driven by our recent acquisitions. This was offset by a decrease of $7.2 million in product and licensing revenues related to our on-premise solutions.

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- Imaging segment revenue decreased $10.4 million for the three months ended June 30, 2014, as compared to the three months ended June 30, 2013, as a result of a decrease of $13.8 million in product and licensing revenue due to lower sales of our multi-functional peripheral products as well as reduced demand for packaged software, offset by a $3.3 million increase in maintenance and support revenue.

Nine months ended June 30, 2014

- Healthcare segment revenue increased $19.5 million for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013. Maintenance and support revenue increased $8.9 million driven by strong renewals related to our Dragon Medical licenses. Professional services and hosting revenue increased $5.4 million due to acquisitions adding $20.2 million in revenue, offset by the negative impact in our on-demand revenue from the continued EMR erosion. Product and licensing revenue increased $5.2 million driven by higher sales in Dragon Medical licenses.

- Mobile and Consumer segment revenue decreased $24.7 million for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013. Product and licensing revenue declined $36.4 million, driven primarily by an $18.9 million decrease in embedded license sales in our automotive and handset businesses, as our markets and customers continued to shift toward on-demand and ratable pricing models. In addition, there was a $16.8 million decrease in sales of our Dragon desktop consumer products in advance of the July 2014 launch of Dragon NaturallySpeaking13 and an overall weakness in desktop software sales. Professional services and hosting revenue increased $10.1 million driven by our recent acquisitions. The combination of our recent acquisitions and the shift toward on-demand and ratable pricing models resulted in a 5.0 percentage point increase in our on-demand revenue as a percentage of Mobile and Consumer segment revenue during the period.

- Enterprise segment revenue increased $24.5 million for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013. Professional services and hosting revenue increased $35.8 million driven by our recent acquisitions. Product and licensing revenue decreased $16.4 million as a result of lower sales of our on-premise solutions. Maintenance and support revenue increased $5.1 million driven by strong renewals related to our on-premise solutions.

- Imaging segment revenue decreased $19.7 million for the nine months ended June 30, 2014, as compared to the nine months ended June 30, 2013, as a result of a decrease of $27.2 million in product and licensing revenue due to lower sales of our multi-functional peripheral products as well as reduced demand for packaged software, offset by a $7.5 million increase in maintenance and support revenue.

Segment Profit

Three months ended June 30, 2014

- Healthcare segment profit for the three months ended June 30, 2014 decreased 10.4% from the same period last year, primarily driven by increased costs from growth in sales of our on-demand solutions and increased investments in research and development. Segment profit margin decreased 4.4 percentage points, from 39.8% for the same period last year to 35.4% during the current period. The decrease in segment profit margin was primarily driven by a decrease of 2.0 percentage points in segment gross margin due to higher transcription related costs. In addition, segment profit margin decreased 1.7 percentage points due to increased investments in research and development to fund the advancement of clinical language understanding.

- Mobile and Consumer segment profit for the three months ended June 30, 2014 decreased 36.3% from the same period last year, driven by lower product and licensing revenue, increased costs to support the growth of our on-demand services and increased investment in research and development. Segment profit margin decreased 10.2 percentage points, from 29.0% for the same period last year to 18.8% during the current period. The decrease in segment profit margin was primarily driven by a 6.1 percentage point decrease in segment gross margin as our markets and customers continued to shift from embedded to on-demand solutions, driving increased costs to deploy large custom solutions for key customers, as well as a 6.1 percentage point increase in research and development spending related to acquisitions and investments to support cloud-based speech systems and natural language understanding advancements.

- Enterprise segment profit for the three months ended June 30, 2014 decreased 12.5% from the same period last year, driven by lower product and licensing sales. Segment profit margin decreased 4.7 percentage points, from 25.3%

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for the same period last year to 20.6% in the current period. The decrease in segment profit margin was driven by decline in segment gross margin as a result of lower product and licensing sales.

- Imaging segment profit for the three months ended June 30, 2014 decreased 32.4% from the same period last year, driven by lower product and licensing sales. Segment profit margin decreased 7.5 percentage points, from 39.8% last year to 32.3% in the current period. The decrease in segment profit margin was primarily driven by increased sales and marketing spending to support new product launches.

Nine months ended June 30, 2014

- Healthcare segment profit for the nine months ended June 30, 2014 decreased 6.8% from the same period last year, primarily driven by increased costs from growth in sales of our on-demand solutions and increased investments in research and development. Segment profit margin decreased 3.7 percentage points, from 39.9% for the same period last year to 36.2% during the current period. The decrease in segment profit margin was primarily driven by a decrease of 2.3 percentage points in segment gross margin due to higher transcription related costs. In addition, segment profit margin decreased 1.1 percentage points due to increased investments in research and development to fund the advancement of clinical language understanding.

- Mobile and Consumer segment profit for the nine months ended June 30, 2014 decreased 52.3% from the same period last year, primarily driven by lower product and licensing revenue, increased costs to support the growth of our on-demand services and increased investments in research and development. Segment profit margin decreased 14.8 percentage points, from 30.3% for the same period last year to 15.5% during the current period. The decrease in segment profit margin was primarily driven by an 8.0 percentage point decrease in segment gross margin as our markets and customers continued to shift from embedded to on-demand solutions, driving increased costs to deploy large custom solutions for key customers, as well as a 7.0 percentage point increase in research and development spending related to acquisitions and investments to support cloud-based speech systems and natural language understanding advancements.

- Enterprise segment profit for the nine months ended June 30, 2014 increased 1.1% from the same period last year, driven by lower product and licensing sales. Segment profit margin decreased 1.9 percentage points, from 23.2% for the same period last year to 21.3% in the current period. The decrease in segment profit margin was driven by decline in segment gross margin as a result of lower product and licensing sales.

- Imaging segment profit for the nine months ended June 30, 2014 decreased 20.2% from the same period last year, driven by lower product and licensing sales. Segment profit margin decreased 4.4 percentage points, from 40.6% for the same period last year to of 36.2% during the current period. The decrease in segment profit margin was primarily driven by increased sales and marketing spending to support new product launches.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents and marketable securities totaled $888.5 million as of June 30, 2014, an increase of $41.7 million as compared to $846.8 million as of September 30, 2013. Our working capital was $595.9 million as of June 30, 2014, as compared to $604.3 million as of September 30, 2013. Cash and cash equivalents and marketable securities held by our international operations totaled $62.9 million and $65.8 million at June 30, 2014 and September 30, 2013, respectively. We expect the cash held overseas will continue to be used for our international operations and therefore do not anticipate repatriating these funds. If we were to repatriate these funds, we do not believe that the resulting withholding taxes payable would have a material impact on our liquidity. As of June 30, 2014, our total accumulated deficit was $529.1 million. We do not expect our accumulated deficit to impact our future ability to operate the business given our strong cash and operating cash flow positions, and believe our current cash and cash equivalents on-hand are sufficient to meet our operating needs for at least the next twelve months.

Cash Provided by Operating Activities

Cash provided by operating activities for the nine months ended June 30, 2014 was $262.2 million, a decrease of $39.3 million, as compared to cash provided by operating activities of $301.5 million for the nine months ended June 30, 2013. The net decrease was primarily driven by the following factors:

- A decrease in cash flows of $59.3 million generated by changes in working capital excluding deferred revenue; and
- Offset by an increase in cash flows of $34.0 million from an overall increase in deferred revenue.

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Cash Used in Investing Activities

Cash used in investing activities for the nine months ended June 30, 2014 was $164.3 million, a decrease of $452.6 million, as compared to cash used in investing activities of $616.9 million for the nine months ended June 30, 2013. The net decrease was primarily driven by the following factors:

- A decrease in cash outflows of $438.6 million for business and technology acquisitions during the nine months ended June 30, 2014 resulting from our strategy to slow the pace and reduce the size of acquisitions during the period; and
- An increase in cash net inflows of $13.7 million from our marketable securities and other investments activities.

Subsequent to June 30, 2014, we made an immaterial acquisition in our Imaging segment for total cash consideration of approximately $119.6 million. There is an additional payment of $12.0 million, payable in cash or shares of our common stock. The payment is due in one year, contingent upon the continued employment of certain named executives. Some or all of this additional consideration may become payable earlier if we elect to terminate the named executives without cause.

Cash (Used in) Provided by Financing Activities

Cash used in financing activities for the nine months ended June 30, 2014 was $59.6 million, a decrease of $120.7 million, as compared to cash provided by financing activities of $61.1 million for the nine months ended June 30, 2013. The net cash decrease was primarily driven by the following factors:

- A decrease in cash inflows of $351.7 million from the issuance of long-term debt. Total proceeds from the issuance of our 5.375% Senior Notes due 2020 in the nine months ended June 30, 2013, net of issuance costs, were $351.7 million;
- A decrease in cash outflows of $143.5 million for the payment of long-term debt in October 2012;
- A decrease in cash outflows of $76.6 million related to our share repurchase program announced in April 2013. During the nine months ended June 30, 2014, we repurchased 1.6 million shares of our common stock for total cash outflows of $26.4 million as compared to the repurchase of 6.1 million shares for total cash outflows of $103.0 million in the nine months ended June 30, 2013; and
- A decrease in cash outflows of $18.3 million as a result of lower cash payments required to net share settle employee equity awards, due to our lower stock price and a decrease in vesting activities during the nine months ended June 30, 2014 as compared to the same period in fiscal 2013.

Credit Facilities and Debt

2.75% Convertible Debentures due in 2031

We have $690 million of 2.75% Convertible Debentures due in 2031 (the “2031 Debentures”) that were issued in a private placement. The 2031 Debentures bear interest at 2.75% per year, payable in cash semiannually in arrears, beginning on May 1, 2012. The 2031 Debentures mature on November 1, 2031, subject to the right of the holders to require us to redeem the 2031 Debentures on November 1, 2017, 2021, and 2026.

If converted, the principal amount of the 2031 Debentures is payable in cash and any amounts payable in excess of the $690 million principal amount, will (based on an initial conversion rate, which represents an initial conversion price of approximately $32.30 per share, subject to adjustment) be paid in cash or shares of our common stock, at our election, only in the following circumstances and to the following extent: (i) on any date during any fiscal quarter (and only during such fiscal quarter) if the closing sale price of our common stock was more than 130% of the then current conversion price for at least 20 trading days in the period of the 30 consecutive trading days ending on the last trading day of the previous fiscal quarter; (ii) during the five consecutive business-day period following any five consecutive trading-day period in which the trading price for $1,000 principal amount of the Debentures for each day during such five trading-day period was less than 98% of the closing sale price of our common stock multiplied by the then current conversion rate; (iii) upon the occurrence of specified corporate transactions, as described in the indenture for the 2031 Debentures; or (iv) at the option of the holder at any time on or after May 1, 2031. Additionally, we may redeem the 2031 Debentures, in whole or in part, on or after November 6, 2017 at par plus accrued and unpaid interest. Each holder shall have the right, at such holder’s option, to require us to repurchase all or any portion of the 2031

Debentures held by such holder on November 1, 2017, November 1, 2021, and November 1, 2026 at par plus accrued and unpaid interest. If we undergo a fundamental change (as described in the indenture for the 2031 Debentures) prior to maturity, holders will have the option to require us to repurchase all or any portion of their debentures for cash at a price equal to 100% of the principal amount of the debentures to be purchased plus any accrued and unpaid interest, including any additional interest to, but excluding, the repurchase date. As of June 30, 2014, no conversion triggers were met. If the conversion triggers were met, we could be required to repay all or some of the principal amount in cash prior to the maturity date.

2.75% Convertible Debentures due in 2027

We have $250 million of 2.75% convertible senior debentures due in 2027 (“the 2027 Debentures”) that were issued in a private placement. The 2027 Debentures bear an interest rate of 2.75% per annum, payable semi-annually in arrears beginning on February 15, 2008, and mature on August 15, 2027 subject to the right of the holders of the 2027 Debentures to require us to redeem the 2027 Debentures on August 15, 2014, 2017 and 2022. We have classified the obligation in current liabilities at June 30, 2014 and September 30, 2013.

If converted, the principal amount of the 2027 Debentures is payable in cash and any amounts payable in excess of the $250 million principal amount, will (based on an initial conversion rate, which represents an initial conversion price of approximately $19.47 per share, subject to adjustment as defined therein) be paid in cash or shares of our common stock, at our election, only in the following circumstances and to the following extent: (i) on any date during any fiscal quarter (and only during such fiscal quarter) if the closing sale price of our common stock was more than 120% of the then current conversion price for at least 20 trading days in the period of the 30 consecutive trading days ending on the last trading day of the previous fiscal quarter; (ii) during the five consecutive business-day period following any five consecutive trading-day period in which the trading price for $1,000 principal amount of the Debentures for each day during such five trading-day period was less than 98% of the closing sale price of our common stock multiplied by the then current conversion rate; (iii) upon the occurrence of specified corporate transactions, as described in the indenture for the 2027 Debentures; and (iv) at the option of the holder at any time on or after February 15, 2027. Additionally, we may redeem the 2027 Debentures, in whole or in part, on or after August 20, 2014 at par plus accrued and unpaid interest. Each holder shall have the right, at such holder’s option, to require us to repurchase all or any portion of the 2027 Debentures held by such holder on August 15, 2014, August 15, 2017 and August 15, 2022 at par plus accrued and unpaid interest. If we undergo a fundamental change (as described in the indenture for the 2027 Debentures) prior to maturity, holders will have the option to require us to repurchase all or any portion of their debentures for cash at a price equal to 100% of the principal amount of the debentures to be purchased plus any accrued and unpaid interest, including any additional interest to, but excluding, the repurchase date. As of June 30, 2014, no conversion triggers were met. If the conversion triggers were met, we could be required to repay all or some of the principal amount in cash prior to the maturity date.

On August 11, 2014, we issued a notice of redemption to the holders of the 2027 Debentures indicating that we are calling the outstanding debentures on or about September 24, 2014. Upon redemption, the holders of the debentures will receive cash equal to $1,000 per $1,000 principal amount, together with any accrued and unpaid interest on the Debentures being redeemed. As a result of the announced redemption, the Debentures are becoming convertible in accordance with their terms.

Credit Facility

The Credit Facility includes a term loan and a $75 million revolving credit line, including letters of credit. The term loans mature on August 7, 2019 and the revolving credit line matures on August 7, 2018. As of June 30, 2014, there were $5.7 million of letters of credit issued, and there were no other outstanding borrowings under the revolving credit line.

Under terms of the amended and restated credit agreement, interest is payable monthly at a rate equal to the applicable margin plus, at our option, either (a) the base rate which is the corporate base rate of Morgan Stanley, the Administrative Agent, or (b) LIBOR (equal to (i) the British Bankers’ Association Interest Settlement Rates for deposits in U.S. dollars divided by (ii) one minus the statutory reserves applicable to such borrowing). The applicable margin for the borrowings at June 30, 2014 is as follows:

Description	Base Rate Margin	LIBOR Margin
Term loans maturing August 2019	1.75%	2.75%
Revolving facility due August 2018	0.50% - 0.75% (a)	1.50% - 1.75% (a)

(a)

The margin is determined based on our net leverage ratio at the date the interest rates are reset on the revolving credit line.

At June 30, 2014, the applicable margin for the term loans was 2.75%, with an effective rate of 2.90%, on the outstanding balance of $478.6 million maturing in August 2019. We are required to pay a commitment fee for unutilized commitments under the revolving credit facility at a rate ranging from 0.250% to 0.375% per annum, based upon our leverage ratio. As of June 30, 2014, the commitment fee rate was 0.375%.

The Credit Facility contains the most restrictive covenants of our long-term debt, including, among other things, covenants that restrict our ability and those of our subsidiaries to incur certain additional indebtedness or issue guarantees, create or permit liens on assets, enter into sale-leaseback transactions, make loans or investments, sell assets, make certain acquisitions, pay dividends, repurchase stock, or merge or consolidate with any entity, and enter into certain transactions with affiliates. The agreement also contains events of default, including failure to make payments of principal or interest, failure to observe covenants, breaches of representations and warranties, defaults under certain other material indebtedness, failure to satisfy material judgments, a change of control and certain insolvency events. As of June 30, 2014, we were in compliance with the covenants under the Credit Facility. The covenants on our other long-term debt are less restrictive, and as of June 30, 2014, we were in compliance with the requirements of our other long-term debt.

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

The Credit Facility includes a provision for an annual excess cash flow sweep, as defined in the agreement, payable in the first quarter of each fiscal year, based on the excess cash flow generated in the previous fiscal year. No excess cash flow sweep was required in the first quarter of fiscal 2014 as no excess cash flow, as defined in the agreement, was generated in fiscal 2013. At the current time, we are unable to predict the amount of the outstanding principal, if any, that we may be required to repay in future fiscal years pursuant to the excess cash flow sweep provisions.

Share Repurchase Program

On April 29, 2013, our Board of Directors approved a share repurchase program for up to $500 million of our outstanding shares of common stock. Approximately $289.2 million remained available for stock repurchases as of June 30, 2014 pursuant to this repurchase program. We repurchased 1.6 million shares for $26.4 million during the nine months ended June 30, 2014. Under the terms of the repurchase program, we expect to continue to repurchase shares from time to time through a variety of methods, which may include open market purchases, privately negotiated transactions, block trades, accelerated stock repurchase transactions, or any combination of such methods. The timing and the amount of any purchases will be determined by management based on an evaluation of market conditions, capital allocation alternatives, and other factors. The share repurchase program does not require us to acquire any specific number of shares and may be modified, suspended, extended or terminated by us at any time without prior notice.

Off-Balance Sheet Arrangements, Contractual Obligations

Contingent Liabilities and Commitments

In connection with some of our acquisitions, we agree to make contingent cash payments to the former shareholders of certain of the acquired companies. The following represents the contingent cash payments that we may be required to make.

In connection with certain acquisitions made in fiscal 2014, we may be required to make up to $13.8 million of additional payments to the selling shareholders contingent upon the achievement of specified objectives, including the achievement of future bookings and sales targets related to the products of the acquired entities. In addition, there are deferred payment obligations to certain former shareholders, contingent upon their continued employment. These deferred payment obligations, totaling $6.9 million, will be recorded as compensation expense over the applicable employment period.

In connection with our acquisition of J.A. Thomas ("JA Thomas") in October 2012, we agreed to make deferred payments to the former shareholders of JA Thomas of up to $25.0 million in October 2014, contingent upon the continued employment of certain named executives and certain other conditions. The contingent payments will be reduced by amounts specified in the merger agreement in the event that any of the named executives terminates their employment prior to the payment date.

Off-Balance Sheet Arrangements

Through June 30, 2014, we have not entered into any off-balance sheet arrangements or material transactions with unconsolidated entities or other persons.

CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES

Generally accepted accounting principles in the United States (GAAP) require us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the dates of the financial

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statements and the reported amounts of revenue and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates, assumptions and judgments, including those related to: revenue recognition; allowance for doubtful accounts and sales returns; the valuation of goodwill and intangible assets; accounting for business combinations; accounting for stock-based compensation; accounting for derivative instruments; accounting for income taxes and related valuation allowances; and loss contingencies. Our management bases its estimates on historical experience, market participant fair value considerations and various other factors that are believed to be reasonable under the circumstances. Actual results could differ from these estimates.

Information about those accounting policies we deem to be critical to our financial reporting may be found in our Annual Report on Form 10-K for the fiscal year ended September 30, 2013. Based on events occurring subsequent to September 30, 2013, we are updating certain of the Critical Accounting Policies, Judgments and Estimates.
Goodwill, Intangible and Other Long-Lived Assets and Impairment Assessments. We have significant long-lived tangible and intangible assets, including goodwill with indefinite lives, which are susceptible to valuation adjustments as a result of changes in various factors or conditions. The most significant finite-lived tangible and intangible assets are customer relationships, licensed technology, patents and core technology, completed technology, fixed assets and trade names. All finite-lived intangible assets are amortized over the estimated economic lives of the assets, generally using the straight-line method except where the pattern of the expected economic benefit is readily identifiable, primarily customer relationship intangibles, whereby amortization follows that pattern. The values of intangible assets determined in connection with a business combination, with the exception of goodwill, were initially determined by a risk-adjusted, discounted cash flow approach. We assess the potential impairment of intangible and fixed assets whenever events or changes in circumstances indicate that the carrying values may not be recoverable. Goodwill and indefinite-lived intangible assets are assessed for potential impairment at least annually, but also whenever events or changes in circumstances indicate the carrying values may not be recoverable. Factors we consider important, which could trigger an impairment of such assets, include the following:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of or use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends;
- significant decline in our stock price for a sustained period; and
- a decline in our market capitalization below net book value.

Future adverse changes in these or other unforeseeable factors could result in an impairment charge that would materially impact future results of operations and financial position in the reporting period identified.
We test goodwill for impairment annually in the fourth quarter, and between annual tests if indicators of potential impairment exist. The impairment test for goodwill compares the fair value of identified reporting unit(s) to its (their) carrying amount to assess whether such assets are impaired. We have six reporting units based on the level of information provided to, and review thereof, by our segment management.
We determine fair values for each of the reporting units using an income approach. When available and appropriate, we also use a comparative market approach to derive the fair values. For purposes of the income approach, fair value is determined based on the present value of estimated future cash flows, discounted at an appropriate risk adjusted rate. We use our internal forecasts to estimate future cash flows and include an estimate of long-term future growth rates based on our most recent views of the long--term outlook for each business. 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 cost of equity financing. We use discount rates that are commensurate with the risks and uncertainty inherent in the respective businesses and in our internally developed forecasts. Discount rates used in our reporting unit valuations ranged from 12.0% to 17.5%. For purposes of the market approach, we use a valuation technique in which values are derived based on market prices of comparable publicly traded companies. We also use a market based valuation technique in which values are determined based on relevant observable information generated by market transactions involving comparable businesses. Compared to the market approach, the income approach more closely aligns each reporting unit valuation to our business profile, including geographic markets served and product offerings. Required rates of return, along with uncertainty inherent

in the forecasts of future cash flows, are reflected in the selection of the discount rate. Equally important, under this approach, reasonably likely scenarios and associated sensitivities can be developed for alternative future states that may not be reflected in an observable market price. A market approach allows for comparison to actual market transactions and multiples. It can be somewhat more limited in its application because the population of potential comparable entities is often limited to publicly-traded companies where the characteristics of the comparative business and ours can be significantly different, market data is usually not available for divisions within larger conglomerates or non-public subsidiaries that could otherwise qualify as comparable, and the specific circumstances surrounding a market transaction (e.g., synergies between the parties, terms and conditions of the transaction, etc.) may be different or irrelevant with respect to our business. It can also be difficult, under certain market conditions, to identify orderly transactions between market participants in similar businesses. 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.

The carrying values of the reporting units were determined based on an allocation of our assets and liabilities through specific allocation of certain assets and liabilities, to the reporting units and an apportionment method based on relative size of the reporting units' revenues and operating expenses compared to the Company as a whole. Goodwill was initially allocated to our reporting units based on the relative fair value of the units at the date we implemented the current reporting unit structure. Goodwill subsequently acquired through acquisitions is allocated to the applicable reporting unit based upon the relative fair value of the acquired business. Certain corporate assets that are not instrumental to the reporting units' operations and would not be transferred to hypothetical purchasers of the reporting units were excluded from the reporting units' carrying values.

Based on our assessments, we have not had any impairment charges during our history as a result of our impairment evaluation of goodwill. Significant adverse changes in our future revenues and/or cash flow results, or significant degradation in the enterprise values of comparable companies within our segments, could result in the determination that all or a portion of our goodwill is impaired. As of our fiscal 2013 annual impairment assessment date, our estimated fair values of our reporting units substantially exceeded their carrying values.

Based on the results of our third quarter of fiscal 2014, we determined that the recent experience of declining revenues and actual revenues not meeting plan for two of our reporting units represents a triggering event requiring a goodwill impairment test. The goodwill associated with these two reporting units totaled approximately $300 million as of June 30, 2014 and September 30, 2013. Based on our annual goodwill impairment analysis performed as of July 1, 2013, the fair values exceeded the carrying values of these reporting units by approximately 130% and 150%. To the extent that revenues do not meet the projected growth used in our fiscal 2013 annual goodwill impairment analysis, there may be a negative impact on the future cash flow assumptions. We were unable to reasonably estimate the amount of goodwill impairment, if any, during the third quarter and will complete our annual impairment test on all of our reporting units during the fourth quarter.

We periodically review long-lived assets other than goodwill for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable or that the useful lives of those assets are no longer appropriate. Each impairment test is based on a comparison of the undiscounted cash flows to the recorded carrying value for the asset or asset group. Asset groups utilized in this analysis are identified as the lowest level grouping of assets for which largely independent cash flows can be identified. If impairment is indicated, the asset or asset group is written down to its estimated fair value.

Significant judgments and estimates are involved in determining the useful lives of our long-lived assets, determining the reporting units and assessing when events or circumstances would require an interim impairment analysis of goodwill or other long-lived assets to be performed. Changes in our organization or management reporting structure, as well as other events and circumstances, including but not limited to technological advances, increased competition and changing economic or market conditions, could result in (a) shorter estimated useful lives, (b) changes to reporting units, which may require alternative methods of estimating fair values or greater disaggregation or aggregation in our analysis by reporting unit, and/or (c) other changes in previous assumptions or estimates. In turn, this could have a significant impact on our consolidated financial statements through accelerated amortization and/or impairment charges.

RECENTLY ISSUED ACCOUNTING STANDARDS

Refer to Note 2 to the unaudited consolidated financial statements included in Item 1 of Part I of this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk from changes in foreign currency exchange rates, interest rates and equity prices 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, when appropriate, through the use of derivative financial instruments.

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.

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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 related to transactions denominated in the euro, British pound, Canadian dollar, Japanese yen, Indian rupee and Hungarian forint.

A hypothetical change of 10% in appreciation or depreciation in foreign currency exchange rates from the quoted foreign currency exchange rates at June 30, 2014 would not have a material impact on our revenue, operating results or cash flows in the coming year.

Periodically, we enter into forward exchange contracts to hedge against foreign currency fluctuations. These contracts may or may not be designated as cash flow hedges for accounting purposes. We have a program that primarily utilizes foreign currency forward contracts to offset the risks associated with the effect of certain foreign currency exposures that arise from transactions denominated in currencies other than the functional currencies of our worldwide operations. We commenced this program so that increases or decreases in our foreign currency exposures are offset by gain or losses on the foreign currency forward contracts. These contracts are not designated as accounting hedges and generally are for periods less than 90 days. The notional contract amount of outstanding foreign currency exchange contracts not designated as cash flow hedges was $210.0 million at June 30, 2014. Based on the nature of the transactions for which the contracts were purchased, a hypothetical change of 10% in exchange rates would not have a material impact on our financial results.

Interest Rate Sensitivity

We are exposed to interest rate risk as a result of our significant cash and cash equivalents, marketable securities and the outstanding debt under the Credit Facility.

At June 30, 2014, we held approximately $888.5 million of cash and cash equivalents and marketable securities primarily consisting of cash and money-market funds. Due to the low current market yields and the short-term nature of our investments, a hypothetical change in market rates of one percentage point would not have a material effect on the fair value of our portfolio. Assuming a one percentage point increase in interest rates, our interest income on our investments classified as cash and cash equivalents and marketable securities would increase by approximately $7.6 million per annum, based on the June 30, 2014 reported balances of our investment accounts.

At June 30, 2014, our total outstanding debt balance exposed to variable interest rates was $478.6 million. A hypothetical one percentage point increase in interest rates would result in an increase in our interest expense relative to our outstanding variable rate debt of $4.8 million per annum.

Equity Price Risk

We are exposed to equity price risk as a result of security price guarantees that we enter into from time to time. Generally, these price guarantees are for a period of six months or less, and require payment from either us to a third party, or from the third party to us, based upon changes in our stock price during the contract term. As of June 30, 2014, we have security price guarantees outstanding covering approximately 234,375 shares. A 10% change in our stock price during the next six months would not have a material impact on our statements of operations or cash flows as a result of security price guarantees.

2027 and 2031 Debentures

The fair value of our 2031 and 2027 Debentures is dependent on the price and volatility of our common stock as well as movements in interest rates. The fair market value of the debentures will generally increase or decrease as the market price of our common stock changes. The fair market value of the debentures will generally increase as interest rates fall and decrease as interest rates rise. The market value and interest rate changes affect the fair market value of the debentures, but do not impact our financial position, cash flows or results of operations due to the fixed nature of the debt obligations. However, increases in the value of our common stock above the stated trigger price for each issuance for a specified period of time may provide the holders of the debentures the right to convert each bond using a conversion ratio and payment method as defined in the debenture agreement.

Our debentures trade in the financial markets, and the fair value at June 30, 2014 was $692.8 million for the 2031 Debentures and $264.4 million for the 2027 Debentures, based on an average of the bid and ask prices for each of the issuances on that day. This compares to conversion values on June 30, 2014 of approximately $401.0 million and

$241.0 million for the 2031 Debentures and the 2027 Debentures, respectively. A 10% increase in the stock price over the June 30, 2014 closing price of $18.77 would have an estimated combined $19.3 million increase to the fair value and a combined $64.2 million increase to the conversion value of the debentures.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management is responsible for establishing and maintaining a system of disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934 (the "Exchange Act")) designed to ensure that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer's management, including its principal executive officer or officers and principal financial officer or officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

We have evaluated the effectiveness of the design and operation of our disclosure controls and procedures under the supervision of, and with the participation of, management, including our Chief Executive Officer and Chief Financial Officer, as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective to meet the requirements of Rule 13a-15 under the Exchange Act.

Changes in internal control over financial reporting

There were no changes to our internal controls over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. Other Information

Item 1.Legal Proceedings

This information is included in Note 16, Commitments and Contingencies, in the accompanying notes to unaudited consolidated financial statements and is incorporated herein by reference from Item 1 of Part I.

Item 1A. Risk Factors

You should carefully consider the risks described below when evaluating our company and when deciding whether to invest in our Company. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we do not currently believe are important to an investor may also harm our business operations. If any of the events, contingencies, circumstances or conditions described in the following risks actually occurs, our business, financial condition or our results of operations could be seriously harmed. If that happens, the trading price of our common stock could decline and you may lose part or all of the value of any of our shares held by you.

Risks Related to Our Business

Our operating results may fluctuate significantly from period to period, and this may cause our stock price to decline. Our revenue, bookings and operating results have fluctuated in the past and are expected to continue to fluctuate in the future. Given this fluctuation, we believe that quarter to quarter comparisons of revenue, bookings and operating results are not necessarily meaningful or an accurate indicator of our future performance. As a result, our results of operations may not meet the expectations of securities analysts or investors in the future. If this occurs, the price of our stock would likely decline. Factors that contribute to fluctuations in operating results include the following:

- the pace of the transition to an on-demand and transactional revenue model;
- slowing sales by our distribution and fulfillment partners to their customers, which may place pressure on these partners to reduce purchases of our products;
- volume, timing and fulfillment of customer orders and receipt of royalty reports;
- our ability to generate additional revenue from our intellectual property portfolio;
- customers delaying their purchasing decisions in anticipation of new versions of our products;
- introduction of new products by us or our competitors;
- seasonality in purchasing patterns of our customers;

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- reduction in the prices of our products in response to competition, market conditions or contractual obligations;
- returns and allowance charges in excess of accrued amounts;
- timing of significant marketing and sales promotions;
- impairment charges against goodwill and intangible assets;
- delayed realization of synergies resulting from our acquisitions;
- write-offs of excess or obsolete inventory and accounts receivable that are not collectible;
- increased expenditures incurred pursuing new product or market opportunities;
- general economic trends as they affect retail and corporate sales; and
- higher than anticipated costs related to fixed-price contracts with our customers.

Due to the foregoing factors, among others, our revenue, bookings and operating results are difficult to forecast. 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 a shortfall in projected revenue. Therefore, our failure to meet revenue expectations would seriously harm our operating results, financial condition and cash flows.

Our ability to realize the anticipated benefits of our acquisitions will depend on successfully integrating the acquired businesses.

Our prior acquisitions required, and our recently completed acquisitions continue to require, substantial integration and management efforts and we expect future acquisitions to require similar efforts. Acquisitions of this nature involve a number of risks, including:

- difficulty in transitioning and integrating the operations and personnel of the acquired businesses;
- potential disruption of our ongoing business and distraction of management;
- potential difficulty in successfully implementing, upgrading and deploying in a timely and effective manner new operational information systems and upgrades of our finance, accounting and product distribution systems;
- difficulty in incorporating acquired technology and rights into our products and technology;
- potential difficulties in completing projects associated with in-process research and development;
- unanticipated expenses and delays in completing acquired development projects and technology integration;
- management of geographically remote business units both in the United States and internationally;
- impairment of relationships with partners and customers;
- assumption of unknown material liabilities of acquired companies;
- accurate projection of revenue and bookings plans of the acquired entity in the due diligence process;
- customers delaying purchases of our products pending resolution of product integration between our existing and our newly acquired products;
- entering markets or types of businesses in which we have limited experience; and
- potential loss of key employees of the acquired business.

As a result of these and other risks, if we are unable to successfully integrate acquired businesses, we may not realize the anticipated benefits from our acquisitions. Any failure to achieve these benefits or failure to successfully integrate acquired businesses and technologies could seriously harm our business.

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Charges to earnings as a result of our acquisitions may adversely affect our operating results in the foreseeable future, which could have a material and adverse effect on the market value of our common stock.

Under accounting principles generally accepted in the United States of America, we record the market value of our common stock or other form of consideration issued in connection with an acquisition as the cost of acquiring the company or business. We have allocated that cost to the individual assets acquired and liabilities assumed, including various identifiable intangible assets such as acquired technology, acquired trade names and acquired customer relationships based on their respective fair values. Our estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain. After we complete an acquisition, the following factors could result in material charges and may adversely affect our operating results and cash flows:

- costs incurred to combine the operations of businesses we acquire, such as transitional employee expenses and employee retention, redeployment or relocation expenses;
- impairment of goodwill or intangible assets;
- amortization of intangible assets acquired;
- a reduction in the useful lives of intangible asset acquired;
- identification of or changes to assumed contingent liabilities, both income tax and non-income tax related after our final determination of the amounts for these contingencies or the conclusion of the measurement period (generally up to one year from the acquisition date), whichever comes first;
- charges to our operating results to eliminate certain duplicative pre-merger activities, to restructure our operations or to reduce our cost structure;
- charges to our operating results resulting from expenses incurred to effect the acquisition; and
- charges to our operating results due to the expensing of certain stock awards assumed in an acquisition.

Intangible assets are generally amortized over a five to fifteen year period. Goodwill and certain intangible assets with indefinite lives, are not subject to amortization but are subject to an impairment analysis, at least annually, which may result in an impairment charge if the carrying value exceeds its implied fair value. As of June 30, 2014, we had identified intangible assets of approximately $880.5 million, net of accumulated amortization, and goodwill of approximately $3.4 billion. In addition, purchase accounting limits our ability to recognize certain revenue that otherwise would have been recognized by the acquired company as an independent business. As a result, the combined company may delay revenue recognition or recognize less revenue than we and the acquired company would have recognized as independent companies.

We have grown, and may continue to grow, through acquisitions, which could dilute our existing stockholders.

As part of our business strategy, we have in the past acquired, and expect to continue to acquire, other businesses and technologies. In connection with past acquisitions, we issued a substantial number of shares of our common stock as transaction consideration and also incurred significant debt to finance the cash consideration used for our acquisitions. We may continue to issue equity securities for future acquisitions, which would dilute existing stockholders, perhaps significantly depending on the terms of such acquisitions. We may also incur additional debt in connection with future acquisitions, which, if available at all, may place additional restrictions on our ability to operate our business.

Our significant debt could adversely affect our financial health and prevent us from fulfilling our obligations under our credit facility and our convertible debentures.

We have a significant amount of debt. As of June 30, 2014, we had a total of $2,468.6 million of gross debt outstanding, $478.6 million in term loans due in August 2019, $1,050.0 million of senior notes due in 2020 and $940.0 million in convertible debentures. On August 11, 2014, we issued a notice of redemption to the holders of the 2027 Debentures calling the $250.0 million of outstanding Debentures. Upon redemption, the holders of the Debentures will receive cash equal to $1,000 per $1,000 principal amount of the Debentures, together with any accrued and unpaid interest on the Debentures being redeemed. Investors may require us to redeem the 2031 Debentures, totaling $690.0 million in aggregate principal amount in November 2017, or sooner if the closing sale price of our common stock is more than 130% of the then current conversion price for certain specified periods. If a holder elects to convert, we will be required to pay the principal amount in cash and any amounts payable in excess of the principal amount will be paid in cash or shares of our common stock, at our election. We also have a $75.0 million revolving credit line available to us through August 2018. As of June 30, 2014, there were $5.7 million of letters of credit issued, but there were no other outstanding borrowings under the revolving credit line. Our debt level could have important consequences, for example it could:

- require us to use a large portion of our cash flow to pay principal and interest on debt, including the convertible debentures and the credit facility, which will reduce the availability of our cash flow to fund working capital, capital expenditures, acquisitions, research and development expenditures and other business activities;

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- restrict us from making strategic acquisitions or exploiting business opportunities;
- place us at a competitive disadvantage compared to our competitors that have less debt; and
- limit, along with the financial and other restrictive covenants related to our debt, our ability to borrow additional funds, dispose of assets or pay cash dividends.

Our ability to meet our payment and other obligations under our debt instruments depends on our ability to generate significant cash flow in the future. This, to some extent, is subject to general economic, financial, competitive, legislative and regulatory factors as well as other factors that are beyond our control. We cannot assure you that our business will generate cash flow from operations, or that additional capital will be available to us, in an amount sufficient to enable us to meet our payment obligations under the convertible debentures and our other debt and to fund other liquidity needs. If we are not able to generate sufficient cash flow to service our debt obligations, we may need to refinance or restructure our debt, including the convertible debentures, sell assets, reduce or delay capital investments, or seek to raise additional capital. If we are unable to implement one or more of these alternatives, we may not be able to meet our payment obligations under the convertible debentures and our other debt.

In addition, approximately $478.6 million of our debt outstanding as of June 30, 2014 bears interest at variable rates. If market interest rates increase, our debt service requirements will increase, which would adversely affect our results of operations and cash flows.

Our debt agreements contain covenant restrictions that may limit our ability to operate our business.

The agreement governing our senior credit facility contains, and any of our other future debt agreements may contain, covenant restrictions that limit our ability to operate our business, including restrictions on our ability to:

- incur additional debt or issue guarantees;
- create liens;
- make certain investments;
- enter into transactions with our affiliates;
- sell certain assets;
- redeem capital stock or make other restricted payments;
- declare or pay dividends or make other distributions to stockholders; and
- merge or consolidate with any entity.

Our ability to comply with these limitations is dependent on our future performance, which will be subject to many factors, some of which are beyond our control, including prevailing economic conditions. As a result of these limitations, our ability to respond to changes in business and economic conditions and to obtain additional financing, if needed, may be significantly restricted, and we may be prevented from engaging in transactions that might otherwise be beneficial to us. In addition, our failure to comply with our debt covenants could result in a default under our debt agreements, which could permit the holders to accelerate our obligation to repay the debt. If any of our debt is accelerated, we may not have sufficient funds available to repay the accelerated debt.

We have a history of operating losses, and may incur losses in the future, which may require us to raise additional capital on unfavorable terms.

We reported a net loss of $148.9 million for the nine months ended June 30, 2014, a loss of $115.2 million in fiscal 2013, and net income of $207.1 million and $38.2 million in fiscal 2012 and 2011, respectively, and have a total accumulated deficit of $529.1 million as of June 30, 2014. If we are unable to return to profitability, the market price for our stock may decline, perhaps substantially. We cannot assure you that our revenue or bookings will grow or that we will return to profitability in the future. If we do not achieve profitability, we may be required to raise additional capital to maintain or grow our operations. Additional capital, if available at all, may be highly dilutive to existing investors or contain other unfavorable terms, such as a high interest rate and restrictive covenants.

Voice and language technologies may not continue to garner widespread acceptance, which could limit our ability to grow our voice and language business.

We have invested and expect to continue to invest heavily in the acquisition, development and marketing of voice and language technologies. The market for voice and language technologies is relatively new and rapidly evolving. Our ability to increase revenue and bookings in the future depends in large measure on the continuing acceptance of these technologies in general and our products in particular. The continued development of the market for our current and future voice and language solutions in general, and our solutions in particular, will also depend on:

- consumer and business demand for speech-enabled applications;

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- development by third-party vendors of applications using voice and language technologies; and
- continuous improvement in voice and language technology.

Sales of our voice and language products would be harmed if the market for these technologies does not continue to increase or increases slower than we expect, or if we fail to develop new technology faster than our competitors, and consequently, our business could be harmed and we may not achieve a level of profitability necessary to successfully operate our business.

The markets in which we operate are 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 our targeted markets. The individual markets in which we compete are highly competitive, and are rapidly changing. Within voice and language, we compete with AT&T, Baidu, Google, Microsoft, and other smaller providers. Within healthcare, we compete with 3M, M*Modal, Optum and other smaller providers. Within imaging, we compete with ABBYY, Adobe, I.R.I.S. and NewSoft. In voice and language, some of our partners such as Avaya, Cisco, Intervoice and Genesys develop and market products that can be considered substitutes for our solutions. In addition, a number of smaller companies in voice, language and imaging produce technologies or products that are in some markets competitive with our solutions. 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.

The competition in these markets could adversely affect our operating results by reducing the volume of the products we license or the prices we can charge. Some of our current or potential competitors, such as 3M, Adobe, Baidu, Google and Microsoft, have significantly greater financial, technical and marketing resources 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. They may also devote greater resources to the development, promotion and sale of their products than we do.

Some of our customers, such as Google and Microsoft, have developed or acquired products or technologies that compete with our products and technologies. These customers may give higher priority to the sale of their competitive products or technologies. To the extent they do so, market acceptance and penetration of our products, and therefore our revenue and bookings, may be adversely affected. Our success will depend substantially upon our ability to enhance our products and technologies and to develop and introduce, on a timely and cost-effective basis, new products and features that meet changing customer requirements and incorporate technological enhancements. If we are unable to develop new products and enhance functionalities or technologies to adapt to these changes, or if we are unable to realize synergies among our acquired products and technologies, our business will suffer.

The failure to successfully maintain the adequacy of our system of internal control over financial reporting could have a material adverse impact on our ability to report our financial results in an accurate and timely manner.

The SEC, as directed by Section 404 of the Sarbanes-Oxley Act of 2002, adopted rules requiring public companies to include a report of management on internal control over financial reporting in their annual reports on Form 10-K that contains an assessment by management of the effectiveness of our internal control over financial reporting. In addition, our independent registered public accounting firm must attest to and report on the effectiveness of our internal control over financial reporting. Any failure in the effectiveness of our system of internal control over financial reporting could have a material adverse impact on our ability to report our financial statements in an accurate and timely manner, could subject us to regulatory actions, civil or criminal penalties, shareholder litigation, or loss of customer confidence, which could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our financial statements, which ultimately could negatively impact our stock price.

A significant portion of our revenue and bookings 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 and other risks associated with these international regions.

Because we operate worldwide, our business is subject to risks associated with doing business internationally. We anticipate that revenue and bookings from international operations could increase in the future. Most of our international revenue and bookings are generated by sales in Europe and Asia. In addition, some of our products are developed and manufactured outside the United States and we have a large number of employees in India that provide transcription services. We also have a large number of employees in Canada, Germany and United Kingdom that provide professional services. A significant portion of the development of our voice and language products is conducted in Canada and Germany, and a significant portion of our imaging research and development is conducted in Hungary. We also have significant research and development resources in Austria, Belgium, Italy, and United Kingdom. Accordingly, our future results could be harmed by a variety of factors associated with international sales and operations, including:

- changes in a specific country's or region's economic conditions;
- geopolitical turmoil, including terrorism and war;

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- trade protection measures and import or export licensing requirements imposed by the United States or by other countries;
- negative consequences from changes in applicable tax laws;
- difficulties in staffing and managing operations in multiple locations in many countries;
- difficulties in collecting trade accounts receivable in other countries; and
- less effective protection of intellectual property than in the United States.

We are exposed to fluctuations in foreign currency exchange rates.

Because we have international subsidiaries and distributors that operate and sell our products outside the United States, we are exposed to the risk of changes in foreign currency exchange rates. In certain circumstances, we have entered into forward exchange contracts to hedge against foreign currency fluctuations. We use these contracts to reduce our risk associated with exchange rate movements, as the gains or losses on these contracts are intended to offset any exchange rate losses or gains on the hedged transaction. We do not engage in foreign currency speculation. With our increased international presence in a number of geographic locations and with international revenue and costs projected to increase, we are exposed to changes in foreign currencies including the euro, British pound, Canadian dollar, Japanese yen, Indian rupee and Hungarian forint. Changes in the value of foreign currencies relative to the value of the U.S. dollar could adversely affect future revenue and operating results.

Tax matters may cause significant variability in our financial results.

Our businesses are subject to income taxation in the U.S., as well as in many tax jurisdictions throughout the world. Tax rates in these jurisdictions may be subject to significant change. Our effective income tax rate can vary significantly between periods due to a number of complex factors including, but not limited to: (i) projected levels of taxable income; (ii) pre-tax income being lower than anticipated in countries with lower statutory rates or higher than anticipated in countries with higher statutory rates; (iii) increases or decreases to valuation allowances recorded against deferred tax assets; (iv) tax audits conducted by various tax authorities; (v) adjustments to income taxes upon finalization of income tax returns; (vi) the ability to claim foreign tax credits; and (vii) the repatriation of non-U.S. earnings for which we have not previously provided for income taxes. If our effective tax rate increases, our operating results and cash flow could be adversely affected.

We are subject to laws and regulations worldwide, changes to which could increase our costs and adversely affect our business.

We are subject to laws and regulations affecting our domestic and international operations in a number of areas. These U.S. and foreign laws and regulations affect various aspects of our business including, but not limited to, areas of labor, advertising, digital content, consumer protection, real estate, billing, e-commerce, promotions, quality of services, telecommunications, mobile communications and media, intellectual property ownership and infringement, import and export requirements, anti-corruption, foreign exchange controls and cash repatriation restrictions, data privacy requirements, anti-competition, environmental, health and safety.

Compliance with these laws, regulations and similar requirements may be onerous and expensive, and they may be inconsistent from jurisdiction to jurisdiction, further increasing the cost of compliance and doing business. Any such costs, which may rise in the future as a result of changes in these laws and regulations or in their interpretation could individually or in the aggregate make our products and services less attractive to our customers, delay the introduction of new products in one or more regions, or cause us to change or limit our business practices. We have implemented policies and procedures designed to ensure compliance with applicable laws and regulations, but there can be no assurance that our employees, contractors, or agents will not violate such laws and regulations or our policies and procedures.

Impairment of our intangible assets could result in significant charges that would adversely impact our future operating results.

We have significant intangible assets, including goodwill and intangibles with indefinite lives, which are susceptible to valuation adjustments as a result of changes in various factors or conditions. The most significant intangible assets are customer relationships, patents and core technology, completed technology and trademarks. Customer relationships are amortized on an accelerated basis based upon the pattern in which the economic benefits of customer relationships are being utilized. Other identifiable intangible assets are amortized on a straight-line basis over their estimated useful lives. We assess the potential impairment of intangible assets on an annual basis, as well as whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that could trigger an impairment of such assets include the following:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of or use of the acquired assets or the strategy for our overall business;
- significant negative industry or economic trends;

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- significant decline in our stock price for a sustained period;
- 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; and
- a decline in our market capitalization 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.

Our sales to government clients subject us to risks, including early termination, audits, investigations, sanctions and penalties.

We derive a portion of our revenues and bookings from contracts with the United States government, as well as various state and local governments, and their respective agencies. Government contracts are generally subject to audits and investigations which could identify violations of these agreements. Government contract violations could result in a range of consequences including, but not limited to, contract price adjustments, civil and criminal penalties, contract termination, forfeiture of profit and/or suspension of payment, and suspension or debarment from future government contracts. We could also suffer serious harm to our reputation if we were found to have violated the terms of our government contracts.

We conducted an analysis of our compliance with the terms and conditions of certain contracts with the U.S. General Services Administration ("GSA"). Based upon our analysis, we voluntarily notified GSA of non-compliance with the terms of two contracts. The final resolution of this matter may adversely impact our financial position.

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. 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 software engineers 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.

Our business is subject to a variety of U.S. and international laws, rules, policies and other obligations regarding data protection.

We are subject to 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 third-party transactions, but also to transfers of information between the Company and its subsidiaries, and among the Company, its subsidiaries and other parties with which we have relations. Several jurisdictions have passed laws in this area, and other jurisdictions are considering imposing additional restrictions. These laws continue to evolve and may be inconsistent from jurisdiction to jurisdiction. Complying with emerging and changing requirements may cause us to incur substantial costs or require us to change our business practices. Noncompliance could result in penalties or significant legal liability.

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

Adverse changes in general economic or political conditions in any of the major countries in which we do business could adversely affect our operating results.

Adverse changes in domestic and global economic and political conditions, as well as uncertainty in the global financial markets may negatively affect our financial results. These macroeconomic developments could negatively affect our business, operating results or financial condition in a number of ways which, in turn, could adversely affect our stock price. A prolonged period of economic decline could have a material adverse effect on our results of operations and financial condition and exacerbate some of the other risk factors described herein. Our customers may defer purchases of our products, licenses, and services in response to tighter credit and negative financial news or reduce their demand for them. Our customers may also not be able to obtain adequate access to credit, which could affect their ability to make timely payments to us or ultimately cause the customer to file for protection from creditors under applicable insolvency or bankruptcy laws. If our customers are not able to make timely payments to us, our accounts receivable could increase. Political instability in any of the major countries in which we do business would also likely harm our business, results of operations and financial condition.

Current uncertainty in the global financial markets and the global economy may negatively affect our financial results.
Our investment portfolio, which primarily includes investments in money market funds, is generally subject to credit, liquidity, counterparty, market and interest rate risks that may be exacerbated by the recent global financial crisis. If the banking system or the fixed income, credit or equity markets deteriorate or remain volatile, our investment portfolio may be impacted and the values and liquidity of our investments could be adversely affected.
In addition, our operating results and financial condition could be negatively affected if, as a result of economic conditions, either:

- the demand for, and prices of, our products, licenses, or services are reduced as a result of actions by our competitors or otherwise; or
- our financial counterparties or other contractual counterparties are unable to, or do not, meet their contractual commitments to us.

Security and privacy breaches may damage client relations and inhibit our growth.
The uninterrupted operation of our hosted solutions and the confidentiality and security of third-party information is critical to our business. Any failures in our security and privacy measures or policies could have a material adverse effect on our financial position and results of operations. If we are unable to protect, or our clients perceive that we are unable to protect, the security and privacy of our confidential information, our growth could be materially adversely affected. A security or privacy breach may:

- cause our clients to lose confidence in our solutions;
- harm our reputation;
- expose us to liability; and
- increase our expenses from potential remediation costs.

While we believe we use proven applications designed for data security and integrity to process electronic transactions, there can be no assurance that our use of these applications will be sufficient to address changing market conditions or the security and privacy concerns of existing and potential clients.
Interruptions or delays in service from data center hosting facilities could impair the delivery of our service and harm our business.
We currently serve our customers from data center hosting facilities. Any damage to, or failure of, our systems generally could result in interruptions in our service. Interruptions in our service may reduce our revenue, cause us to issue credits or pay penalties, cause customers to terminate their on-demand services and adversely affect our renewal rates and our ability to attract new customers.
Risks Related to Our Intellectual Property and Technology
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 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 efforts.
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 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.

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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. In the event of a claim of intellectual property infringement, we may be required to enter into costly royalty or license agreements. Third parties claiming intellectual property infringement may be able to obtain injunctive or other equitable relief that could effectively block our ability to develop and sell our products.

We may incur substantial costs enforcing or acquiring intellectual property rights and defending against third-party claims as a result of litigation or other proceedings.

In connection with the enforcement of our own intellectual property rights, the acquisition of third-party intellectual property rights, or disputes relating to the validity or alleged infringement of third-party intellectual property rights, including patent rights, we have been, are currently, and may in the future be, subject to claims, negotiations or complex, protracted litigation. Intellectual property disputes and litigation are typically very costly and can be disruptive to our business operations by diverting the attention and energy of management and key technical personnel. Although we have successfully defended or resolved past litigation and disputes, we may not prevail in any ongoing or future litigation and disputes. In addition, we may incur significant costs in acquiring the necessary third party intellectual property rights for use in our products. Third party intellectual property disputes could subject us to significant liabilities, require us to enter into royalty and licensing arrangements on unfavorable terms, prevent us from manufacturing or 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 license arrangements. Any of these could seriously harm our business.

Our software products may have bugs, which could result in delayed or lost revenue and bookings, 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 and bookings, 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.

Risks Related to our Corporate Structure, Organization and Common Stock

The holdings of our largest stockholder may enable them to influence matters requiring stockholder approval.

As of June 30, 2014, High River Limited Partnership, Hopper Investments LLC, Barberry Corp., Icahn Partners LP, Icahn Partners Master Fund LP, Icahn Partners Master Fund II LP, Icahn Partners Master Fund III LP, Icahn Enterprises G.P. Inc., Icahn Enterprises Holdings L.P., IPH GP LLC, Icahn Capital LP, Icahn Onshore LP, Icahn Offshore LP, and Beckton Corp. (collectively, the “Icahn Group”), beneficially owned approximately 19% of the outstanding shares of our common stock. Brett Icahn and David Schechter of the Icahn Group have been appointed as directors of the Company. Because of its large holdings of our capital stock relative to other stockholders, the Icahn Group has a strong influence over matters requiring approval by our stockholders.

The market price of our common stock has been and may continue to be subject to wide fluctuations, and this may make it difficult for you to resell the common stock when you want or at prices you find attractive.

Our stock price historically has been, and may continue to be, volatile. Various factors contribute to the volatility of our stock price, including, for example, quarterly variations in our financial results, new product introductions by us or our competitors and general economic and market conditions. Sales of a substantial number of shares of our common stock by our largest stockholders, or the perception that such sales could occur, could also contribute to the volatility or our stock price. While we cannot predict the individual effect that these factors may have on the market price of our common stock, these factors, either individually or in the aggregate, could result in significant volatility in our stock price during any given period of time. Moreover, companies that have experienced volatility in the market price of their stock often are subject to securities class action litigation. If we were the subject of such litigation, it could result in substantial costs and divert management's attention and resources.

Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act, new regulations promulgated by the Securities and Exchange Commission and the rules of the Nasdaq Marketplace, are resulting in increased general and administrative expenses for companies such as ours. These new or changed laws, regulations and standards are subject to varying interpretations in many cases, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, we intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies, our business may be harmed.

Future sales of our common stock in the public market could adversely affect the trading price of our common stock and our ability to raise funds in new stock offerings.

Future sales of substantial amounts of our common stock in the public market, or the perception that such sales could occur, could adversely affect prevailing trading prices of our common stock and could impair our ability to raise capital through future offerings of equity or equity-related securities. In connection with past acquisitions, we issued a substantial number of shares of our common stock as transaction consideration. We may continue to issue equity securities for future acquisitions, which would dilute existing stockholders, perhaps significantly depending on the terms of such acquisitions. No prediction can be made as to the effect, if any, that future sales of shares of common stock, or the availability of shares of common stock for future sale, will have on the trading price of our common stock.

Our business could be negatively affected as a result of the actions of activist stockholders.

Responding to actions by activist stockholders can be costly and time-consuming, disrupting our operations and diverting the attention of management and our employees. Furthermore, any perceived uncertainties as to our future direction could result in the loss of potential business opportunities, and may make it more difficult to attract and retain qualified personnel and business partners.

We have implemented anti-takeover provisions, which could discourage or prevent a takeover, even if an acquisition would be beneficial to our stockholders.

Provisions of our certificate of incorporation, bylaws and Delaware law, as well as other organizational documents could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders. These provisions include:

- authorized “blank check” preferred stock;
- prohibiting cumulative voting in the election of directors;
- limiting the ability of stockholders to call special meetings of stockholders;
- requiring all stockholder actions to be taken at meetings of our stockholders; and
- establishing advance notice requirements for nominations of directors and for stockholder proposals.

In addition, on August 19, 2013, we implemented a stockholder rights plan, also called a poison pill, that may have the effect of discouraging or preventing a change of control by, among other things, making it uneconomical for a third party to acquire us without the consent of our Board of Directors.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On April 30, 2013, we announced a share repurchase program for up to $500 million of our outstanding shares of common stock. The plan has no expiration date. There were no repurchases under the program during the three months ended June 30, 2014.

For the majority of restricted stock units granted to employees, the number of shares issued on the date the restricted stock units vest is net of the minimum statutory income withholding tax requirements that we pay in cash to the applicable taxing authorities on behalf of our employees. We do not consider these transactions to be common stock repurchases.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

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None.

Item 6. Exhibits
The exhibits listed on the Exhibit Index are filed or incorporated by reference (as stated therein) as part of this Quarterly Report on Form 10-Q.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the Town of Burlington, Commonwealth of Massachusetts, on August 11, 2014.

Nuance Communications, Inc.

By: /s/ Thomas L. Beaudoin
Thomas L. Beaudoin
Executive Vice President and Chief Financial Officer

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EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated by Reference Form	File No.	Exhibit	Filing Date	Filed Herewith
3.1	Amended and Restated Certificate of Incorporation of the Registrant.	10-Q	000-27038	3.2	5/11/2001	
3.2	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant.	10-Q	000-27038	3.1	8/9/2004	
3.3	Certificate of Ownership and Merger.	8-K	000-27038	3.1	10/19/2005	
3.4	Certificate of Amendment of the Amended and Restated Certificate of Incorporation of the Registrant.	S-3	333-142182	3.3	4/18/2007	
3.5	Amended and Restated Bylaws of the Registrant.	8-K	000-27038	3.1	11/13/2007	
3.6	Certificate of Elimination of the Series A Participating Preferred Stock	8-K	000-27038	3.1	8/20/2013	
3.7	Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock	8-K	000-27038	3.2	8/20/2013	
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) or 15d-14(a).					X
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) or 15d-14(a).					X
32.1	Certification Pursuant to 18 U.S.C. Section 1350.					X
101	The following materials from Nuance Communications, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2014, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Operations, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Cash Flows, and (iv) Notes of Consolidated Financial Statements.					X