CADENCE DESIGN SYSTEMS INC
Form 10-Q
July 29, 2008

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 28, 2008

OR

o **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 0-15867

CADENCE DESIGN SYSTEMS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**77-0148231**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
2655 Seely Avenue, Building 5, San Jose, California	**95134**
(Address of Principal Executive Offices)	(Zip Code)

(408) 943-1234
Registrant s Telephone Number, including Area Code

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 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 a 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

On June 28, 2008, 260,256,338 shares of the registrant s common stock, $0.01 par value, were outstanding.

CADENCE DESIGN SYSTEMS, INC.
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CADENCE DESIGN SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

ASSETS

	June 28, 2008	December 29, 2007
Current Assets:		
Cash and cash equivalents	$ 836,513	$ 1,062,920
Short-term investments	52,751	15,193
Receivables, net of allowances of $3,218 and $2,895, respectively	315,677	326,211
Inventories	23,689	31,003
Prepaid expenses and other	99,153	94,236
Total current assets	1,327,783	1,529,563
Property, plant and equipment, net of accumulated depreciation of $640,382 and $624,680, respectively	359,023	339,463
Goodwill	1,314,238	1,310,211
Acquired intangibles, net	112,191	127,072
Installment contract receivables	192,503	238,010
Other assets	320,585	326,831
Total Assets	$ 3,626,323	$ 3,871,150

LIABILITIES AND STOCKHOLDERS EQUITY

	June 28, 2008	December 29, 2007
Current Liabilities:		
Convertible notes	$ 230,385	$ 230,385
Accounts payable and accrued liabilities	246,981	289,934
Current portion of deferred revenue	247,758	265,168
Total current liabilities	725,124	785,487
Long-Term Liabilities:		
Long-term portion of deferred revenue	122,116	136,655
Convertible notes	500,000	500,000
Other long-term liabilities	350,422	368,942
Total long-term liabilities	972,538	1,005,597

Stockholders Equity:		
Common stock and capital in excess of par value	1,530,635	1,516,493
Treasury stock, at cost	(734,608)	(619,125)
Retained earnings	1,104,821	1,162,441
Accumulated other comprehensive income	27,813	20,257
Total stockholders equity	1,928,661	2,080,066
Total Liabilities and Stockholders Equity	$ 3,626,323	$ 3,871,150

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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CADENCE DESIGN SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Revenue:				
Product	$ 195,444	$ 263,793	$ 351,637	$ 501,697
Services	33,694	32,816	65,890	64,738
Maintenance	100,340	94,352	199,140	189,711
Total revenue	329,478	390,961	616,667	756,146
Costs and Expenses:				
Cost of product	18,018	12,827	30,019	28,479
Cost of services	27,213	23,442	52,406	47,057
Cost of maintenance	14,439	15,295	28,979	30,418
Marketing and sales	89,907	98,063	182,941	200,761
Research and development	120,087	122,962	245,443	240,027
General and administrative	34,963	41,808	72,671	82,419
Amortization of acquired intangibles	5,820	4,413	11,580	8,922
Restructuring and other charges (credits)	(355)	(1,573)	(355)	(2,518)
Write-off of acquired in-process technology	----	----	600	----
Total costs and expenses	310,092	317,237	624,284	635,565
Income (loss) from operations	19,386	73,724	(7,617)	120,581
Interest expense	(2,880)	(3,064)	(5,875)	(6,524)
Other income (expense), net	(1,750)	14,207	4,013	33,737
Income (loss) before provision for income taxes	14,756	84,867	(9,479)	147,794
Provision for income taxes	9,760	25,271	4,272	43,777
Net income (loss)	$ 4,996	$ 59,596	$ (13,751)	$ 104,017
Basic net income (loss) per share	$ 0.02	$ 0.22	$ (0.05)	$ 0.38
Diluted net income (loss) per share	$ 0.02	$ 0.20	$ (0.05)	$ 0.35
Weighted average common shares outstanding basic	252,629	274,425	257,724	272,043
Weighted average common shares outstanding diluted	269,060	302,746	257,724	297,048

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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CADENCE DESIGN SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended	
	June 28, 2008	June 30, 2007
Cash and Cash Equivalents at Beginning of Period	$ 1,062,920	$ 934,342
Cash Flows from Operating Activities:		
Net income (loss)	(13,751)	104,017
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	65,553	63,308
Stock-based compensation	43,044	54,709
Equity in loss from investments, net	718	1,720
(Gain) loss on investments, net	1,729	(12,093)
Gain on sale and leaseback of land and buildings	(1,070)	(12,071)
Write-down of investment securities	8,304	550
Write-off of acquired in-process technology	600	----
Tax benefit of call options	----	4,292
Deferred income taxes	880	1,332
Proceeds from the sale of receivables, net	46,025	76,311
Provisions (recoveries) for losses (gains) on trade accounts receivable and sales returns	324	(106)
Other non-cash items	(1,503)	5,045
Changes in operating assets and liabilities, net of effect of acquired businesses:		
Receivables	11,007	24,168
Installment contract receivables	7,298	(153,636)
Inventories	7,350	(972)
Prepaid expenses and other	(8,075)	(7,760)
Other assets	(4,562)	810
Accounts payable and accrued liabilities	(56,629)	(19,493)
Deferred revenue	(37,187)	(16,926)
Other long-term liabilities	(12,580)	6,940
Net cash provided by operating activities	57,475	120,145
Cash Flows from Investing Activities:		
Proceeds from the sale of available-for-sale investments	3,693	3,256
Purchases of available-for-sale investments	(31,758)	----
Proceeds from the sale of long-term investments	3,250	6,241
Proceeds from the sale of property, plant and equipment	----	46,500
Purchases of property, plant and equipment	(60,769)	(37,996)

Purchases of software licenses	(375)	----
Investment in venture capital partnerships and equity investments	(1,419)	(1,948)
Cash paid in business combinations and asset acquisitions, net of cash acquired, and acquisition of intangibles	(6,189)	(7,394)
Net cash provided by (used for) investing activities	(93,567)	8,659
Cash Flows from Financing Activities:		
Principal payments on term loan	----	(28,000)
Tax benefit from employee stock transactions	288	17,732
Proceeds from issuance of common stock	26,637	205,219
Stock received for payment of employee taxes on vesting of restricted stock	(3,287)	(10,337)
Purchases of treasury stock	(216,236)	(121,455)
Net cash provided by (used for) financing activities	(192,598)	63,159
Effect of exchange rate changes on cash and cash equivalents	2,283	2,224
Increase (decrease) in cash and cash equivalents	(226,407)	194,187
Cash and Cash Equivalents at End of Period	$ 836,513	$ 1,128,529

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

CADENCE DESIGN SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q have been prepared by Cadence Design Systems, Inc., or Cadence, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, or the SEC. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, Cadence believes that the disclosures contained in this Quarterly Report on Form 10-Q comply with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, for a Quarterly Report on Form 10-Q and are adequate to make the information presented not misleading. These Condensed Consolidated Financial Statements are meant to be, and should be, read in conjunction with the Consolidated Financial Statements and the Notes thereto included in Cadence s Annual Report on Form 10-K for the fiscal year ended December 29, 2007.

The unaudited Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q reflect all adjustments (which include only normal, recurring adjustments and those items discussed in these Notes) that are, in the opinion of management, necessary to state fairly the results for the periods presented. The results for such periods are not necessarily indicative of the results to be expected for the full fiscal year.

Preparation of the Condensed Consolidated Financial Statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

In September 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standard, or SFAS, No. 157, Fair Value Measurements, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position, or FSP, FAS No. 157-2, Effective Date of FASB Statement No. 157, which delayed the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Cadence adopted SFAS No. 157 for fiscal 2008, except as it applies to those non-financial assets and non-financial liabilities as described in FSP FAS No. 157-2, and it did not have a material impact on its consolidated financial position, results of operations or cash flows. See Note 3 for information and related disclosures regarding Cadence s fair value measurements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. Under SFAS No. 159, companies may elect to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Cadence adopted SFAS No. 159 for fiscal 2008. However Cadence did not elect to apply the fair value option to any

financial instruments or other items upon adoption of SFAS No. 159 or during the six months ended June 28, 2008. Therefore, the adoption of SFAS No. 159 did not impact Cadence s consolidated financial position, results of operations or cash flows.

Cadence has determined that Product revenue totaling $8.4 million recognized during the three months ended June 28, 2008 should have been recognized during the three months ended March 29, 2008. As a result, Cadence s net loss for the three months ended March 29, 2008 would have decreased by $2.8 million, and net income for the three-months ended June 28, 2008 would have decreased by $2.8 million. The effect on the Condensed Consolidated Financial Statements for the three months ended June 28, 2008 and March 29, 2008 is not considered

material, and there is no effect to the Condensed Consolidated Financial Statements for the six months ended June 28, 2008.

NOTE 2. STOCK-BASED COMPENSATION

Cadence has equity incentive plans that provide for the grant to employees of stock-based awards, including stock options, restricted stock awards and restricted stock units. Restricted stock awards and restricted stock units are referred to as restricted stock in this Quarterly Report on Form 10-Q. In addition, the 1995 Directors Stock Option Plan, or 1995 Directors Plan, provides for the automatic grant of stock options to non-employee members of Cadence s Board of Directors. Cadence also has an employee stock purchase plan, or ESPP, which enables employees to purchase shares of Cadence common stock.

Stock-based compensation expense and the related income tax benefit recognized under SFAS No. 123R, Share-Based Payment in the Condensed Consolidated Statements of Operations in connection with stock options, restricted stock and the ESPP for the three and six months ended June 28, 2008 and June 30, 2007 were as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands)			
Stock options	$ 6,708	$ 9,667	$ 14,227	$ 20,097
Restricted stock and stock bonuses	10,888	14,325	22,052	29,509
ESPP	3,858	3,035	6,765	5,103
Total stock-based compensation expense	$ 21,454	$ 27,027	$ 43,044	$ 54,709
Income tax benefit	$ 5,443	$ 9,002	$ 11,503	$ 19,013

Stock Options

The exercise price of each stock option granted under Cadence s employee equity incentive plans is equal to or greater than the market price of Cadence s common stock on the date of grant. Generally, option grants vest over four years, expire no later than ten years from the grant date and are subject to the employee s continuing service to Cadence. The options granted under the 1995 Directors Plan vest one year from the date of grant. Options assumed in connection with acquisitions generally have exercise prices that differ from the fair value of Cadence s common stock on the date of acquisition and such options generally continue to vest under their original vesting schedules and expire on the original dates stated in the acquired company s option agreements. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The weighted average grant date fair value of options granted and the weighted average assumptions used in the model for the three and six months ended June 28, 2008 and June 30, 2007 were as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007

Dividend yield	None	None	None	None
Expected volatility	38.0%	24.0%	42.9%	23.1%
Risk-free interest rate	3.36%	4.92%	2.76%	4.70%
Expected life (in years)	4.5	4.4	4.5	4.4
Weighted average fair value of options granted	$ 4.04	$ 6.24	$ 4.22	$ 5.09

The computation of the expected volatility assumption used in the Black-Scholes pricing model for new grants is based on implied volatility. When establishing the expected life assumption, Cadence reviews annual historical employee exercise behavior with respect to option grants having similar vesting periods. The risk-free interest rate for the period within the expected term of the option is based on the yield of United States Treasury notes in effect at

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the time of grant. Cadence has not historically paid dividends; thus the expected dividend yield used in the calculation is zero.

Restricted Stock and Stock Bonuses

The cost of restricted stock is determined using the fair value of Cadence s common stock on the date of the grant, and compensation expense is recognized over the vesting period. The weighted average grant date fair values of restricted stock granted during the three and six months ended June 28, 2008 and June 30, 2007 were as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Weighted average fair value of restricted stock granted	$ 11.24	$ 22.00	$ 11.10	$ 20.53

Generally, restricted stock vests over four years and is subject to the employee s continuing service to Cadence. Cadence issues some of its restricted stock with performance-based vesting. The terms of these restricted stock grants are consistent with grants of restricted stock described above, with the exception that the shares vest not upon the mere passage of time, but upon the attainment of certain predetermined performance goals. Cadence estimates the most likely outcome of such performance goals and recognizes the related stock-based compensation expense at each period. The amount of stock-based compensation expense recognized in any one period can vary based on the attainment or estimated attainment of the various performance goals. If such performance goals are not met, no compensation expense is recognized and any previously recognized compensation expense is reversed. Stock-based compensation expense related to these performance-based restricted stock grants for the three and six months ended June 28, 2008 and June 30, 2007 was as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands)			
Stock-based compensation expense related to performance-based grants	$ 1,915	$ 1,869	$ 3,931	$ 3,633

Liability-based Awards

Cadence maintains a performance-based bonus plan under which payments may be made in Cadence s common stock. Each period, Cadence estimates the most likely outcome of predetermined performance goals and recognizes any related stock-based compensation expense. The amount of stock-based compensation expense recognized in any one period can vary based on the attainment or estimated attainment of the various performance goals. If such performance goals are not met, no compensation expense is recognized and any previously recognized compensation expense is reversed. The dollar amount earned under this bonus plan is based on the achievement of the performance goals, and the number of shares to be issued under the plan is based on the average stock price for three days preceding the grant date. Stock issued under the performance-based bonus plan vests immediately. During the six months ended June 28, 2008, Cadence agreed to make the period s payment of $2.7 million in cash. Under the terms of this performance-based bonus plan, future payments are to be made in stock. Stock-based compensation expense related to these performance-based bonus plans and the shares issued for the three and six months ended June 28, 2008 and

June 30, 2007 were as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands)			
Stock-based compensation expense related to performance-based bonus plan	$ 1,402	$ 2,857	$ 2,827	$ 6,789
Shares issued for performance-based bonus plan	----	----	----	252

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Employee Stock Purchase Plan

Under the ESPP, substantially all employees may purchase Cadence s common stock at a price equal to 85% of the lower of the fair market value at the beginning of the applicable offering period or at the end of each applicable purchase period, in an amount up to 12% of their annual base earnings plus bonuses, subject to a limit in any calendar year of $25,000 worth of common stock. The duration of each offering period under the ESPP is six months. New offerings begin on each February 1st and August 1st of each year and the purchase dates under the ESPP are January 31st and July 31st of each year.

Shares of Cadence s common stock issued under the ESPP for the three and six months ended June 28, 2008 and June 30, 2007 were as follows:

	Six Months Ended	
	June 28, 2008	June 30, 2007
	(In thousands, except per share amounts)	
Cadence shares issued under the ESPP	2,719	1,921
Cash received from the exercise of purchase rights under the ESPP	$ 23,455	$ 22,581
Weighted average purchase price per share	$ 8.63	$ 11.76

Compensation expense is calculated using the fair value of the employees purchase rights under the Black-Scholes option pricing model. The weighted average grant date fair value of purchase rights granted under the ESPP and the weighted average assumptions used in the model for the three and six months ended June 28, 2008 and June 30, 2007 were as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Dividend yield	None	----	None	None
Expected volatility	38.0%	----	43.0%	23.0%
Risk-free interest rate	1.67%	----	2.05%	5.16%
Expected life (in years)	0.25	----	0.45	0.50
Weighted average fair value of purchase rights granted	$ 2.50	----	$ 2.86	$ 4.49

The computation of the expected volatility assumption used in the Black-Scholes pricing model for purchase rights is based on implied volatility. The expected life assumption is based on the average exercise date for the purchase periods in each offering period. The risk-free interest rate for the period within the expected life of the purchase right is based on the yield of United States Treasury notes in effect at the time of grant. Cadence has not historically paid dividends; thus the expected dividend yield used in the calculation is zero.

NOTE 3. FINANCIAL INSTRUMENTS

Fair Value of Financial Instruments

On a quarterly basis, Cadence measures at fair value certain financial assets and liabilities, including cash equivalents, available-for-sale securities, time deposits, trading securities held in Cadence s Nonqualified Deferred Compensation Plans, or NQDCs, and foreign exchange contracts. SFAS No. 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Cadence s market assumptions. These two types of inputs have created the following fair-value hierarchy:

Level 1 Quoted prices for identical instruments in active markets;

Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3 Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

This hierarchy requires Cadence to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value. The fair value of these financial assets and liabilities was determined using the following levels of inputs as of June 28, 2008:

	Fair Value Measurements as of June 28, 2008:			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Cash equivalents Money market mutual funds	$ 695,502	$ 695,502	$ ----	$ ----
Available-for-sale securities	52,483	52,408	----	75
Time deposits	268	268	----	----
Trading securities held in NQDCs	46,978	46,978	----	----
Foreign currency exchange contracts	161	----	161	----
Total	$ 795,392	$ 795,156	$ 161	$ 75

Marketable Securities

Cadence considers all of its investments in marketable securities as available-for-sale. Available-for-sale securities are stated at fair value, with the unrealized gains and losses presented net of tax and reported as a separate component of Stockholders equity. Realized gains and losses are determined using the specific identification method. Gains are recognized when realized and are recorded in the Condensed Consolidated Statements of Operations as Other income (expense), net. Losses are recognized as realized or when Cadence has determined that an other-than-temporary decline in fair value has occurred.

It is Cadence s policy to review the fair value of these marketable securities on a regular basis to determine whether its investments in these companies are other-than-temporarily impaired. This evaluation includes, but is not limited to, reviewing each company s cash position, financing needs, earnings or revenue outlook, operational performance, management or ownership changes and competition. If Cadence believes the carrying value of an investment is in excess of its fair value, and this difference is other-than-temporary, it is Cadence s policy to write down the investment to reduce its carrying value to fair value.

The following tables summarize Cadence s available-for-sale marketable securities as of June 28, 2008 and December 29, 2007:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
June 28, 2008	$ 43,403	$ 9,881	$ (801)	$ 52,483
December 29, 2007	$ 14,044	$ 4,467	$ (3,572)	$ 14,939

The following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized

loss position as of June 28, 2008:

	Less than 12 Months	
	Fair Value	Gross Unrealized Losses
	(In thousands)	
Marketable securities available-for-sale	$ 4,502	$ (801)

During the six months ended June 28, 2008, Cadence determined that one of its available-for-sale securities was other-than-temporarily impaired based on the severity and the duration of the impairment and Cadence wrote down the investment by $5.4 million. This impairment is included in Other income (expense), net in the Condensed Consolidated Statement of Operations for the six months ended June 28, 2008. Cadence did not recognize an other-

than-temporary impairment of available-for-sale securities during the three months ended June 28, 2008 or during the three and six months ended June 30, 2007.

Cost Method Investments

Investments accounted for by Cadence under the cost method of accounting are carried at historical cost and Cadence periodically evaluates the fair value of each investment to determine if an other-than-temporary decline in value has occurred. Cadence recorded write-downs due to other-than-temporary declines in value of non-marketable securities carried on the cost basis of $2.9 million for the three and six months ended June 28, 2008 and $0.6 million for the three and six months ended June 30, 2007. These write-downs are included in Other income (expense), net, in the Condensed Consolidated Statement of Operations.

NOTE 4. CONVERTIBLE NOTES

1.375% Convertible Senior Notes Due 2011 and 1.500% Convertible Senior Notes Due 2013

In December 2006, Cadence issued $250.0 million principal amount of 1.375% Convertible Senior Notes Due 2011, or the 2011 Notes, and $250.0 million of 1.500% Convertible Senior Notes Due 2013, or the 2013 Notes, and collectively, the Convertible Senior Notes, to three initial purchasers in a private placement pursuant to Section 4(2) of the Securities Act for resale to qualified institutional buyers pursuant to SEC Rule 144A. Cadence received net proceeds of approximately $487.0 million after transaction fees of approximately $13.0 million, including $12.0 million of underwriting discounts. A portion of the net proceeds totaling $228.5 million was used to purchase $189.6 million principal amount of Cadence s Zero Coupon Zero Yield Senior Convertible Notes Due 2023, or the 2023 Notes.

Holders may convert their Convertible Senior Notes prior to maturity upon the occurrence of one of the following events:

- The price of Cadence s common stock reaches $27.50 during certain periods of time specified in the Convertible Senior Notes;
- Specified corporate transactions occur; or
- The trading price of the Convertible Senior Notes falls below a certain threshold.

On and after November 2, 2011, in the case of the 2011 Notes, and November 1, 2013, in the case of 2013 Notes, until the close of business on the scheduled trading day immediately preceding the maturity date, holders may convert their Convertible Senior Notes at any time, regardless of the foregoing circumstances. Cadence may not redeem the Convertible Senior Notes prior to maturity.

The initial conversion rate for the Convertible Senior Notes is 47.2813 shares of Cadence common stock per $1,000 principal amount of Convertible Senior Notes, equivalent to a conversion price of approximately $21.15 per share of Cadence common stock. Upon conversion, a holder will receive the sum of the daily settlement amounts, calculated on a proportionate basis for each day, during a specified observation period following the conversion date. The daily settlement amount during each date of the observation period consists of:

- Cash up to the principal amount of the note; and
- Cadence s common stock to the extent that the conversion value exceeds the amount of cash paid upon conversion of the Convertible Senior Notes.

In addition, if a fundamental change occurs prior to maturity, the conversion rate will increase by an additional amount of up to $8.27 per share, for a holder that elects to convert its Convertible Senior Notes in connection with such fundamental change, which amount will be paid entirely in cash. A fundamental change is any transaction or event (whether by means of an exchange offer, liquidation, tender offer, consolidation, merger, combination, reclassification, recapitalization or otherwise) in which more than 50% of Cadence s common stock is exchanged for, converted into, acquired for or constitutes solely the right to receive, consideration. No fundamental change will

have occurred if at least 90% of the consideration received consists of shares of common stock, or depositary receipts representing such shares, that are:

Listed on, or immediately after the transaction or event will be listed on, a United States national securities exchange; or

Approved, or immediately after the transaction or event will be approved, for quotation on a United States system of automated dissemination of quotations of securities prices similar to the NASDAQ National Market prior to its designation as a national securities exchange.

As of June 28, 2008, none of the conditions allowing the holders of the Convertible Senior Notes to convert had been met.

Cadence evaluated the embedded conversion option in accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities and concluded that the embedded conversion option contained within the Convertible Senior Notes should not be accounted for separately because the conversion option is indexed to Cadence s common stock and is classified as stockholders equity. Furthermore, Cadence evaluated the terms of the Convertible Senior Notes for a beneficial conversion feature in accordance with Emerging Issues Task Force, or EITF, No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios and EITF No. 00-27, Application of Issue 98-5 to Certain Convertible Instruments and concluded there was no beneficial conversion feature at the commitment date based on the conversion rate of the Convertible Senior Notes relative to the commitment date stock price.

Interest on the Convertible Senior Notes began accruing in December 2006 and is payable semi-annually each December 15th and June 15th.

Concurrently with the issuance of the Convertible Senior Notes, Cadence entered into hedge transactions with various parties whereby Cadence has the option to purchase up to 23.6 million shares of Cadence s common stock at a price of $21.15 per share, subject to adjustment. These options expire on December 15, 2011, in the case of the 2011 Notes, and December 15, 2013, in the case of the 2013 Notes, and must be settled in net shares. The aggregate cost of these hedge transactions was $119.8 million and has been recorded as a reduction to Stockholders equity in accordance with EITF No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock. The estimated fair value of the hedges acquired in connection with the issuance of the Convertible Senior Notes was $29.4 million as of June 28, 2008. Subsequent changes in the fair value of these hedges will not be recognized as long as the instruments remain classified as equity.

In separate transactions, Cadence also sold warrants to various parties for the purchase of up to 23.6 million shares of Cadence s common stock at a price of $31.50 per share in a private placement pursuant to Section 4(2) of the Securities Act. The warrants expire on various dates from February 2012 through April 2012 in the case of the 2011 Notes, and February 2014 through April 2014 in the case of the 2013 Notes, and must be settled in net shares. Cadence received $39.4 million in cash proceeds from the sale of these warrants, which has been recorded as a reduction to Stockholders equity in accordance with EITF No. 00-19. The estimated fair value of the warrants sold in connection with the issuance of the Convertible Senior Notes was $12.7 million as of June 28, 2008. Subsequent changes in the fair value of these warrants will not be recognized as long as the instruments remain classified as equity. The warrants will be included in diluted earnings per share, or EPS, to the extent the impact is considered dilutive.

Zero Coupon Zero Yield Senior Convertible Notes Due 2023

In August 2003, Cadence issued $420.0 million principal amount of its 2023 Notes to two initial purchasers in a private placement pursuant to Section 4(2) of the Securities Act for resale to qualified institutional buyers pursuant to SEC Rule 144A. Cadence received net proceeds of $406.4 million after transaction fees of $13.6 million that were recorded in Other long-term assets and are being amortized to interest expense using the straight-line method over five years, which is the duration of the first redemption period. The 2023 Notes were issued by Cadence at par and bear no interest. The 2023 Notes are convertible into Cadence common stock initially at a conversion price of $15.65 per share, which would result in an aggregate of 26.8 million shares issued upon conversion, subject to adjustment upon the occurrence of specified events. In connection with the issuance of the Convertible Senior Notes

in December 2006, Cadence repurchased $189.6 million principal amount of the 2023 Notes, reducing the aggregate number of shares to be issued upon conversion to 14.7 million.

Cadence may redeem for cash all or any part of the 2023 Notes on or after August 15, 2008 for 100.00% of the principal amount, except for the 2023 Notes that the holders require Cadence to repurchase on the repurchase dates described below. The holders of the 2023 Notes may require Cadence to repurchase for cash all or any portion of their 2023 Notes on August 15, 2008 for 100.25% of the principal amount, on August 15, 2013 for 100.00% of the principal amount or on August 15, 2018 for 100.00% of the principal amount, by providing to the paying agent a written repurchase notice. On July 16, 2008, Cadence filed a Tender Offer Statement on Schedule TO with the SEC and made available to the holders of the 2023 Notes, through the Depository Trust Company, documents specifying the terms, conditions and procedures for requiring Cadence to repurchase the 2023 Notes on August 15, 2008 for 100.25% of the principal amount. Because the holders of the 2023 Notes can require Cadence to repurchase for cash all or any portion of the 2023 Notes on August 15, 2008, the 2023 Notes are classified as a Current liability in Cadence s Condensed Consolidated Balance Sheets as of June 28, 2008 and December 29, 2007.

Each $1,000 of principal of the 2023 Notes will initially be convertible into 63.8790 shares of Cadence common stock, subject to adjustment upon the occurrence of specified events. Holders of the 2023 Notes may convert their 2023 Notes prior to maturity only if:

- The price of Cadence common stock reaches $22.69 during certain periods of time specified in the 2023 Notes;
- Specified corporate transactions occur;
- The 2023 Notes have been called for redemption; or
- The trading price of the 2023 Notes falls below a certain threshold.

In the event of a fundamental change in Cadence s corporate ownership or structure, the holders may require Cadence to repurchase all or any portion of their 2023 Notes for 100.00% of the principal amount. Upon a fundamental change in Cadence s corporate ownership or structure, in certain circumstances Cadence may choose to pay the repurchase price in cash, shares of Cadence common stock or a combination of cash and shares of Cadence common stock. As of June 28, 2008, none of the conditions allowing the holders of the 2023 Notes to convert had been met.

Cadence evaluated the embedded conversion option in accordance with SFAS No. 133 and concluded that the embedded conversion option contained within the 2023 Notes should not be accounted for separately because the conversion option is indexed to Cadence s common stock and is classified as stockholders equity. Furthermore, Cadence evaluated the terms of the 2023 Notes for a beneficial conversion feature in accordance with EITF No. 98-5 and EITF No. 00-27 and concluded there was no beneficial conversion feature at the commitment date based on the conversion rate of the 2023 Notes relative to the commitment date stock price.

In connection with the issuance of the Convertible Senior Notes in December 2006, a portion of the proceeds were used to purchase in the open market the 2023 Notes with a principal balance of $189.6 million and for a total purchase price of $228.5 million. In connection with this purchase, Cadence incurred expenses of $40.8 million for the early extinguishment of debt. The loss on early extinguishment of debt included the call premium on the purchased 2023 Notes and the write-off of a portion of the unamortized deferred debt issuance costs.

Concurrently with the issuance of the 2023 Notes, Cadence entered into hedge transactions with a financial institution whereby Cadence originally acquired options to purchase up to 26.8 million shares of Cadence common stock at a price of $15.65 per share. These options expire on August 15, 2008 and must be settled in net shares. The cost of the hedge transactions to Cadence was $134.6 million. In connection with the purchase of a portion of the 2023 Notes in December 2006, Cadence also sold 12.1 million of the hedges that were originally purchased in connection with the

2023 Notes and received proceeds of $55.9 million.

In addition, Cadence sold warrants for its common stock to a financial institution for the purchase of up to 26.8 million shares of Cadence common stock at a price of $23.08 per share. All of the warrants expired out of the money on various dates from February 2008 through May 2008 and no settlement was required. Cadence received $56.4 million in cash proceeds from the sale of these warrants. In connection with the purchase of a portion of the

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2023 Notes in December 2006, Cadence also purchased 12.1 million of the warrants for its common stock that were originally issued in connection with the 2023 Notes at a cost of $10.2 million.

The costs incurred in connection with the hedge transaction and the proceeds from the sale of the warrants are included as a net reduction in Common stock and capital in excess of par in the accompanying Condensed Consolidated Balance Sheets as of June 28, 2008 and December 29, 2007, in accordance with the guidance in EITF No. 00-19. Additionally, the cost to purchase a portion of the warrants and the proceeds received from selling a portion of the notes hedges during December 2006 have also been recorded to stockholders equity. As of June 28, 2008, the estimated fair value of the remaining hedges acquired in connection with the issuance of the 2023 Notes was zero. Subsequent changes in the fair value of these hedge transactions will not be recognized as long as the instruments remain classified as equity.

NOTE 5. GOODWILL AND ACQUIRED INTANGIBLES

Goodwill

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, Cadence conducts an annual impairment analysis of goodwill. The most recent analysis was completed during the third quarter of 2007, at which time Cadence determined that no indicators of impairment existed. For purposes of SFAS No. 142, Cadence operates under one reporting unit. Cadence s annual impairment review process compares the fair value of its reporting unit to its carrying value, including the goodwill related to the reporting unit. To determine the reporting unit s fair value, Cadence utilized the market valuation approach in the most recent evaluation.

The changes in the carrying amount of goodwill for the six months ended June 28, 2008 were as follows:

	(In thousands)
Balance as of December 29, 2007	$ 1,310,211
Goodwill resulting from acquisition during the period	3,074
Foreign currency translation	961
Tax benefits allocable to goodwill	(8)
Balance as of June 28, 2008	$ 1,314,238

Acquired Intangibles, net

Acquired intangibles with finite lives as of June 28, 2008 were as follows:

	Gross Carrying Amount	Accumulated Amortization (In thousands)	Acquired Intangibles, net
Existing technology and backlog	$ 655,467	$ (614,579)	$ 40,888
Agreements and relationships	100,812	(59,069)	41,743
Distribution rights	30,100	(15,050)	15,050

Tradenames, trademarks and patents		29,867		(15,357)		14,510
Total acquired intangibles	$	816,246	$	(704,055)	$	112,191

During the six months ended June 28, 2008, Cadence acquired intangible assets of $8.6 million, including $0.6 million allocated to acquired in-process technology related to Cadence s acquisition of Chip Estimate Corporation. The acquired in-process technology was immediately expensed because technological feasibility had not been established and no future alternative use existed.

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Acquired intangibles with finite lives as of December 29, 2007 were as follows:

	Gross Carrying Amount	Accumulated Amortization	Acquired Intangibles, net
		(In thousands)	
Existing technology and backlog	$ 651,427	$ (602,161)	$ 49,266
Agreements and relationships	96,585	(51,791)	44,794
Distribution rights	30,100	(13,545)	16,555
Tradenames, trademarks and patents	29,367	(12,910)	16,457
Total acquired intangibles	$ 807,479	$ (680,407)	$ 127,072

Amortization of acquired intangibles for the three and six months ended June 28, 2008 and June 30, 2007 was as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
		(In thousands)		
Cost of product	$ 4,762	$ 5,225	$ 9,445	$ 10,778
Cost of services	3	3	6	6
Cost of maintenance	1,045	1,217	2,090	2,444
Amortization of acquired intangibles	5,820	4,413	11,580	8,922
Total acquired intangibles	$ 11,630	$ 10,858	$ 23,121	$ 22,150

Amortization of costs from existing technology is included in Cost of product and Cost of services. Amortization of costs from acquired maintenance contracts is included in Cost of maintenance.

Estimated amortization expense for the following fiscal years and thereafter is as follows:

	(In thousands)
2008 remaining period	$ 21,123
2009	35,176
2010	22,857
2011	17,553
2012	12,063
Thereafter	3,419
Total estimated amortization expense	$ 112,191

NOTE 6. CONTINGENCIES

Legal Proceedings

From time to time, Cadence is involved in various disputes and litigation matters that arise in the ordinary course of business. These include disputes and lawsuits related to intellectual property, mergers and acquisitions, licensing, contracts, distribution arrangements and employee relations matters. At least quarterly, Cadence reviews the status of each significant matter and assesses its potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount or the range of loss can be estimated, Cadence accrues a liability for the estimated loss in accordance with SFAS No. 5, Accounting for Contingencies. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based only on the best information available at the time. As additional information becomes available, Cadence reassesses the potential liability related to pending claims and litigation matters and may revise estimates.

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On May 30, 2007, Ahmed Higazi, a former Cadence employee, filed suit against Cadence in the United States District Court for the Northern District of California alleging that Cadence improperly classified him and a class of other Cadence information technology employees as exempt from overtime pay. The suit alleges claims for unpaid overtime under the federal Fair Labor Standards Act and California law, waiting-time penalties under the California Labor Code, failure to provide proper earnings statements under California law, failure to provide meal periods and rest breaks as required by California law, unfair business practices under California Business & Professions Code section 17200, and unpaid 401(k) Plan contributions in violation of the Employee Retirement Income Security Act. On June 20, 2007, Cadence answered the plaintiff s complaint, denying its material allegations and raising a number of affirmative defenses, and on December 19, 2007, Cadence filed an amended answer. A period of discovery conducted by both sides then ensued, and was followed in January 2008 by a private mediation of the case. At the mediation, the parties were successful in resolving their respective differences, and entered into a settlement agreement without contesting the merits of the claims or admitting liability. On July 7, 2008, the court approved the settlement agreement and Cadence paid the settlement amount shortly thereafter. Cadence accrued for this settlement in its Condensed Consolidated Balance Sheets as of June 28, 2008 and December 29, 2007.

While the outcome of disputes and litigation matters cannot be predicted with any certainty, management does not believe that the outcome of any current matters will have a material adverse effect on Cadence s consolidated financial position, liquidity or results of operations.

Income Taxes

The Internal Revenue Service, or IRS, and other tax authorities regularly examine Cadence s income tax returns. In July 2006, the IRS completed its field examination of Cadence s federal income tax returns for the tax years 2000 through 2002 and issued a Revenue Agent s Report, or RAR, in which the IRS proposed to assess an aggregate tax deficiency for the three-year period of approximately $324.0 million. In November 2006, the IRS revised the proposed aggregate tax deficiency for the three-year period to be approximately $318.0 million. The IRS is contesting Cadence s qualification for deferred recognition of certain proceeds received from restitution and settlement in connection with litigation during the period. The proposed tax deficiency for this item is approximately $152.0 million. The remaining proposed tax deficiency of approximately $166.0 million is primarily related to proposed adjustments to Cadence s transfer pricing arrangements with its foreign subsidiaries and to Cadence s deductions for foreign trade income. The IRS took similar positions with respect to Cadence s transfer pricing arrangements in the prior examination period and may make similar claims against Cadence s transfer pricing arrangements in future examinations. Cadence has filed a timely protest with the IRS and will seek resolution of the issues through the Appeals Office of the IRS, or the Appeals Office.

Cadence believes that the proposed IRS adjustments are inconsistent with applicable tax laws and Cadence is vigorously challenging these proposed adjustments. The RAR is not a final Statutory Notice of Deficiency, but the IRS imposes interest on the proposed deficiencies until the matters are resolved. Interest is compounded daily at rates that are published and adjusted quarterly by the IRS and have been between 4% and 10% since 2001. The IRS is currently examining Cadence s federal income tax returns for the tax years 2003 through 2005.

Other Contingencies

Cadence provides its customers with a warranty on sales of hardware products for a 90-day period. These warranties are accounted for in accordance with SFAS No. 5. To date, Cadence has not incurred any significant costs related to warranty obligations.

Cadence s product license and services agreements include a limited indemnification provision for claims from third parties relating to Cadence s intellectual property. Such indemnification provisions are accounted for in accordance

with SFAS No. 5. The indemnification is generally limited to the amount paid by the customer. To date, claims under such indemnification provisions have not been significant.

NOTE 7. NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed by dividing net income (loss), the numerator, by the weighted average number of shares of common stock outstanding, less unvested restricted stock grants, the denominator,

during the period. Diluted net income per share gives effect to equity instruments considered to be potential common shares, if dilutive, computed using the treasury stock method of accounting. In periods in which a net loss is recorded, potentially dilutive equity instruments would decrease the loss per share and therefore are not added to the weighted average shares outstanding.

Cadence accounts for the effect of its 2023 Notes in the diluted net income per share calculation using the if-converted method of accounting. Under that method, the 2023 Notes are assumed to be converted to shares (weighted for the number of days outstanding in the period) at a conversion price of $15.65, and amortization of transaction fees, net of taxes, related to the 2023 Notes is added back to net income.

EITF No. 04-08, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share, requires Cadence to include in diluted earnings per share the shares of Cadence s common stock into which the 1.375% Convertible Senior Notes Due 2011 and the 1.500% Convertible Senior Notes Due 2013, together, the Convertible Senior Notes, may be converted. However, since the Convertible Senior Notes meet the qualification of an Instrument C under EITF No. 90-19, Convertible Bonds with Issuer Option to Settle for Cash Upon Conversion, and because cash will be paid for the principal amount of the obligation upon conversion, the only shares that will be considered for inclusion in diluted net income per share are those relating to the excess of the conversion premium over the principal amount, using the if-converted method of accounting.

The calculations for basic and diluted net income (loss) per share for the three and six months ended June 28, 2008 and June 30, 2007 were as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands, except per share amounts)			
Basic:				
Net income (loss)	$ 4,996	$ 59,596	$ (13,751)	$ 104,017
Weighted average common shares outstanding	252,629	274,425	257,724	272,043
Basic net income (loss) per share	$ 0.02	$ 0.22	$ (0.05)	$ 0.38
Diluted:				
Net income (loss)	$ 4,996	$ 59,596	$ (13,751)	$ 104,017
Effect of dilutive securities:				
Amortization of 2023 Notes transaction fees, net of tax	219	219	----	438
Net income (loss) as adjusted	$ 5,215	$ 59,815	$ (13,751)	$ 104,455
Weighted average common and potential common shares used to calculate basic net income (loss) per share	252,629	274,425	257,724	272,043
Convertible Senior Notes	----	1,359	----	----
2023 Notes	14,721	14,721	----	14,721
Options	826	9,634	----	7,970
Restricted stock and ESPP shares	884	2,607	----	2,314

Weighted average common and potential common shares used to calculate diluted net income (loss) per share	269,060	302,746	257,724	297,048
Diluted net income (loss) per share	$ 0.02	$ 0.20	$ (0.05)	$ 0.35

The following table presents the potential shares of Cadence s common stock outstanding for the three and six months ended June 28, 2008 and June 30, 2007 that were not included in the computation of diluted net income per share because the effect of including these shares would have been anti-dilutive:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands)			
Options to purchase shares of common stock (various expiration dates through 2017)	36,638	7,959	40,345	11,860
Non-vested shares of restricted stock	2,237	----	6,543	----
Warrants to purchase shares of common stock related to the Convertible Senior Notes (various expiration dates through 2014)	23,640	23,640	23,640	23,640
Warrants to purchase shares of common stock related to the 2023 Notes (various expiration dates through May 2008)	----	14,717	----	14,717
Total potential common shares excluded	62,515	46,316	70,528	50,217

NOTE 8. STOCK REPURCHASE PROGRAMS

In December 2006, Cadence s Board of Directors authorized a program to repurchase shares of Cadence s common stock in the open market with a value of up to $500.0 million in the aggregate that was completed during the six months ended June 28, 2008. In February 2008, Cadence s Board of Directors authorized a new program to repurchase shares of Cadence s common stock in the open market with a value of up to $500.0 million in the aggregate.

The shares repurchased under Cadence s stock repurchase programs during the three and six months ended June 28, 2008 and June 30, 2007 were as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands)			
Shares repurchased	----	----	19,774	5,900
Total cost of repurchased shares	$ ----	$ ----	$ 216,236	$ 121,455

As of June 28, 2008, the repurchase authorization remaining under Cadence s repurchase program totaled $412.1 million.

NOTE 9. RETAINED EARNINGS

The changes in retained earnings for the three and six months ended June 28, 2008 were as follows:

	Three Months Ended (In thousands)
Balance as of March 29, 2008	$ 1,119,176
Net income	4,996
Re-issuance of treasury stock	(19,351)
Balance as of June 28, 2008	$ 1,104,821

	Six Months Ended (In thousands)
Balance as of December 29, 2007	$ 1,162,441
Net loss	(13,751)
Re-issuance of treasury stock	(43,869)
Balance as of June 28, 2008	$ 1,104,821

Cadence records a gain or loss on re-issuance of treasury stock based on the total proceeds received in the transaction. Gains on the re-issuance of treasury stock are recorded as a component of Capital in excess of par in Stockholders Equity. Losses on the re-issuance of treasury stock are recorded as a component of Capital in excess of par to the extent that there are gains to offset the losses. If there are no treasury stock gains in Capital in excess of par, the losses upon re-issuance of treasury stock are recorded as a component of Retained earnings in Stockholders Equity. Cadence recorded losses on the re-issuance of treasury stock as a component of Retained earnings of $19.4 million and $43.9 million during the three and six months ended June 28, 2008, respectively.

NOTE 10. OTHER COMPREHENSIVE INCOME (LOSS)

Other comprehensive income (loss) includes foreign currency translation gains and losses and unrealized gains and losses on available-for-sale marketable securities, net of related tax effects. These items have been excluded from net income (loss) and are reflected instead in Stockholders Equity.

Cadence s comprehensive income (loss) for the three and six months ended June 28, 2008 and June 30, 2007 was as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands)			
Net income (loss)	$ 4,996	$ 59,596	$ (13,751)	$ 104,017
Foreign currency translation gain (loss)	(3,069)	(258)	2,638	2,322
Changes in unrealized holding gains (losses) on available-for-sale securities, net of reclassification adjustment for realized gains and losses, net of related tax effects	4,025	(859)	4,918	(1,694)
Other	----	(932)	----	(932)
Comprehensive income (loss)	$ 5,952	$ 57,547	$ (6,195)	$ 103,713

NOTE 11. OTHER INCOME (EXPENSE), NET

Cadence s Other income (expense), net, for the three and six months ended June 28, 2008 and June 30, 2007 was as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands)			
Interest income	$ 5,059	$ 12,641	$ 13,834	$ 24,863
Gains on sale of non-marketable securities	----	1,400	884	5,559
Gains on sale of available-for-sale securities	1,435	2,311	1,435	2,311
Gains (losses) on sale of non-marketable securities in Cadence s non-qualified deferred compensation trust	(3,388)	884	(4,048)	4,223
Gains (losses) on foreign exchange	(1,853)	(1,081)	420	(634)
Equity in loss from investments, net	(385)	(1,083)	(718)	(1,720)
Write-down of investment securities (Note 3)	(2,903)	(550)	(8,304)	(550)
Other income (expense)	285	(315)	510	(315)
Total other income (expense), net	$ (1,750)	$ 14,207	$ 4,013	$ 33,737

NOTE 12. STATEMENT OF CASH FLOWS

The supplemental cash flow information for the six months ended June 28, 2008 and June 30, 2007 is as follows:

	Six Months Ended	
	June 28, 2008	June 30, 2007
	(In thousands)	
Cash Paid During the Period for:		
Interest	$ 3,594	$ 3,930
Income taxes, including foreign withholding tax	$ 21,555	$ 8,376
Non-Cash Investing and Financing Activities:		
Stock options assumed for acquisitions	$ 1,140	$ ----
Treasury stock issued for payment under a performance-based bonus plan	----	$ 5,216
Unrealized gain (loss) on available-for-sale securities, net of taxes	$ 4,918	$ (1,694)
Accrual for executed and unsettled stock purchases	$ 5,258	$ ----

Cadence adopted FASB Interpretation, or FIN, No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109, on December 31, 2006, the first day of fiscal 2007. The cumulative effect of adopting FIN No. 48 was reported as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets) in the Condensed Consolidated Balance Sheet, which amounts were non-cash items in Cadence s Statement of Cash Flows for the six months ended June 30, 2007.

NOTE 13. SEGMENT AND GEOGRAPHY REPORTING

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, requires disclosures of certain information regarding operating segments, products and services, geographic areas of operation and major customers. SFAS No. 131 reporting is based upon the management approach : how management organizes

the company s operating segments for which separate financial information is (i) available and (ii) evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Cadence s chief operating decision maker is its President and Chief Executive Officer, or CEO.

Cadence s CEO reviews Cadence s consolidated results within one segment. In making operating decisions, the CEO primarily considers consolidated financial information, accompanied by disaggregated information about revenues by geographic region.

Outside the United States, Cadence markets and supports its products and services primarily through its subsidiaries. Revenue is attributed to geography based on the country in which the product is used or services are delivered. Long-lived assets are attributed to geography based on the country where the assets are located.

The following table presents a summary of revenue by geography:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In thousands)			
Americas:				
United States	$ 150,071	$ 195,477	$ 259,623	$ 363,426
Other Americas	9,160	8,916	15,377	16,577
Total Americas	159,231	204,393	275,000	380,003
Europe, Middle East and Africa:				
Germany	12,458	18,801	28,854	32,020
Other Europe, Middle East and Africa	56,900	47,128	103,756	87,362
Total Europe, Middle East and Africa	69,358	65,929	132,610	119,382
Japan and Asia:				
Japan	60,774	55,509	135,861	153,591
Asia	40,115	65,130	73,196	103,170
Total Japan and Asia	100,889	120,639	209,057	256,761
Total	$ 329,478	$ 390,961	$ 616,667	$ 756,146

No one customer accounted for 10% of total revenue during the three months ended June 28, 2008 and one customer accounted for 18% of total revenue for the three months ended June 30, 2007. No one customer accounted for 10% of total revenue during the six months ended June 28, 2008 and one customer accounted for 11% of total revenue for the six months ended June 30, 2007.

As of June 28, 2008, two customers each accounted for 10% of Cadence s Receivables, net and Installment contract receivables. As of December 29, 2007, one customer accounted for 11% and one customer accounted for 10% of Cadence s Receivables, net and Installment contract receivables.

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The following table presents a summary of long-lived assets by geography:

	As of June 28, 2008	As of December 29, 2007
	(In thousands)	
Americas:		
United States	$ 320,971	$ 303,347
Other Americas	53	67
Total Americas	321,024	303,414
Europe, Middle East and Africa:		
Germany	1,106	1,269
Other Europe, Middle East and Africa	6,856	7,733
Total Europe, Middle East and Africa	7,962	9,002
Japan and Asia:		
Japan	6,166	1,070
Asia	23,871	25,977
Total Japan and Asia	30,037	27,047
Total	$ 359,023	$ 339,463

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and notes thereto included in this Quarterly Report on Form 10-Q, or this Quarterly Report, and in conjunction with our Annual Report on Form 10-K for the fiscal year ended December 29, 2007. Certain of these statements, including, without limitation, statements regarding the extent and timing of future revenues and expenses and customer demand, statements regarding the deployment of our products, statements regarding our reliance on third parties and other statements using words such as anticipates, believes, could, estimates, expects, intends, may, plans, should, will and would, and words of similar import and the negatives thereof, constitute forward-looking statements. These statements are predictions based upon our current expectations about future events. Actual results could vary materially as a result of certain factors, including but not limited to, those expressed in these statements. We refer you to the Risk Factors, Results of Operations, Disclosures About Market Risk, and Liquidity and Capital Resources sections contained in this Quarterly Report, and the risks discussed in our other Securities Exchange Commission, or SEC, filings, which identify important risks and uncertainties that could cause actual results to differ materially from those contained in the forward-looking statements.

We urge you to consider these factors carefully in evaluating the forward-looking statements contained in this Quarterly Report. All subsequent written or oral forward-looking statements attributable to our company or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The forward-looking statements included in this Quarterly Report are made only as of the date of this Quarterly Report. We do not intend, and undertake no obligation, to update these forward-looking statements.

Overview

We develop electronic design automation, or EDA, software and hardware. We license software, sell or lease hardware technology, provide maintenance for our software and hardware and provide design, methodology and education services throughout the world to help manage and accelerate electronics product development processes. Our broad range of products and services are used by the world s leading electronics companies to design and develop complex integrated circuits, or ICs, and electronics systems.

We primarily generate revenue from licensing our EDA software, selling or leasing our hardware technology, providing maintenance for our software and hardware and providing design and methodology services. Our revenue recognition is significantly affected by the mix of license types executed in any given period. Our revenue may also be deferred until payments become due and payable or cash is received from certain customers and for certain contracts. Substantially all of our revenue is generated from IC manufacturers, IC designers and electronics systems companies and is dependent upon their commencement of new design projects. As a result, our revenue is significantly influenced by our customers business outlook and investment in the introduction of new products and the improvement of existing products.

We have identified certain items that management uses as performance indicators to manage our business, including revenue, certain elements of operating expenses and cash flow from operations, and we describe these items more fully below under the heading Results of Operations and Liquidity and Capital Resources.

During 2007 and the first six months of 2008, we saw increasing pressures on the research and development budgets in our customer base due to the deceleration of growth in the electronics systems and semiconductor industries and the deteriorating macroeconomic environment. In this slowing and price-conscious environment, customers are looking for more flexibility in the type of software and hardware products they purchase and how and when they purchase them.

Facing uncertainty and cost pressures in their own businesses, some of our customers are waiting to purchase our products as long as they can and are increasingly seeking even more aggressive purchasing terms and conditions. As a result of this trend, we have forecasted lower business levels for the remainder of 2008. In addition, our recent announcement of the proposed acquisition of Mentor Graphics Corporation, or Mentor Graphics, has caused some customers to demand more flexibility in accessing new technology. To enable us to keep our focus on

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the value of our technology and to assist with customer demands, we are moving to a license mix that will provide our customers with greater flexibility and will result in increased ratable revenue for us.

Our operating results are affected by the mix of license types executed in any given period. We license software using three different license types: subscription, term and perpetual. Product revenue associated with term and perpetual licenses is generally recognized at the beginning of the license period, whereas product revenue associated with subscription licenses is recognized over multiple periods during the term of the license. In order to provide our customers with the desired flexibility, our license mix will change to a higher proportion of licenses that require ratable revenue recognition which will result in a decrease in our expected revenue for the second half of fiscal year 2008.

We plan operating expense levels primarily based on forecasted revenue levels. These expenses and the impact of long-term commitments are relatively fixed in the short term. However, a shortfall in revenue could lead to operating results below expectations because we may not be able to quickly reduce these fixed expenses in response to these short-term business changes. To offset some of the impact of our expected decrease in revenue, we have implemented cost savings initiatives, including reducing headcount, decreasing employee bonuses and reducing other discretionary spending. Due to the change in license mix noted above, we will recognize a net loss for fiscal 2008.

Semiconductor volumes grew during 2007 and have grown during the first six months of 2008, fueled by strong consumer demand in traditional and emerging markets, but at the same time, average selling prices have declined. Product performance and size specifications of the mobile and other consumer electronics market are requiring electronic systems to be smaller, consume less power and provide multiple functions in one system-on-chip, or SoC, or system-in-package, or SiP. The design challenge is also becoming more complex with each new generation of electronics and as providers of EDA solutions are required to deliver products that address these technical challenges and improve the efficiency and productivity of the design process.

With the addition of emerging nanometer design considerations to the already burgeoning set of traditional design tasks, complex SoC or IC design can no longer be accomplished using a collection of discrete design tools. What previously consisted of sequential design activities must be merged and accomplished nearly simultaneously without time-consuming data translation steps. We combine our design technologies into platforms addressing four major design activities: functional verification, digital IC design, custom IC design and system interconnect design. The four Cadence® design platforms are Incisive® functional verification, Encounter® digital IC design, Virtuoso® custom design and Allegro® system interconnect design platforms. In addition, we augment these platform product offerings with a set of design for manufacturing, or DFM, products that service both the digital and custom IC design flows. These four platforms, together with our DFM products, comprise our primary product lines.

Proposed Acquisition of Mentor Graphics Corporation

On May 2, 2008, we made a proposal to the board of directors of Mentor Graphics to acquire all of the outstanding shares of Mentor Graphics common stock for cash consideration of $16.00 per Mentor Graphics share, representing a total value of approximately $1.6 billion. On May 23, 2008, the Mentor Graphics board of directors informed us that it did not wish to pursue discussions with us given Mentor Graphics desire to stay independent. On June 17, 2008, we publicly announced our offer and Mentor Graphics publicly confirmed that it received an unsolicited offer from us and that it previously rejected our offer. We currently expect to borrow in excess of $1.0 billion if we are successful in acquiring all of Mentor Graphics outstanding shares and we are currently reviewing various alternatives for financing this transaction. There are no assurances that the acquisition will be completed or that financing will be available on terms that are acceptable to us.

Critical Accounting Estimates

In preparing our Condensed Consolidated Financial Statements, we make assumptions, judgments and estimates that can have a significant impact on our revenue, operating income and net income, as well as on the value of certain assets and liabilities on our Condensed Consolidated Balance Sheets. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under

the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. At least quarterly, we evaluate our assumptions, judgments and estimates and make changes accordingly. Historically, our assumptions, judgments and estimates relative to our critical accounting estimates have not differed materially from actual results.

For further information about our other critical accounting estimates, see the discussion under the heading Critical Accounting Estimates in our Annual Report on Form 10-K for the fiscal year ended December 29, 2007.

Results of Operations

We primarily generate revenue from licensing our EDA software, selling or leasing our hardware technology, providing maintenance for our software and hardware and providing design and methodology services. We principally utilize three license types: subscription, term and perpetual. The different license types provide a customer with different terms of use for our products, such as:

- The right to access new technology;
- The duration of the license; and
- Payment terms.

Customer decisions regarding these aspects of license transactions determine the license type, timing of revenue recognition and potential future business activity. For example, if a customer chooses a fixed term of use, this will result in either a subscription or term license. A business implication of this decision is that, at the expiration of the license period, the customer must decide whether to continue using the technology and therefore renew the license agreement. Because larger customers generally use products from two or more of our five product groups, rarely will a large customer completely terminate its relationship with us at expiration of the license. See the discussion under the heading Critical Accounting Estimates in our Annual Report on Form 10-K for the fiscal year ended December 29, 2007 for additional description of license types and timing of revenue recognition.

Although we believe that pricing volatility has not generally been a material component of the change in our revenue from period to period, we believe that the amount of revenue recognized in future periods will depend on, among other things, the competitiveness of our new technology, the length of our sales cycle, and the size, duration, terms, type and timing of our:

- Contract renewals with existing customers;
- Additional sales to existing customers; and
- Sales to new customers.

A substantial portion of our total revenue is recognized over multiple periods. However, a significant portion of our product revenue is recognized upon delivery of licensed software, which generally occurs upon the later of the effective date of the arrangement or delivery of the software product.

The value and duration of contracts, and consequently product revenue recognized, is affected by the competitiveness of our products. Product revenue recognized in any period is also affected by the extent to which customers purchase subscription, term or perpetual licenses, and the extent to which contracts contain flexible payment terms. The timing of revenue recognition is also affected by changes in the extent to which existing contracts contain flexible payment terms and by changes in contractual arrangements with existing customers (e.g., customers transitioning from subscription license arrangements to term license arrangements).

Revenue and Revenue Mix

We analyze our software and hardware businesses by product group, combining revenues for both product and maintenance because of their interrelationship. We have formulated a design solution strategy that combines our design technologies into platforms, which are included in the various product groups described below.

Our product groups are:

Functional Verification: Products in this group, which include the Incisive functional verification platform, are used to verify that the high level, logical representation of an IC design is functionally correct.

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Digital IC Design: Products in this group, which include the Encounter digital IC design platform, are used to accurately convert the high-level, logical representation of a digital IC into a detailed physical blueprint and then detailed design information showing how the IC will be physically implemented. This data is used for creation of the photomasks used in chip manufacture.

Custom IC Design: Our custom design products, which include the Virtuoso custom design platform, are used for ICs that must be designed at the transistor level, including analog, radio frequency, memories, high performance digital blocks and standard cell libraries. Detailed design information showing how an IC will be physically implemented is used for creation of the photomasks used in chip manufacture.

System Interconnect Design: This product group consists of our printed circuit board, or PCB, and IC package design products, including the Allegro and OrCAD® products. The Allegro system interconnect design platform enables consistent co-design of interconnects across ICs, IC packages and PCBs, while the OrCAD line focuses on cost-effective, entry-level PCB solutions.

Design for Manufacturing: Included in this product group are our physical verification and analysis products. These products are used to analyze and verify that the physical blueprint of the IC has been constructed correctly and can be manufactured successfully.

Revenue by Period

The following table shows our revenue for the three and six months ended June 28, 2008 and June 30, 2007 and the percentage change in revenue between periods:

	Three Months Ended			Six Months Ended		
	June 28, 2008	June 30, 2007	% Change	June 28, 2008	June 30, 2007	% Change
	(In millions, except percentages)					
Product	$ 195.5	$ 263.8	(26)%	$ 351.7	$ 501.7	(30)%
Services	33.7	32.8	3%	65.9	64.7	2%
Maintenance	100.3	94.4	6%	199.1	189.7	5%
Total revenue	$ 329.5	$ 391.0	(16)%	$ 616.7	$ 756.1	(18)%

Product revenue decreased in the three and six months ended June 28, 2008, as compared to the three and six months ended June 30, 2007, primarily because of a challenging economic environment and a longer sales cycle. As a result, product revenue decreased for all product groups, and particularly for Digital IC Design, Design for Manufacturing, Functional Verification and Custom IC Design products.

Our product revenue is affected by the mix of license types executed in any given period. We license software using three different license types: subscription, term and perpetual. Product revenue associated with term and perpetual licenses is generally recognized at the beginning of the license period, whereas product revenue associated with subscription licenses is recognized over multiple periods during the term of the license. Our expected revenue for the second half of fiscal 2008 will decrease due to the slowing and price-conscious environment, as well as changes to our license mix, which will result in a higher proportion of revenue recognized over multiple periods during the term of the license and decreased revenue recognized at the beginning of the license.

We have determined that Product revenue totaling $8.4 million recognized during the three months ended June 28, 2008 should have been recognized during the three months ended March 29, 2008. The effect on the Condensed Consolidated Financial Statements for the three months ended June 28, 2008 and March 29, 2008 is not considered material, and there is no effect to the Condensed Consolidated Financial Statements for the six months ended June 28, 2008.

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Revenue by Product Group

The following table shows for the past five consecutive quarters the percentage of product and related maintenance revenue contributed by each of our five product groups, and Services and other:

	Three Months Ended				
	June 28, 2008	March 29, 2008	December 29, 2007	September 29, 2007	June 30, 2007
Functional Verification	25%	20%	26%	20%	24%
Digital IC Design	23%	27%	27%	27%	29%
Custom IC Design	26%	25%	25%	32%	24%
System Interconnect	9%	11%	9%	7%	8%
Design for Manufacturing	7%	6%	6%	6%	7%
Services and other	10%	11%	7%	8%	8%
Total	100%	100%	100%	100%	100%

As described under the heading Critical Accounting Estimates in our Annual Report on Form 10-K for the fiscal year ended December 29, 2007, certain of our licenses allow customers the ability to remix among software products. Additionally, we have licensed a combination of our products to customers with the actual product selection and number of licensed users to be determined at a later date. For these arrangements, we estimate the allocation of the revenue to product groups based upon the expected usage of our products by these customers. The actual usage of our products by these customers may differ and, if that proves to be the case, the revenue allocation in the above table would differ.

Although we believe the methodology of allocating revenue to product groups is reasonable, there can be no assurance that such allocated amounts reflect the amounts that would result had the customer individually licensed each specific software solution at the outset of the arrangement.

Revenue by Geography

	Three Months Ended			Six Months Ended		
	June 28, 2008	June 30, 2007	% Change	June 28, 2008	June 30, 2007	% Change
	(In millions, except percentages)					
United States	$ 150.0	$ 195.5	(23)%	$ 259.6	$ 363.4	(29)%
Other Americas	9.2	8.9	3%	15.4	16.6	(7)%
Europe, Middle East and Africa	69.4	66.0	5%	132.6	119.4	11%
Japan	60.8	55.5	10%	135.9	153.6	(12)%
Asia	40.1	65.1	(38)%	73.2	103.1	(29)%
Total revenue	$ 329.5	$ 391.0	(16)%	$ 616.7	$ 756.1	(18)%

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Revenue by Geography as a Percent of Total Revenue

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
United States	46%	50%	42%	48%
Other Americas	3%	2%	3%	2%
Europe, Middle East and Africa	21%	17%	21%	16%
Japan	18%	14%	22%	20%
Asia	12%	17%	12%	14%
Total	100%	100%	100%	100%

The rate of revenue change varies geographically primarily due to differences in the timing and size of term licenses in those regions. No one customer accounted for 10% or more of total revenue for the three months ended June 28, 2008 and one customer accounted for 18% of total revenue for the three months ended June 30, 2007. No one customer accounted for 10% or more of total revenue for the six months ended June 28, 2008 and one customer accounted for 11% of total revenue for the six months ended June 30, 2007.

Most of our revenue is transacted in the United States dollar. However, certain revenue transactions are in foreign currencies, primarily the Japanese yen, and we recognize additional revenue in periods when the United States dollar weakens in value against the Japanese yen. For additional description of how changes in foreign exchange rates affect our Condensed Consolidated Financial Statements, see the discussion under the heading Item 3. Quantitative and Qualitative Disclosures About Market Risk Disclosures About Market Risk Foreign Currency Risk below.

Stock-based Compensation Expense Summary

Stock-based compensation expense is reflected throughout our costs and expenses as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions)			
Cost of product	$ 0.1	$ ----	$ 0.1	$ 0.1
Cost of services	1.1	1.0	2.1	1.9
Cost of maintenance	0.7	0.6	1.3	1.2
Marketing and sales	4.8	5.4	9.2	12.1
Research and development	9.4	12.5	19.2	25.7
General and administrative	5.4	7.5	11.1	13.7
Total	$ 21.5	$ 27.0	$ 43.0	$ 54.7

During the three months ended June 28, 2008, stock-based compensation expense decreased $5.5 million, as compared to the three months ended June 30, 2007, primarily due to:

- A decrease of $3.4 million in stock-compensation expense for restricted stock and stock bonuses, primarily due to new grants of restricted stock being valued at a lower stock price and a decrease in stock bonuses; and
- A decrease of $2.9 million in stock-compensation expense for stock options, primarily due to our increased use of restricted stock instead of stock options in recent years; partially offset by
- An increase of $0.8 million in stock-compensation expense primarily due to an increase in purchase rights granted under our ESPP during the current period.

During the six months ended June 28, 2008, stock-based compensation expense decreased $11.7 million, as compared to the six months ended June 30, 2007, primarily due to:

A decrease of $7.5 million in stock-compensation expense for restricted stock and stock bonuses, primarily due to new grants of restricted stock being valued at a lower stock price and a decrease in stock bonuses; and
A decrease of $5.9 million in stock-compensation expense for stock options, primarily due to our increased use of restricted stock instead of stock options in recent years; partially offset by
An increase of $1.7 million in stock-compensation expense primarily due to an increase in purchase rights granted under our ESPP during the current period.

Cost of Revenue

	Three Months Ended			Six Months Ended		
	June 28, 2008	June 30, 2007	% Change	June 28, 2008	June 30, 2007	% Change
	(In millions, except percentages)					
Product	$ 18.0	$ 12.8	41%	$ 30.0	$ 28.5	5%
Services	$ 27.2	$ 23.4	16%	$ 52.4	$ 47.1	11%
Maintenance	$ 14.4	$ 15.3	(6)%	$ 29.0	$ 30.4	(5)%

Cost of Revenue as a Percent of Related Revenue

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Product	9%	5%	9%	6%
Services	81%	71%	80%	73%
Maintenance	14%	16%	15%	16%

Cost of product includes costs associated with the sale or lease of our hardware and licensing of our software products. Cost of product primarily includes the cost of employee salary, benefits and other employee-related costs, including stock-based compensation expense, amortization of acquired intangibles directly related to our products, the cost of technical documentation and royalties payable to third-party vendors. Cost of product associated with our hardware products also includes materials, assembly and overhead. These additional manufacturing costs make our cost of hardware product higher, as a percentage of revenue, than our cost of software product.

A summary of Cost of product is as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions)			

Product related costs	$ 13.2	$ 7.6	$ 20.6	$ 17.7
Amortization of acquired intangibles	4.8	5.2	9.4	10.8
Total Cost of product	$ 18.0	$ 12.8	$ 30.0	$ 28.5

During the three months ended June 28, 2008, Cost of product increased $5.2 million, as compared to the three months ended June 30, 2007, primarily due to:

- An increase of $7.3 million in hardware costs attributable to sales of hardware products with higher costs and increased hardware sales; partially offset by
- A decrease of $1.3 million in amortization of license costs related to third-party technology.

During the six months ended June 28, 2008, Cost of product increased $1.5 million, as compared to the six months ended June 30, 2007, primarily due to:

- An increase of $4.7 million in hardware costs attributable primarily to increased hardware sales; partially offset by
- A decrease of $1.5 million in amortization of license costs related to third-party technology; and
- A decrease of $1.4 million in amortization of acquired intangible assets because certain acquired intangible assets became fully amortized during the period.

Cost of product depends primarily upon the extent to which we acquire intangible assets, acquire licenses and incorporate third-party technology in our products that are licensed or sold in any given period, and the actual mix of hardware and software product sales in any given period.

Cost of services primarily includes employee salary, benefits and other employee-related costs, costs to maintain the infrastructure necessary to manage a services organization, and provisions for contract losses, if any. During the three months ended June 28, 2008, Cost of services increased $3.8 million, as compared to the three months ended June 30, 2007, primarily due to:

- An increase of $1.6 million in facilities and other infrastructure costs; and
- An increase of $1.5 million in employee salary, benefits and other employee-related costs.

During the six months ended June 28, 2008, Cost of services increased $5.3 million, as compared to the six months ended June 30, 2007, primarily due to:

- An increase of $2.8 million in facilities and other infrastructure costs;
- An increase of $1.8 million in salary, benefits and other employee-related costs; and
- During the six months ended June 30, 2007 we recognized a gain of $0.9 million on the sale of land and buildings that related to and accordingly reduced the overall Cost of services for that period. There was no similar reduction during the six months ended June 28, 2008.

Cost of maintenance includes the cost of customer services, such as hot-line and on-site support, employee salary, benefits and other employee-related costs, and documentation of maintenance updates. There were no material fluctuations in these components of Cost of maintenance during the three months ended June 28, 2008, as compared to the three months ended June 30, 2007. During the six months ended June 28, 2008, Cost of maintenance decreased $1.4 million, as compared to the six months ended June 30, 2007, primarily due to a decrease in salary, benefits and other employee-related costs.

Operating Expenses

	Three Months Ended			Six Months Ended		
	June 28, 2008	June 30, 2007	% Change	June 28, 2008	June 30, 2007	% Change
	(In millions, except percentages)					
Marketing and sales	$ 89.9	$ 98.1	(8)%	$ 182.9	$ 200.8	(9)%
Research and development	120.1	123.0	(2)%	245.4	240.0	2%

General and administrative	35.0	41.8	(16)%	72.7	82.4	(12)%
Total operating expenses	$ 245.0	$ 262.9	(7)%	$ 501.0	$ 523.2	(4)%

Operating Expenses as a Percent of Total Revenue

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
Marketing and sales	27%	25%	30%	27%
Research and development	36%	31%	40%	32%
General and administrative	11%	11%	12%	11%

Operating Expense Summary

Operating expenses decreased $17.9 million during the three months ended June 28, 2008, as compared to the three months ended June 30, 2007, primarily due to:

- A decrease of $9.1 million in salary, benefits and other employee-related costs;
- A decrease of $5.8 million in stock-based compensation;
- A decrease of $3.4 million in travel and customer conference costs;
- A decrease of $2.0 million in legal and other professional services costs; and
- A decrease of $1.2 million in losses on the sale of installment contract receivables; partially offset by
- An increase of $5.5 million in facilities and other infrastructure costs.

Operating expenses decreased $22.2 million during the six months ended June 28, 2008, as compared to the six months ended June 30, 2007, primarily due to:

- A decrease of $13.7 million in salary, benefits and other employee-related costs;
- A decrease of $12.0 million in stock-based compensation;
- A decrease of $5.7 million in travel and customer conference costs;
- A decrease of $3.9 million in legal and other professional services costs; and
- A decrease of $2.2 million in losses on the sale of installment contract receivables; partially offset by
- An increase of $8.9 million in facilities and other infrastructure costs; and
- During the six months ended June 30, 2007, we recognized a gain of $7.9 million on the sale of land and buildings that related to and accordingly reduced Operating expenses for that period. There was no similar reduction during the six months ended June 28, 2008.

In January 2007, we completed the sale of certain land and buildings in San Jose, California for a sales price of $46.5 million in cash. Concurrently with the sale, we leased back from the purchaser approximately 262,500 square feet of office space, which represents all available space in the buildings. A substantial portion of the gain upon sale offset our costs and expenses during the three months ended March 31, 2007, and the remaining gain will be amortized over the remaining initial lease term.

Fluctuations in foreign currency exchange rates, primarily due to the decrease in the valuation of the United States dollar when compared to the European Union euro, the Indian rupee and the Japanese yen, increased operating expenses by $4.9 million in the three months ended June 28, 2008, as compared to the three months ended June 30, 2007, and increased operating expenses by $9.8 million in the six months ended June 28, 2008, as compared to the six months ended June 30, 2007.

Marketing and Sales

Marketing and sales expense decreased $8.2 million during the three months ended June 28, 2008, as compared to the three months ended June 30, 2007, primarily due to:

- A decrease of $6.1 million in salary, benefits and other employee-related costs; and
- A decrease of $2.2 million in travel and customer conference costs; partially offset by
- An increase of $1.4 million in facilities and other infrastructure costs.

Marketing and sales expense decreased $17.9 million during the six months ended June 28, 2008, as compared to the six months ended June 30, 2007, primarily due to:

A decrease of $14.7 million in salary, benefits and other employee-related costs;
A decrease of $4.3 million in travel and customer conference costs; and
A decrease of $2.9 million in stock-based compensation; partially offset by
During the six months ended June 30, 2007, we recognized a gain of $2.8 million on the sale of land and buildings that related to and accordingly reduced Marketing and sales expense for that period. There was no similar reduction during the six months ended June 28, 2008; and
An increase of $2.5 million in facilities and other infrastructure costs.

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Research and Development

Research and development expense decreased $2.9 million during the three months ended June 28, 2008, as compared to the three months ended June 30, 2007, primarily due to:

- A decrease of $3.1 million in stock-based compensation; and
- A decrease of $1.0 million in travel costs; partially offset by
- An increase of $2.9 million in facilities and other infrastructure costs.

Research and development expense increased $5.4 million during the six months ended June 28, 2008, as compared to the six months ended June 30, 2007, primarily due to:

- An increase of $5.6 million in facilities and other infrastructure costs;
- During the six months ended June 30, 2007, we recognized a gain of $4.7 million on the sale of land and buildings that related to and accordingly reduced Research and development expense for that period. There was no similar reduction during the six months ended June 28, 2008; and
- An increase of $4.3 million in salary, benefits and other employee-related costs, primarily due to an increase in the number of employees supporting product development, our acquisitions of Clear Shape Technologies, Inc. and Invarium, Inc., and increases in salary costs generally; partially offset by
- A decrease of $6.5 million in stock-based compensation;
- A decrease of $2.2 million in professional services costs; and
- A decrease of $1.4 million in travel costs.

General and Administrative

General and administrative expense decreased $6.8 million during the three months ended June 28, 2008, as compared to the three months ended June 30, 2007, primarily due to:

- A decrease of $2.6 million in salary, benefits and other employee-related costs;
- A decrease of $2.1 million in stock-based compensation;
- A decrease of $1.4 million in depreciation, computer equipment lease costs and maintenance costs associated with third-party software;
- A decrease of $1.3 million in legal and other professional services costs; and
- A decrease of $1.2 million in losses on the sale of installment contract receivables; partially offset by
- An increase of $1.1 million in facilities and other infrastructure costs.

General and administrative expense decreased $9.7 million during the six months ended June 28, 2008, as compared to the six months ended June 30, 2007, primarily due to:

- A decrease of $3.3 million in salary, benefits and other employee-related costs;
- A decrease of $2.6 million in stock-based compensation;
- A decrease of $2.3 million in depreciation, computer equipment lease costs and maintenance costs associated with third-party software;
- A decrease of $2.2 million in losses on the sale of installment contract receivables; and
- A decrease of $1.9 million in legal and other professional services costs.

Amortization of Acquired Intangibles

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions)			
Amortization of acquired intangibles	$ 5.8	$ 4.4	$ 11.6	$ 8.9

Amortization of acquired intangibles increased $1.4 million during the three months ended June 28, 2008, as compared to the three months ended June 30, 2007, primarily due to:

An increase of $2.0 million of amortization for intangibles acquired in 2007 and 2008; partially offset by

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A decrease of $0.6 million of amortization for intangible assets from prior year acquisitions that became fully amortized during 2007 and 2008.

Amortization of acquired intangibles increased $2.7 million during the six months ended June 28, 2008, as compared to the six months ended June 30, 2007, primarily due to:

An increase of $4.4 million of amortization for intangibles acquired in 2007 and 2008; partially offset by
A decrease of $1.7 million of amortization for intangible assets from prior year acquisitions that became fully amortized during 2007 and 2008.

Write-off of Acquired In-process Technology

In connection with the acquisition completed during the six months ended June 28, 2008, we immediately charged to expense $0.6 million representing certain acquired in-process technologies that had not yet reached technological feasibility and had no alternative future use. The value assigned to acquired in-process technology was determined by identifying research projects in areas for which technological feasibility had not been established. The value was determined by estimating costs to develop the various acquired in-process technologies into commercially viable products, estimating the resulting net cash flows from such projects and discounting the net cash flows back to their present value. The discount rate assumed in these calculations was 22% and included factors that reflect the uncertainty surrounding successful development of the acquired in-process technology. The in-process technologies became commercially viable in June 2008 at a cost of approximately $0.2 million, but will require further research and development even though they have reached a state of technological and commercial feasibility.

Interest Expense

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions)			
Interest expense	$ 2.9	$ 3.1	$ 5.9	$ 6.5

During the three and six months ended June 28, 2008 and June 30, 2007, the primary component of interest expense was the Convertible Senior Notes. The decrease in interest expense for the six months ended June 28, 2008, as compared to the six months ended June 30, 2007, was primarily due to the repayment in full of our Term Loan during the three months ended March 31, 2007.

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Other income (expense), net

Other income (expense), net, for the three and six months ended June 28, 2008 and June 30, 2007 was as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions)			
Interest income	$ 5.1	$ 12.6	$ 13.8	$ 24.8
Gains on sale of non-marketable securities	----	1.4	0.9	5.5
Gains on sale of available-for-sale securities	1.4	2.3	1.4	2.3
Gains (losses) on sale of non-marketable and trading securities in Cadence s non-qualified deferred compensation trust	(3.4)	0.9	(4.0)	4.2
Gains (losses) on foreign exchange	(1.9)	(1.1)	0.4	(0.6)
Equity losses from investments	(0.4)	(1.1)	(0.7)	(1.7)
Write-down of investments	(2.9)	(0.5)	(8.3)	(0.5)
Other income (expense)	0.3	(0.3)	0.5	(0.3)
Total other income (expense), net	$ (1.8)	$ 14.2	$ 4.0	$ 33.7

Interest income decreased $7.5 million and $11.0 million for the three and six months ended June 28, 2008, respectively, as compared to the three and six months ended June 30, 2007. The decrease was due to lower average cash balances and lower interest rates during the three and six months ended June 28, 2008.

During the six months ended June 28, 2008, we determined that one of our available-for-sale securities was other-than-temporarily impaired based on the severity and the duration of the impairment and we wrote down the investment by $5.4 million.

Income Taxes

The following table presents the provision for income taxes and the effective tax rate for the three and six months ended June 28, 2008 and June 30, 2007:

	Three Months Ended		Six Months Ended	
	June 28, 2008	June 30, 2007	June 28, 2008	June 30, 2007
	(In millions, except percentages)			
Provision for income taxes	$ 9.8	$ 25.3	$ 4.3	$ 43.8
Effective tax rate	66.1%	29.8%	(45.1)%	29.6%

For interim periods, we calculate our provision for income tax based on our current estimate of the annual effective tax rate. See the discussion below regarding our current estimate of the annual effective tax rate. We generally apply the estimated annual effective tax rate to year to date pre-tax income or loss. We adjust the provision for income tax expense for the current quarter to reflect our current estimate of the annual effective tax rate and period-specific items

of tax expense or benefit. Our effective tax rate for the three months ended June 28, 2008 primarily reflects the adjustment of our estimated annual effective tax rate for the fiscal year ending January 3, 2009 and period-specific items of net tax expense of $1.8 million. The largest of the period-specific items of net tax expense was interest expense related to unrecognized tax benefits, net of related tax effects of $2.0 million.

Our negative effective tax rate for the six months ended June 28, 2008 primarily reflects period-specific items of net tax expense of $4.3 million. The largest of the period-specific items of net tax expense was interest expense related to unrecognized tax benefits, net of related tax effects, of $4.2 million. Our effective tax rate was negative for the six months ended June 28, 2008 as compared to the positive effective tax rate for the six months ended June 30, 2007, primarily due to the Loss before provision for income taxes and the period specific items of net tax expense for the six months ended June 28, 2008.

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Because we currently expect to recognize a pre-tax loss for the year, we have revised our estimate of our annual effective tax rate for the fiscal year ending January 3, 2009 to be approximately (4.0)%. We anticipate having a negative effective tax rate primarily as a result of tax expense on certain of our foreign earnings and interest expense on our unrecognized tax benefits which is partially offset by the tax benefit of losses recognized in certain tax jurisdictions. However, we expect that the effective tax rate for interim reporting periods will vary from the estimated annual effective tax rate. Our effective tax rate for the year ended December 29, 2007 was 18.6%.

During the three months ended June 28, 2008, we recognized a $7.9 million decrease in the net liabilities for unrecognized tax benefits based on new information received during the period, which we accounted for as a $7.9 million increase in the balance of Common stock and capital in excess of par value.

The IRS and other tax authorities regularly examine our income tax returns. In July 2006, the IRS completed its field examination of our federal income tax returns for the tax years 2000 through 2002 and issued a Revenue Agent s Report, or RAR, in which the IRS proposed to assess an aggregate tax deficiency for the three-year period of approximately $324.0 million. In November 2006, the IRS revised the proposed aggregate tax deficiency for the three-year period to be approximately $318.0 million. The IRS is contesting our qualification for deferred recognition of certain proceeds received from restitution and settlement in connection with litigation during the period. The proposed tax deficiency for this item is approximately $152.0 million. The remaining proposed tax deficiency of approximately $166.0 million is primarily related to proposed adjustments to our transfer pricing arrangements with our foreign subsidiaries and to our deductions for foreign trade income. The IRS may make similar claims against our transfer pricing arrangements and deductions for foreign trade income in future examinations. We have filed a timely protest with the IRS and will seek resolution of the issues with the Appeals Office of the IRS, or the Appeals Office.

We believe that the proposed IRS adjustments are inconsistent with applicable tax laws and we are vigorously challenging these proposed adjustments. The RAR is not a final Statutory Notice of Deficiency but the IRS imposes interest on the proposed deficiencies until the matters are resolved. Interest is compounded daily at rates that are published and adjusted quarterly by the IRS and have been between 4% and 10% since 2001. The IRS is currently examining our federal income tax returns for the tax years 2003 through 2005.

We believe that it is reasonably possible that the total amounts of unrecognized tax benefits for our transfer pricing arrangements with our foreign subsidiaries could significantly increase or decrease during the fiscal year ending January 3, 2009 if the Appeals Office develops new settlement guidelines that change our measurement of the tax benefits to be recognized upon effective settlement with the IRS. Because of the uncertain impact of any potential settlement guidelines, we cannot currently provide an estimate of the range of the reasonably possible change.

We also believe that it is reasonably possible that the total amounts of unrecognized tax benefits related to the value of stock options included in our cost sharing arrangements with our foreign subsidiaries could significantly increase or decrease during the fiscal year ending January 3, 2009 based on the outcome of the IRS appeal of Xilinx, Inc. v. Commissioner, which is before the U.S. Court of Appeal for the Ninth Circuit. We believe that the range of reasonably possible change is an increase in unrecognized tax benefits of $6.4 million to a decrease of unrecognized tax benefit of $1.6 million.

Significant judgment is required in applying the principles of FASB Interpretation, or FIN, No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, and Statement of Financial Accounting Standard, or SFAS, No. 109, Accounting for Income Taxes. The calculation of our provision for income taxes involves dealing with uncertainties in the application of complex tax laws and regulations. In determining the adequacy of our provision for income taxes, we regularly assess the potential settlement outcomes resulting from income tax examinations. However, the final outcome of tax examinations, including the total amount payable or the timing of any such payments upon resolution of these issues, cannot be estimated with certainty. In addition, we

cannot be certain that such amount will not be materially different than that which is reflected in our historical income tax provisions and accruals. Should the IRS or other tax authorities assess additional taxes as a result of a current or a future examination, we may be required to record charges to operations in future periods that could have a material impact on our results of operations, financial position or cash flows in the applicable period or periods.

Liquidity and Capital Resources

	As of	
	June 28, 2008	December 29, 2007
	(In millions)	
Cash, cash equivalents and Short-term investments	$ 889.3	$ 1,078.1
Net working capital	602.7	744.1

	Six Months Ended	
	June 28, 2008	June 30, 2007
	(In millions)	
Cash provided by operating activities	$ 57.5	$ 120.1
Cash provided by (used for) investing activities	(93.6)	8.7
Cash provided by (used for) financing activities	(192.6)	63.2

Cash and cash equivalents and Short-term investments

As of June 28, 2008, our principal sources of liquidity consisted of $889.3 million of Cash and cash equivalents and Short-term investments, as compared to $1,078.1 million as of December 29, 2007.

Our primary sources of cash in the six months ended June 28, 2008 were:

- Customer payments under software licenses and from the sale or lease of our hardware products;
- Customer payments for design and methodology services;
- Proceeds from the sale of receivables; and
- Cash received for common stock purchases under our employee stock purchase plan.

Our primary uses of cash in the six months ended June 28, 2008 were:

- Payments relating to payroll, product, services and other operating expenses;
- Payments to former shareholders of acquired businesses;
- Purchases of property, plant and equipment;
- Purchases of available-for-sale investments; and
- Purchases of treasury stock.

If all holders of the 2023 Notes elect to surrender their notes for repurchase by us, we expect to use approximately $231.0 million to repurchase all of the outstanding 2023 Notes on or about August 15, 2008, the day after the last day by which the holders of the 2023 Notes can elect to surrender their 2023 Notes for repurchase by us at a purchase price of 100.25% of the principal amount thereof.

Net working capital

Net working capital decreased $141.4 million as of June 28, 2008, as compared to December 29, 2007, primarily due to:

- A decrease of $226.4 million in Cash and cash equivalents; partially offset by
- A decrease of $43.0 million in Accounts payable and accrued liabilities;
- An increase of $37.6 million in Short-term investments; and
- A decrease of $17.4 million in Current portion of deferred revenue.

Cash flows from operating activities

Cash flows provided by operating activities include net income (loss), adjusted for certain non-cash charges, as well as changes in the balances of certain assets and liabilities. Our cash flows from operating activities are significantly influenced by the payment terms set forth in our license agreements and by sales of our receivables.

We have entered into agreements whereby we may transfer accounts receivable to certain financing institutions on a non-recourse or limited-recourse basis. These transfers are recorded as sales and accounted for in accordance with SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. During the six months ended June 28, 2008, we transferred accounts receivable, net of the losses on the sale of the receivables, totaling $46.0 million, which approximated fair value, to financing institutions on a non-recourse basis, as compared to $76.3 million for the six months ended June 30, 2007. As a result of the credit losses recorded by banks over the last twelve months, a number of banks have become less willing to purchase assets because of capital constraints and concerns about over-exposure to the technology sector. In addition, due to the change in the license mix that will result in an increased number of subscription licenses that cannot be transferred to financing institutions, we expect a reduced level of Proceeds from the sale of receivables throughout the remainder of 2008. Due to the lower order levels and the reduced level of sale of receivables, we expect Cash flows from operating activities to be approximately $175 million for fiscal 2008.

Net cash provided by operating activities of $57.5 million for the six months ended June 28, 2008 was primarily comprised of:

- Net loss, net of non-cash related expenses, of $104.8 million; and
- A decrease in Receivables, net and Installment contract receivables of $64.3 million, net of sales of receivables, due to the payment terms set forth in our license agreements; partially offset by
- A decrease in Accounts payable and other accrued liabilities of $56.6 million;
- A decrease in cash received for deferred revenue of $37.2 million; and
- A decrease in Other long-term liabilities of $12.6 million.

Net cash provided by operating activities of $120.1 million for the six months ended June 30, 2007 was primarily comprised of:

- Net income, net of non-cash related expenses, of $210.7 million; partially offset by
- An increase in Receivables, net and Installment contract receivables of $53.2 million, net of sales of receivables, due to the payment terms set forth in our license agreements;
- A decrease in Accounts payable and other accrued liabilities of $19.5 million; and
- A decrease in cash received for deferred revenue of $16.9 million.

Cash flows from investing activities

Our primary investing activities consisted of:

- Purchases and proceeds from the sale of property, plant and equipment;
- Purchases of available-for-sale investments;
- Cash paid in business combinations and asset acquisitions, net of cash acquired, and acquisition of intangibles; and
- Proceeds from the sale of available-for-sale and long-term investments.

Net cash used for investing activities was $93.6 million for the six months ended June 28, 2008, as compared to net cash provided by investing activities of $8.7 million for the six months ended June 30, 2007. The change was primarily due to:

- An increase of $31.8 million in Purchases of available-for-sale investments; and
- An increase of $22.8 million of Purchases of property, plant and equipment, including payments associated with our construction of a new building on our San Jose campus; partially offset by

A decrease of $46.5 million of Proceeds from the sale of property, plant and equipment.

In January 2007, we completed the sale of certain land and buildings in San Jose, California for a sales price of $46.5 million in cash. Concurrently with the sale, we leased back from the purchaser all available space in the buildings. During the lease term, we are constructing an additional building located on our San Jose, California campus to replace the buildings we sold in this transaction. We expect to use approximately $20.0 million in cash during the remainder of fiscal 2008 for construction of this new building. We expect to continue our investing

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activities, including purchasing property, plant and equipment, purchasing intangible assets, purchasing software licenses and making long-term equity investments.

In connection with our acquisitions completed prior to June 28, 2008, we may be obligated to pay up to an aggregate of $62.4 million in cash during the next 50 months if certain defined performance goals are achieved in full. Of this amount, up to $51.4 million would be expensed as compensation expense in our Condensed Consolidated Statements of Operations and up to $11.0 million would be added to the purchase price of the acquisitions and will be recorded in Goodwill in our Condensed Consolidated Balance Sheets.

Cash flows from financing activities

Financing cash flows during the six months ended June 28, 2008 consisted primarily of the issuance of common stock under certain employee plans and purchases of treasury stock.

Net cash used for financing activities increased by $255.8 million during the six months ended June 28, 2008, as compared to the six months ended June 30, 2007. The increase was primarily due to:

- A decrease of $178.6 million in Proceeds from the sale of common stock due to a decreased number of options exercised during the six months ended June 28, 2008; and
- An increase of $94.8 million in Purchases of treasury stock; partially offset by
- A decrease of $28.0 million of payments on our Term Loan, the repayment of which was completed in March 2007.

If all holders of the 2023 Notes elect to surrender their notes for repurchase by us, we expect to use approximately $231.0 million to repurchase all of the outstanding 2023 Notes on or about August 15, 2008, the day after the last day by which the holders of the 2023 Notes can elect to surrender their 2023 Notes for repurchase by us at a purchase price of 100.25% of the principal amount thereof.

We record a gain or loss on re-issuance of treasury stock based on the total proceeds received in the transaction. During the six months ended June 28, 2008, we recorded losses on the re-issuance of treasury stock of $43.9 million as a component of Retained earnings.

As noted above, we made a proposal to the board of directors of Mentor Graphics to acquire all of the outstanding shares of Mentor Graphics common stock for cash consideration of $16.00 per Mentor Graphics share, representing a total value of approximately $1.6 billion. On June 17, 2008, we publicly announced our offer and Mentor Graphics publicly confirmed that it received an unsolicited offer from us and that it previously rejected our offer. We currently expect to borrow in excess of $1.0 billion if we are successful in acquiring all of Mentor Graphics outstanding shares and we are currently reviewing various alternatives for financing this transaction. There are no assurances that the acquisition will be completed or that financing will be available on terms that are acceptable to us.

Other factors affecting liquidity and capital resources

Income Taxes

We provide for United States income taxes on the earnings of our foreign subsidiaries unless the earnings are considered indefinitely invested outside of the United States. As of June 28, 2008, we intend to indefinitely reinvest our undistributed foreign earnings outside of the United States.

The IRS and other tax authorities regularly examine our income tax returns. In July 2006, the IRS completed its field examination of our federal income tax returns for the tax years 2000 through 2002 and issued an RAR in which the IRS proposed to assess an aggregate tax deficiency for the three-year period of approximately $324.0 million. In November 2006, the IRS revised the proposed aggregate tax deficiency for the three-year period to be approximately $318.0 million. The IRS is contesting our qualification for deferred recognition of certain proceeds received from restitution and settlement in connection with litigation during the period. The proposed tax deficiency for this item is approximately $152.0 million. The remaining proposed tax deficiency of approximately $166.0 million is primarily related to proposed adjustments to our transfer pricing arrangements with our foreign subsidiaries and to our deductions for foreign trade income. The IRS may make similar claims against our transfer pricing

arrangements and deductions for foreign trade income in future examinations. We have filed a timely protest with the IRS and will seek resolution of the issues with the Appeals Office.

We believe that the proposed IRS adjustments are inconsistent with applicable tax laws and we are vigorously challenging these proposed adjustments. The RAR is not a final Statutory Notice of Deficiency but the IRS imposes interest on the proposed deficiencies until the matters are resolved. Interest is compounded daily at rates published and adjusted quarterly by the IRS and have been between 4% and 10% since 2001. The IRS is currently examining our federal income tax returns for the tax years 2003 through 2005.

1.375% Convertible Senior Notes Due 2011 and 1.500% Convertible Senior Notes Due 2013

In December 2006, we issued $250.0 million principal amount of 1.375% Convertible Senior Notes Due 2011, or the 2011 Notes, and $250.0 million principal amount of 1.500% Convertible Senior Notes Due 2013, or the 2013 Notes, and collectively, the Convertible Senior Notes, to three initial purchasers in a private placement pursuant to Section 4(2) of the Securities Act of 1933, as amended, or Securities Act, for resale to qualified institutional buyers pursuant to Rule 144A of the Securities Act. We received net proceeds of approximately $487.0 million after transaction fees of approximately $13.0 million, including $12.0 million of underwriting discounts. A portion of the net proceeds totaling $228.5 million was used to purchase $189.6 million principal amount of our Zero Coupon Zero Yield Senior Convertible Notes Due 2023, or the 2023 Notes.

Holders may convert their Convertible Senior Notes prior to maturity upon the occurrence of one of the following events:

- The price of our common stock reaches $27.50 during certain periods of time specified in the Convertible Senior Notes;
- Specified corporate transactions occur; or
- The trading price of the Convertible Senior Notes falls below a certain threshold.

On and after November 2, 2011, in the case of the 2011 Notes, and November 1, 2013, in the case of 2013 Notes, until the close of business on the scheduled trading day immediately preceding the maturity date, holders may convert their Convertible Senior Notes at any time, regardless of the foregoing circumstances. We may not redeem the Convertible Senior Notes prior to maturity.

The initial conversion rate for the Convertible Senior Notes is 47.2813 shares of our common stock per $1,000 principal amount of Convertible Senior Notes, equivalent to a conversion price of approximately $21.15 per share of our common stock. Upon conversion, a holder will receive the sum of the daily settlement amounts, calculated on a proportionate basis for each day, during a specified observation period following the conversion date. The daily settlement amount during each date of the observation period consists of:

- Cash up to the principal amount of the note; and
- Our common stock to the extent that the conversion value exceeds the amount of cash paid upon conversion of the Convertible Senior Notes.

In addition, if a fundamental change occurs prior to maturity, the conversion rate will increase by an additional amount of up to $8.27 per share, for a holder that elects to convert its Convertible Senior Notes in connection with such fundamental change, which amount will be paid entirely in cash. A fundamental change is any transaction or event (whether by means of an exchange offer, liquidation, tender offer, consolidation, merger, combination, reclassification, recapitalization or otherwise) in which more than 50% of our common stock is exchanged for, converted into, acquired for or constitutes solely the right to receive, consideration. No fundamental change will have

occurred if at least 90% of the consideration received consists of shares of common stock, or depositary receipts representing such shares, that are:

Listed on, or immediately after the transaction or event will be listed on, a United States national securities exchange; or

Approved, or immediately after the transaction or event will be approved, for quotation on a United States system of automated dissemination of quotations of securities prices similar to the NASDAQ National Market prior to its designation as a national securities exchange.

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As of June 28, 2008, none of the conditions allowing the holders of the Convertible Senior Notes to convert had been met.

Interest on the Convertible Senior Notes began accruing in December 2006 and is payable semi-annually each December 15th and June 15th.

Concurrently with the issuance of the Convertible Senior Notes, we entered into hedge transactions with various parties whereby we have the option to purchase up to 23.6 million shares of our common stock at a price of $21.15 per share, subject to adjustment. These options expire on December 15, 2011, in the case of the 2011 Notes, and December 15, 2013, in the case of the 2013 Notes, and must be settled in net shares. The aggregate cost of these hedge transactions was $119.8 million and has been recorded as a reduction to Stockholders equity in accordance with EITF No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock. The estimated fair value of the hedges acquired in connection with the issuance of the Convertible Senior Notes was $29.4 million as of June 28, 2008. Subsequent changes in the fair value of these hedges will not be recognized as long as the instruments remain classified as equity.

In separate transactions, we also sold warrants to various parties for the purchase of up to 23.6 million shares of our common stock at a price of $31.50 per share in a private placement pursuant to Section 4(2) of the Securities Act. The warrants expire on various dates from February 2012 through April 2012 in the case of the 2011 Notes, and February 2014 through April 2014 in the case of the 2013 Notes, and must be settled in net shares. We received $39.4 million in cash proceeds from the sale of these warrants, which has been recorded as a reduction to Stockholders equity in accordance with EITF No. 00-19. The estimated fair value of the warrants sold in connection with the issuance of the Convertible Senior Notes was $12.7 million as of June 28, 2008. Subsequent changes in the fair value of these warrants will not be recognized as long as the instruments remain classified as equity. The warrants will be included in diluted earnings per share, or EPS, to the extent the impact is dilutive.

Zero Coupon Zero Yield Senior Convertible Notes Due 2023

In August 2003, we issued $420.0 million principal amount of our 2023 Notes to two initial purchasers in a private placement pursuant to Section 4(2) of the Securities Act for resale to qualified institutional buyers pursuant to Rule 144A of the Securities Act. We received net proceeds of $406.4 million after transaction fees of $13.6 million that were recorded in Other long-term assets and are being amortized to interest expense using the straight-line method over five years, which is the duration of the first redemption period. The 2023 Notes were issued by us at par and bear no interest. The 2023 Notes are convertible into our common stock initially at a conversion price of $15.65 per share, which would result in an aggregate of 26.8 million shares issued upon conversion, subject to adjustment upon the occurrence of specified events. In connection with the issuance of the Convertible Senior Notes in December 2006, we repurchased $189.6 million principal amount of the 2023 Notes, reducing the aggregate number of shares to be issued upon conversion to 14.7 million.

We may redeem for cash all or any part of the 2023 Notes on or after August 15, 2008 for 100.00% of the principal amount, except for the 2023 Notes that the holders require us to repurchase on the repurchase dates described below. The holders of the 2023 Notes may require us to repurchase for cash all or any portion of their 2023 Notes on August 15, 2008 for 100.25% of the principal amount, on August 15, 2013 for 100.00% of the principal amount or on August 15, 2018 for 100.00% of the principal amount, by providing to the paying agent a written repurchase notice. On July 16, 2008, we filed a Tender Offer Statement on Schedule TO with the SEC and made available to the holders of the 2023 Notes, through the Depository Trust Company, documents specifying the terms, conditions and procedures for requiring us to repurchase all or a portion of the 2023 Notes on August 15, 2008 for 100.25% of the principal amount. Because the holders of the 2023 Notes can require us to repurchase for cash all or any portion of the

2023 Notes on August 15, 2008, the 2023 Notes are classified as a Current liability in our Condensed Consolidated Balance Sheets as of June 28, 2008 and December 29, 2007.

Each $1,000 of principal of the 2023 Notes will initially be convertible into 63.8790 shares of our common stock, subject to adjustment upon the occurrence of specified events. Holders of the 2023 Notes may convert their 2023 Notes prior to maturity only if:

The price of our common stock reaches $22.69 during certain periods of time specified in the 2023 Notes;

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Specified corporate transactions occur;
The 2023 Notes have been called for redemption; or
The trading price of the 2023 Notes falls below a certain threshold.

In the event of a fundamental change in our corporate ownership or structure, the holders may require us to repurchase all or any portion of their 2023 Notes for 100.00% of the principal amount. Upon a fundamental change in our corporate ownership or structure, in certain circumstances we may choose to pay the repurchase price in cash, shares of our common stock or a combination of cash and shares of our common stock. As of June 28, 2008, none of the conditions allowing the holders of the 2023 Notes to convert had been met.

In connection with the issuance of the Convertible Senior Notes in December 2006, a portion of the proceeds were used to purchase in the open market 2023 Notes with a principal balance of $189.6 million for a total purchase price of $228.5 million. In connection with this purchase, we incurred expenses of $40.8 million for the early extinguishment of debt. The loss on early extinguishment of debt included the call premium on the purchased 2023 Notes and the write-off of a portion of the unamortized deferred debt issuance costs.

Concurrently with the issuance of the 2023 Notes, we entered into hedge transactions with a financial institution whereby we originally acquired options to purchase up to 26.8 million shares of our common stock at a price of $15.65 per share. These options expire on August 15, 2008 and must be settled in net shares. The cost of the hedge transactions to us was $134.6 million. In connection with the purchase of a portion of the 2023 Notes in December 2006, we also sold 12.1 million of the hedges that were originally purchased in connection with the 2023 Notes and received proceeds of $55.9 million.

In addition, we sold warrants for our common stock to a financial institution for the purchase of up to 26.8 million shares of our common stock at a price of $23.08 per share. All of the warrants expired out of the money on various dates from February 2008 through May 2008 and no settlement was required. We received $56.4 million in cash proceeds from the sale of these warrants. In connection with the purchase of a portion of the 2023 Notes in December 2006, we also purchased 12.1 million of the warrants for our common stock that were originally issued in connection with the 2023 Notes at a cost of $10.2 million.

As of June 28, 2008, the estimated fair value of the remaining hedges acquired in connection with the issuance of the 2023 Notes was zero. Subsequent changes in the fair value of these hedge transactions will not be recognized as long as the instruments remain classified as equity.

For further information about our 2023 Notes, including conversion rights and the effect of a fundamental change, see the discussion under the heading Liquidity and Capital Resources Other Factors Affecting Liquidity and Capital Resources in our Annual Report on Form 10-K for the fiscal year ended December 29, 2007.

New Accounting Standards

In May 2008, the FASB issued FASB Staff Position, or FSP, APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement), which will require us to recognize additional non-cash interest expense related to our Convertible Senior Notes in our Condensed Consolidated Statements of Operations. FSP APB 14-1 is effective for fiscal 2009 and is required to be applied retrospectively for all periods for which our Convertible Senior Notes were outstanding prior to the date of adoption. FSP APB 14-1 will have an adverse effect on our operating results and financial condition, particularly with respect to interest expense ratios commonly referred to by lenders, and could potentially hinder our ability to raise capital through the issuance of debt or equity securities.

In December 2007, the FASB issued SFAS No. 141R, Business Combinations and SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51.
SFAS No. 141R will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS No. 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests and classified as a component of equity.
SFAS No. 141R and SFAS No. 160 are effective for fiscal years beginning after December 15, 2008. Early adoption is not permitted. We are currently evaluating the impact that SFAS No. 141R and SFAS No. 160 will have on our condensed consolidated financial statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Disclosures About Market Risk

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our portfolio of Cash and cash equivalents. While we are exposed to interest rate fluctuations in many of the world s leading industrialized countries, our interest income and expense is most sensitive to fluctuations in the general level of United States interest rates. In this regard, changes in United States interest rates affect the interest earned on our Cash and cash equivalents and costs associated with foreign currency hedges.

We invest in high quality credit issuers and, by policy, limit the amount of our credit exposure to any one issuer. As part of our policy, our first priority is to reduce the risk of principal loss. Consequently, we seek to preserve our invested funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in only high quality credit securities that we believe to have low credit risk and by positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. The short-term interest-bearing portfolio of Cash and cash equivalents includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity.

All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents. Investments with maturities greater than three months are classified as available-for-sale and are considered to be short-term investments. The carrying value of our interest-bearing instruments approximated fair value as of June 28, 2008. The following table presents the carrying value and related weighted average interest rates for our interest-bearing instruments, which are all classified as Cash and cash equivalents on our Condensed Consolidated Balance Sheet as of June 28, 2008.

	Carrying Value (In millions)	Average Interest Rate
Interest-Bearing Instruments:		
Cash equivalents variable rate	$ 695.5	2.61%
Cash variable rate	83.5	0.85%
Cash fixed rate	35.3	1.67%
Total interest-bearing instruments	$ 814.3	2.39%

Foreign Currency Risk

Most of our revenue and material business activity are transacted in the United States dollar. However, certain of our operations include transactions in foreign currencies and, therefore, we benefit from a weaker dollar, and in certain countries where we invoice customers in the local currency, we are adversely affected by a stronger dollar relative to major currencies worldwide. The primary effect of foreign currency transactions on our results of operations from a weakening United States dollar is an increase in revenue offset by a smaller increase in expenses. Conversely, the primary effect of foreign currency transactions on our results of operations from a strengthening United States dollar is a reduction in revenue offset by a smaller reduction in expenses.

We enter into foreign currency forward exchange contracts with financial institutions to protect against currency exchange risks associated with existing assets and liabilities. A foreign currency forward exchange contract acts as a hedge by increasing in value when underlying assets decrease in value or underlying liabilities increase in value due to changes in foreign exchange rates. Conversely, a foreign currency forward exchange contract decreases in value when underlying assets increase in value or underlying liabilities decrease in value due to changes in foreign exchange rates. These forward contracts are not designated as accounting hedges under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and, therefore, the unrealized gains and losses are recognized in Other income (expense), net, in advance of the actual foreign currency cash flows with the fair value of these forward contracts being recorded as accrued liabilities or other current assets.

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Our policy governing hedges of foreign currency risk does not allow us to use forward contracts for trading purposes. Our forward contracts generally have maturities of 90 days or less. The effectiveness of our hedging program depends on our ability to estimate future asset and liability exposures. We enter into currency forward exchange contracts based on estimated future asset and liability exposures. Recognized gains and losses with respect to our current hedging activities will ultimately depend on how accurately we are able to match the amount of currency forward exchange contracts with actual underlying asset and liability exposures.

The following table provides information, as of June 28, 2008, about our forward foreign currency contracts. The information is provided in United States dollar equivalent amounts. The table presents the notional amounts, at contract exchange rates, and the weighted average contractual foreign currency exchange rates expressed as units of the foreign currency per United States dollar, which in some cases may not be the market convention for quoting a particular currency. All of these forward contracts mature prior to or during August 2008.

	Notional Principal (In millions)	Weighted Average Contract Rate
Forward Contracts:		
Japanese yen	$ 43.5	105.58
British pound sterling	24.1	0.51
European union euro	14.3	0.65
Israeli shekel	9.6	3.39
Indian rupee	9.5	43.20
Taiwan dollar	7.7	30.35
Other	14.7	N/A
Total	$ 123.4	
Estimated fair value	$ 0.2	

While we actively monitor our foreign currency risks, there can be no assurance that our foreign currency hedging activities will substantially offset the impact of fluctuations in currency exchange rates on our results of operations, cash flows and financial position.

Equity Price Risk

1.375% Convertible Senior Notes Due 2011 and 1.500% Convertible Senior Notes Due 2013

In December 2006, we issued $250.0 million principal amount of our 2011 Notes, and $250.0 million principal amount of our 2013 Notes, or collectively, the Convertible Senior Notes, to three initial purchasers in a private placement pursuant to Section 4(2) of the Securities Act for resale to qualified institutional buyers pursuant to Rule 144A of the Securities Act. Concurrently with the issuance of the Convertible Senior Notes, we entered into hedge transactions with various parties, and in separate transactions, sold warrants for the purchase of our common stock to various parties to reduce the potential dilution from the conversion of the Convertible Senior Notes and to mitigate any negative effect such conversion may have on the price of our common stock. For additional description

of the Convertible Senior Notes, including the hedge and warrants transactions, see the discussion under the heading Liquidity and Capital Resources Other Factors Affecting Liquidity and Capital Resources above.

Zero Coupon Zero Yield Senior Convertible Notes Due 2023

In August 2003, we issued $420.0 million principal amount of our 2023 Notes to two initial purchasers in a private placement pursuant to Section 4(2) of the Securities Act for resale to qualified institutional buyers pursuant to Rule 144A of the Securities Act. Concurrently with the issuance of the 2023 Notes, we entered into hedge transactions with one of the initial purchasers and in a separate transaction, sold warrants for the purchase of our

common stock to one of the initial purchasers to reduce the potential dilution from the conversion of the 2023 Notes and to mitigate any negative effect such conversion may have on the price of our common stock. For additional description of the 2023 Notes, including the hedge and warrants transactions, see the discussion under the heading Liquidity and Capital Resources Other Factors Affecting Liquidity and Capital Resources above.

Investments

We have a portfolio of equity investments that includes marketable equity securities and non-marketable equity securities. Our equity investments are made primarily in connection with our strategic investment program. Under our strategic investment program, from time to time, we make cash investments in companies with technologies that are potentially strategically important to us.

We consider all of our investments in marketable securities as available-for-sale. It is our policy to review the fair value of these marketable securities on a regular basis to determine whether our investments in these companies are other-than-temporarily impaired. This evaluation includes, but is not limited to, reviewing each company s cash position, financing needs, earnings or revenue outlook, operational performance, management or ownership changes and competition. If we believe the carrying value of an investment is in excess of its fair value, and this difference is other-than-temporary, it is our policy to write down the investment to reduce its carrying value to fair value.

The fair value of our portfolio of available-for-sale marketable equity securities, which are included in Short-term investments on the accompanying Condensed Consolidated Balance Sheets, was $52.5 million as of June 28, 2008 and $14.9 million as of December 29, 2007. While we actively monitor these investments, we do not currently engage in any hedging activities to reduce or eliminate equity price risk with respect to these equity investments. Accordingly, we could lose all or part of our investment portfolio of marketable equity securities if there is an adverse change in the market prices of the companies we invest in.

Our investments in marketable and non-marketable equity securities would be negatively affected by an adverse change in equity market prices, although the impact on our investments in non-marketable securities cannot be directly quantified. Such a change, or any negative change in the financial performance or prospects of the companies whose non-marketable securities we own, would harm the ability of these companies to raise additional capital and the likelihood of our being able to realize any gains or return of our investments through liquidity events such as initial public offerings, acquisitions and private sales. These types of investments involve a high degree of risk, and there can be no assurance that any company we invest in will grow or will be successful or that we will be able to liquidate a particular investment when desired. Accordingly, we could lose all or part of our investment.

Our investments in non-marketable equity securities had a carrying amount of $21.7 million as of June 28, 2008 and $26.2 million as of December 29, 2007. If we determine that an other-than-temporary decline in fair value exists for a non-marketable equity security, we write down the investment to its fair value and record the related write-down as an investment loss in our Condensed Consolidated Statements of Operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation required by Rule 13a-15 of the Securities Exchange Act of 1934, as amended, or the Exchange Act, under the supervision and with the participation of our management, including the Chief Executive Officer, or CEO, and the Chief Financial Officer, or CFO, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13-15(e) and 15d-15(e) under the Exchange Act) as of June 28, 2008.

The evaluation of our disclosure controls and procedures included a review of our processes and implementation and the effect on the information generated for use in this Quarterly Report. In the course of this evaluation, we sought to identify any material weaknesses in our disclosure controls and procedures, to determine whether we had identified any acts of fraud involving personnel who have a significant role in our disclosure controls and procedures, and to confirm that any necessary corrective action, including process improvements, was taken. This type of evaluation is done every fiscal quarter so that our conclusions concerning the effectiveness of these controls

can be reported in our periodic reports filed with the SEC. The overall goals of these evaluation activities are to monitor our disclosure controls and procedures and to make modifications as necessary. We intend to maintain these disclosure controls and procedures, modifying them as circumstances warrant.

Based on their evaluation as of June 28, 2008, our CEO and CFO have concluded that our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended June 28, 2008 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. While our disclosure controls and procedures and internal control over financial reporting are designed to provide reasonable assurance of their effectiveness, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Cadence have been detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in various disputes and litigation matters that arise in the ordinary course of business. These include disputes and lawsuits related to intellectual property, mergers and acquisitions, licensing, contracts, distribution arrangements and employee relations matters. At least quarterly, we review the status of each significant matter and assess its potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount or the range of loss can be estimated, we accrue a liability for the estimated loss in accordance with SFAS No. 5, Accounting for Contingencies. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based only on the best information available at the time. As additional information becomes available, we reassess the potential liability related to pending claims and litigation matters and may revise estimates.

On May 30, 2007, Ahmed Higazi, a former employee, filed suit against us in the United States District Court for the Northern District of California alleging that we improperly classified him and a class of our other information technology employees as exempt from overtime pay. The suit alleges claims for unpaid overtime under the federal Fair Labor Standards Act and California law, waiting-time penalties under the California Labor Code, failure to provide proper earnings statements under California law, failure to provide meal periods and rest breaks as required by California law, unfair business practices under California Business & Professions Code section 17200, and unpaid 401(k) Plan contributions in violation of the Employee Retirement Income Security Act. On June 20, 2007, we answered the plaintiff s complaint, denying its material allegations and raising a number of affirmative defenses, and on December 19, 2007, we filed an amended answer. A period of discovery conducted by both sides then ensued, and was followed in January 2008 by a private mediation of the case. At the mediation, the parties were successful in resolving their respective differences, and entered into a settlement agreement without contesting the merits of the claims or admitting liability. On July 7, 2008, the court approved the settlement agreement and we paid the settlement amount shortly thereafter.

While the outcome of disputes and litigation matters cannot be predicted with any certainty, management does not believe that the outcome of any current matters will have a material adverse effect on our consolidated financial position, liquidity or results of operations.

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Item 1A. Risk Factors

Our business faces many risks. Described below are what we believe to be the material risks that we face. If any of the events or circumstances described in the following risks actually occurs, our business, financial condition or results of operations could suffer. The descriptions below include any material changes to and supersede the description of the risk factors as previously disclosed in Item 1A to Part I of our Annual Report on Form 10-K for the fiscal year ended December 29, 2007, filed with the SEC on February 26, 2008.

Risks Related to Our Business

We are subject to the cyclical nature of the integrated circuit and electronics systems industries, and any downturn in these industries may reduce our revenue.

Purchases of our products and services are dependent upon the commencement of new design projects by IC manufacturers and electronics systems companies. The IC and electronics systems industries are cyclical and are characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand.

The IC and electronics systems industries have experienced significant downturns, often connected with, or in anticipation of, maturing product cycles of both these industries and their customers products and a decline in general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. Any economic downturn in the industries we serve could harm our business, operating results or financial condition.

Our failure to respond quickly to technological developments could make our products uncompetitive and obsolete.

The industries in which we compete experience rapid technology developments, changes in industry standards, changes in customer requirements and frequent new product introductions and improvements. Currently, the industries we serve are experiencing several revolutionary trends:

- Migration to nanometer design: the size of features such as wires, transistors and contacts on ICs continuously shrink due to the ongoing advances in semiconductor manufacturing processes. Process feature sizes refer to the width of the transistors and the width and spacing of interconnect on the IC. Feature size is normally identified by the transistor length, which is shrinking rapidly to 65 nanometers and smaller. This is commonly referred to in the semiconductor industry as the migration to nanometer design. It represents a major challenge for participants in the semiconductor industry, from IC design and design automation to design of manufacturing equipment and the manufacturing process itself. Shrinkage of transistor length to such proportions is challenging the industry in the application of more complex physics and chemistry that is needed to realize advanced silicon devices. For EDA tools, models of each component s electrical properties and behavior become more complex as do requisite analysis, design and verification capabilities. Novel design tools and methodologies must be invented quickly to remain competitive in the design of electronics in the smallest nanometer ranges.
- The challenges of nanometer design are leading some customers to work with older, less risky manufacturing processes. This may reduce their need to upgrade and/or proliferate their EDA products and design flows.
- The ability to design SoCs, increases the complexity of managing a design that, at the lowest level, is represented by billions of shapes on the fabrication mask. In addition, SoCs typically incorporate microprocessors and digital signal processors that are programmed with software, requiring simultaneous design of the IC and the related software embedded on the IC.

With the availability of seemingly endless gate capacity, there is an increase in design reuse, or the combining of off-the-shelf design IP with custom logic to create ICs. The unavailability of high-quality design IP that can be reliably incorporated into a customer s design with our IC implementation products and services could reduce demand for our products and services.

Increased technological capability of the Field-Programmable Gate Array, which is a programmable logic chip, creates an alternative to IC implementation for some electronics companies. This could reduce demand for our IC implementation products and services.

A growing number of low-cost design and methodology services businesses could reduce the need for some IC companies to invest in EDA products.

If we are unable to respond quickly and successfully to these developments, we may lose our competitive position, and our products or technologies may become uncompetitive or obsolete. To compete successfully, we must develop or acquire new products and improve our existing products and processes on a schedule that keeps pace with technological developments and the requirements for products addressing a broad spectrum of designers and designer expertise in our industries. We must also be able to support a range of changing computer software, hardware platforms and customer preferences. We cannot guarantee that we will be successful in this effort.

We have experienced varied operating results, and our operating results for any particular fiscal period are affected by the timing of significant orders for our software products, fluctuations in customer preferences for license types and the timing of revenue recognition under those license types.

We have experienced, and may continue to experience, varied operating results. In particular, we experienced a net loss for the three months ended March 29, 2008 and the six months ended June 28, 2008, we have experienced net losses for some other past periods and we may experience net losses in future periods. Various factors affect our operating results and some of them are not within our control. Our operating results for any period are affected by the timing of significant orders for our software products because a significant number of licenses for our software products are in excess of $5.0 million.

Our operating results are also affected by the mix of license types executed in any given period. We license software using three different license types: subscription, term and perpetual. Product revenue associated with term and perpetual licenses is generally recognized at the beginning of the license period, whereas product revenue associated with subscription licenses is recognized over multiple periods during the term of the license. Revenue may also be deferred under term and perpetual licenses until payments become due and payable from customers with nonlinear payment terms or as cash is collected from customers with lower credit ratings. In addition, revenue is impacted by the timing of license renewals, the extent to which contracts contain flexible payment terms, changes in existing contractual arrangements with customers and the mix of license types (i.e., perpetual, term or subscription) for existing customers, which changes could have the effect of accelerating or delaying the recognition of revenue from the timing of recognition under the original contract.

We plan operating expense levels primarily based on forecasted revenue levels. These expenses and the impact of long-term commitments are relatively fixed in the short term. A shortfall in revenue could lead to operating results below expectations because we may not be able to quickly reduce these fixed expenses in response to these short-term business changes.

The majority of our contracts are executed in the final two weeks of a fiscal quarter. This makes it difficult to determine with accuracy how much business will be executed in each fiscal quarter. Due to the volume or complexity of transactions that we review at the very end of the quarter, or due to operational matters regarding particular agreements, we may not finish processing or ship products under some contracts that have been signed during that fiscal quarter, which means that the associated revenue cannot be recognized in that particular period.

You should not view our historical results of operations as reliable indicators of our future performance. If revenue, operating results or our business outlook for future periods fall short of the levels expected by public market analysts or investors, the trading price of our common stock could decline.

Our future revenue is dependent in part upon our installed customer base continuing to license or buy additional products, renew maintenance agreements and purchase additional services.

Our installed customer base has traditionally generated additional new license, service and maintenance revenues. In future periods, customers may not necessarily license or buy additional products or contract for additional services or maintenance. Maintenance is generally renewable annually at a customer s option, and there are no mandatory payment obligations or obligations to license additional software. If our customers decide not to renew their maintenance agreements or license additional products or contract for additional services, or if they reduce the scope of the maintenance agreements, our revenue could decrease, which could have an adverse effect on our results of operations. Our customers, which include the largest semiconductor companies in the world, often have significant bargaining power in negotiations with us. Mergers of our customers can reduce the total level of purchases of our software and services, and in some cases, increase customers bargaining power in negotiations with their suppliers, including us.

We may not receive significant revenue from our current research and development efforts for several years, if at all.

Internally developing software products, integrating acquired software products and integrating intellectual property into existing platforms is expensive, and these investments often require a long time to generate returns. Our strategy involves significant investments in software research and development and related product opportunities. We believe that we must continue to dedicate a significant amount of resources to our research and development efforts to maintain our competitive position. However, we cannot predict that we will receive significant, if any, revenue from these investments.

Our failure to attract, train, motivate and retain key employees may make us less competitive in our industries and therefore harm our results of operations.

Our business depends on the efforts and abilities of our employees. The high cost of training new employees, not fully utilizing these employees, or losing trained employees to competing employers could reduce our gross margins and harm our business or operating results. Competition for highly skilled employees can be intense, particularly in geographic areas recognized as high technology centers such as the Silicon Valley area, where our principal offices are located, and the other locations where we maintain facilities. To attract, retain and motivate individuals with the requisite expertise, we may be required to grant large numbers of stock options or other stock-based incentive awards, which may be dilutive to existing stockholders and increase compensation expense. We may also be required to pay key employees significant base salaries and cash bonuses, which could harm our operating results.

In addition, the NASDAQ Marketplace Rules require stockholder approval for new equity compensation plans and significant amendments to existing plans, including increases in shares available for issuance under such plans, and prohibit NASDAQ member organizations from giving a proxy to vote on equity compensation plans unless the beneficial owner of the shares has given voting instructions. These regulations could make it more difficult for us to grant equity compensation to employees in the future. To the extent that these regulations make it more difficult or expensive to grant equity compensation to employees, we may incur increased compensation costs or find it difficult to attract, retain and motivate employees, which could materially and adversely affect our business.

We have acquired and expect to acquire other companies and businesses and may not realize the expected benefits of these acquisitions, including the proposed acquisition of Mentor Graphics.

We have acquired and expect to acquire other companies and businesses in the future. While we expect to carefully analyze each potential acquisition before committing to the transaction, we may not be able to integrate and manage acquired products and businesses effectively. In addition, acquisitions involve a number of risks. If any of the following events occurs after we acquire another business, it could seriously harm our business, operating results or financial condition:

- Difficulties in combining previously separate businesses into a single unit;
- The substantial diversion of management s attention from day-to-day business when evaluating and negotiating these transactions and integrating an acquired business;
- The discovery, after completion of the acquisition, of liabilities assumed from the acquired business or of assets acquired for which we cannot realize the anticipated value;
- The failure to realize anticipated benefits such as cost savings and revenue enhancements;
- The failure to retain key employees of the acquired business;
- Difficulties related to integrating the products of an acquired business in, for example, distribution, engineering and customer support areas;
- Unanticipated costs;

Exposure to undisclosed or unknown potential liabilities of an acquired business;

Customer dissatisfaction with existing license agreements with us which may dissuade them from licensing or buying products acquired by us after the effective date of the license; and

The failure to understand and compete effectively in markets in which we have limited experience.

In a number of our previously completed acquisitions, we have agreed to make future payments, either in the form of employee bonuses or contingent purchase price payments, or earnouts, based on the performance of the acquired businesses or the employees who joined us with the acquired businesses. The performance goals pursuant to which these future payments may be made generally relate to achievement by the acquired business or the employees who joined us with the acquired business of certain specified bookings, revenue, product proliferation, product development or employee retention goals during a specified period following completion of the applicable acquisition. Future acquisitions may involve issuances of stock as full or partial payment of the purchase price for the acquired business, grants of incentive stock or options to employees of the acquired businesses (which may be dilutive to existing stockholders), expenditure of substantial cash resources or the incurrence of material amounts of debt.

The specific performance goal levels and amounts and timing of employee bonuses or contingent purchase price payments vary with each acquisition. In connection with our acquisitions completed prior to June 28, 2008, we may be obligated to pay up to an aggregate of $62.4 million in cash during the next 50 months if certain performance goals related to one or more of the criteria mentioned above are achieved in full. Of this amount, up to $51.4 million would be expensed as compensation expense in our Condensed Consolidated Statements of Operations and up to $11.0 million would be added to the purchase price of the acquisitions and will be recorded in Goodwill in our Condensed Balance Sheets.

In December 2007, the FASB issued SFAS No. 141R, which will change how business acquisitions are accounted for and will impact financial statements both on the acquisition date and in subsequent periods. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008. Early adoption is not permitted. We are currently evaluating the impact that SFAS No. 141R will have on our condensed consolidated financial statements.

On May 2, 2008, we made a proposal to the board of directors of Mentor Graphics to acquire all of the outstanding shares of Mentor Graphics common stock for cash consideration of $16.00 per Mentor Graphics share, representing a total value of approximately $1.6 billion. On May 23, 2008, the Mentor Graphics board of directors informed us that it did not wish to pursue discussions with us given Mentor Graphics desire to stay independent. On June 17, 2008, we publicly announced our offer and Mentor Graphics publicly confirmed that it received an unsolicited offer from us and that it previously rejected our offer. We currently expect to borrow in excess of $1.0 billion if we are successful in acquiring all of Mentor Graphics outstanding shares and we are currently reviewing various alternatives for financing this transaction. There are no assurances that the acquisition will be completed or that financing will be available on terms that are acceptable to us. If we were to acquire Mentor Graphics, the transaction would have a material impact on our business, operating results or financial condition, which impact could be negative.

The announcement regarding our proposal to acquire Mentor Graphics has made us subject to a number of risks, uncertainties and other factors, many of which are outside our control, including, among others:

- The possibility that the transaction will not be consummated;
- The effect of the announcement of the proposal on our business, including our strategic and customer relationships, ability to retain key employees and stock prices;
- The possibility that the announcement of the proposal may result in delays in customers purchases of products and services;
- The possibility that the announcement of the proposal may result in changes in the mix of license types (i.e. perpetual, term or subscription) for existing customers, which changes could have the effect of delaying the recognition of revenue when compared with our or Mentor Graphics existing license mix;
- Our ability to successfully integrate Mentor Graphics into a combined company and otherwise realize within anticipated time periods the potential benefits of the acquisition, including any potential synergies we may anticipate from the transaction;

Our ability to access capital and debt markets to finance the acquisition on favorable or acceptable terms;
That Cadence will incur significant deal related cost and expenses in connection with the Mentor Graphics proposed acquisition, even if the acquisition is not consummated. The timing and effect of the recognition of such deal costs and expenses will depend on whether a transaction is consummated before

fiscal year 2009, when SFAS No. 141R becomes effective, and if no transaction is to be consummated, the timing of when that becomes clear; and

The value of any investment we may have in Mentor Graphics securities in advance of the transaction may decline if the transaction is not completed and Mentor Graphics share price declines.

The competition in our industries is substantial and we may not be able to continue to successfully compete in our industries.

The EDA market and the commercial electronics design and methodology services industries are highly competitive. If we fail to compete successfully in these industries, it could seriously harm our business, operating results or financial condition. To compete in these industries, we must identify and develop or acquire innovative and cost-competitive EDA products, integrate them into platforms and market them in a timely manner. We must also gain industry acceptance for our design and methodology services and offer better strategic concepts, technical solutions, prices and response time, or a combination of these factors, than those of other design companies and the internal design departments of electronics manufacturers. We cannot assure you that we will be able to compete successfully in these industries. Factors that could affect our ability to succeed include:

- The development by others of competitive EDA products or platforms and design and methodology services, which could result in a shift of customer preferences away from our products and services and significantly decrease revenue;
- Decisions by electronics manufacturers to perform design and methodology services internally, rather than purchase these services from outside vendors due to budget constraints or excess engineering capacity;
- The challenges of developing (or acquiring externally-developed) technology solutions that are adequate and competitive in meeting the requirements of next-generation design challenges;
- The significant number of current and potential competitors in the EDA industry and the low cost of entry;
- Intense competition to attract acquisition targets, which may make it more difficult for us to acquire companies or technologies at an acceptable price or at all; and
- The combination of or collaboration among many EDA companies to deliver more comprehensive offerings than they could individually.

We compete in the EDA products market with Synopsys, Inc., Magma Design Automation, Inc. and Mentor Graphics. We also compete with numerous smaller EDA companies, with manufacturers of electronic devices that have developed or have the capability to develop their own EDA products, and with numerous electronics design and consulting companies. Manufacturers of electronic devices may be reluctant to purchase design and methodology services from independent vendors such as us because they wish to promote their own internal design departments.

We may need to change our pricing models to compete successfully.

The highly competitive markets in which we compete can put pressure on us to reduce the prices of our products. If our competitors offer deep discounts on certain products in an effort to recapture or gain market segment share or to sell other software or hardware products, we may then need to lower our prices or offer other favorable terms to compete successfully. Any such changes would be likely to reduce our profit margins and could adversely affect our operating results. Any substantial changes to our prices and pricing policies could cause sales and software license revenues to decline or be delayed as our sales force implements and our customers adjust to the new pricing policies. Some of our competitors may bundle products for promotional purposes or as a long-term pricing strategy or provide guarantees of prices and product implementations. These practices could, over time, significantly constrain the prices that we can charge for our products. If we cannot offset price reductions with a corresponding increase in the number of sales or with lower spending, then the reduced license revenues resulting from lower prices could have an adverse effect on our results of operations.

We rely on our proprietary technology as well as software and other intellectual property rights licensed to us by third parties, and we cannot assure you that the precautions taken to protect our rights will be adequate or that we will continue to be able to adequately secure such intellectual property rights from third parties.

Our success depends, in part, upon our proprietary technology. We generally rely on patents, copyrights, trademarks, trade secret laws, licenses and restrictive agreements to establish and protect our proprietary rights in technology and products. Despite precautions we may take to protect our intellectual property, third parties have tried in the past, and may try in the future, to challenge, invalidate or circumvent these safeguards. The rights granted under our patents or attendant to our other intellectual property may not provide us with any competitive advantages and there is no guarantee that patents will be issued on any of our pending applications and future patents may not be sufficiently broad to protect our technology. Furthermore, the laws of foreign countries may not protect our proprietary rights in those countries to the same extent as applicable law protects these rights in the United States. Many of our products include software or other intellectual property licensed from third parties. We may have to seek new or renew existing licenses for such software and other intellectual property in the future. Our design and methodology services business holds licenses to certain software and other intellectual property owned by third parties, including that of our competitors. Our failure to obtain, for our use, software or other intellectual property licenses or other intellectual property rights on favorable terms, or the need to engage in litigation over these licenses or rights, could seriously harm our business, operating results or financial condition.

We could lose key technology or suffer serious harm to our business because of the infringement of our intellectual property rights by third parties or because of our infringement of the intellectual property rights of third parties.

There are numerous patents in the EDA industry and new patents are being issued at a rapid rate. It is not always practicable to determine in advance whether a product or any of its components infringes the patent rights of others. As a result, from time to time, we may be compelled to respond to or prosecute intellectual property infringement claims to protect our rights or defend a customer s rights.

Intellectual property infringement claims, regardless of merit, could consume valuable management time, result in costly litigation, or cause product shipment delays, all of which could seriously harm our business, operating results or financial condition. In settling these claims, we may be required to enter into royalty or licensing agreements with the third parties claiming infringement. These royalty or licensing agreements, if available, may not have terms favorable to us. Being compelled to enter into a license agreement with unfavorable terms could seriously harm our business, operating results or financial condition. Any potential intellectual property litigation could compel us to do one or more of the following:

- Pay damages (including the potential for treble damages), license fees or royalties (including royalties for past periods) to the party claiming infringement;
- Stop licensing products or providing services that use the challenged intellectual property;
- Obtain a license from the owner of the infringed intellectual property to sell or use the relevant technology, which license may not be available on reasonable terms, or at all; or
- Redesign the challenged technology, which could be time-consuming and costly, or not be accomplished.

If we were compelled to take any of these actions, our business or results of operations may suffer.

If our security measures are breached and an unauthorized party obtains access to customer data, our information systems may be perceived as being unsecure and customers may curtail or stop their use of our products and services.

Our products and services involve the storage and transmission of customers proprietary information, and breaches of our security measures could expose us to a risk of loss or misuse of this information, litigation and potential liability. Because techniques used to obtain unauthorized access or to sabotage information systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventive measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose existing customers and our ability to obtain new customers.

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We may not be able to effectively implement our restructuring activities, and our restructuring activities may not result in the expected benefits, which would negatively impact our future results of operations.

The EDA market and the commercial electronics design and methodology services industries are highly competitive and change quickly. We have responded to increased competition and changes in the industries in which we compete, in part, by restructuring our operations and at times reducing the size of our workforce. Despite our restructuring efforts in prior years, we may not achieve all of the operating expense reductions and improvements in operating margins and cash flows anticipated from those restructuring activities in the periods contemplated. Our inability to realize these benefits may result in an inefficient business structure that could negatively impact our results of operations.

We have reduced the workforce in certain revenue-generating portions of our business. These reductions in staffing levels could require us to forego certain future opportunities due to resource limitations, which could negatively affect our long-term revenues. We may need to implement further restructuring activities or reductions in our workforce based on changes in the markets and industries in which we compete and there is no assurance that any such restructuring efforts will be successful.

The long sales cycle of our products and services makes the timing of our revenue difficult to predict and may cause our operating results to fluctuate unexpectedly.

Generally, we have a long sales cycle that can extend up to six months or longer. The length of the sales cycle may cause our revenue or operating results to vary from quarter to quarter. The complexity and expense associated with our business generally require a lengthy customer education, evaluation and approval process. Consequently, we may incur substantial expenses and devote significant management effort and expense to develop potential relationships that do not result in agreements or revenue and may prevent us from pursuing other opportunities.

In addition, sales of our products and services may be delayed if customers delay approval or commencement of projects because of:

- The timing of customers competitive evaluation processes; or
- Customers budgetary constraints and budget cycles.

Long sales cycles for acceleration and emulation hardware products subject us to a number of significant risks over which we have limited control, including insufficient, excess or obsolete inventory, variations in inventory valuation and fluctuations in quarterly operating results.

The majority of our contracts are executed in the final two weeks of a fiscal quarter. This makes it difficult to determine with accuracy how much business will be executed in each fiscal quarter. Also, because of the timing of large orders and our customers buying patterns, we may not learn of bookings shortfalls, revenue shortfalls, earnings shortfalls or other failures to meet market expectations until late in a fiscal quarter. These factors may cause our operating results to fluctuate unexpectedly, which can cause significant fluctuations in the trading price of our common stock.

We may not be able to sell certain installment contracts to generate cash, which may impact our operating cash flows for any particular fiscal period.

We sell certain installment contracts to certain financing institutions on a non-recourse or limited-recourse basis to generate cash. Our ability to complete these sales of installment contracts is affected by a number of factors, including the:

- Economic conditions in the securities markets;
- Credit policies of the financing institutions; and
- Credit quality of customers whose installment contracts we wish to sell.

If we are unable to sell certain installment contracts, our operating cash flows would be adversely affected. There can be no assurance that funding will be available to us or, if available, that it will be on terms acceptable to us. If sources of funding are not available to us on a regular basis for any reason, including the occurrence of events of default, deterioration in credit quality in the underlying pool of receivables or otherwise, it would have a material adverse effect on our operating cash flows.

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The effect of foreign exchange rate fluctuations and other risks to our international operations may seriously harm our financial condition.

We have significant operations outside the United States. Our revenue from international operations as a percentage of total revenue was approximately 54% for the three months ended June 28, 2008 and 50% for the three months ended June 30, 2007. We expect that revenue from our international operations will continue to account for a significant portion of our total revenue. We also transact business in various foreign currencies, primarily the Japanese yen. The volatility of foreign currencies in certain regions, most notably the Japanese yen, European Union euro, British pound and Indian rupee have had, and may in the future have, a harmful effect on our revenue or operating results.

Fluctuations in the rate of exchange between the United States dollar and the currencies of other countries in which we conduct business could seriously harm our business, operating results or financial condition. For example, when a foreign currency declines in value relative to the United States dollar, it takes more of the foreign currency to purchase the same amount of United States dollars than before the change. If we price our products and services in the foreign currency, we receive fewer United States dollars than we did before the change. If we price our products and services in United States dollars, the decrease in value of the local currency results in an increase in the price for our products and services compared to those products of our competitors that are priced in local currency. This could result in our prices being uncompetitive in markets where business is transacted in the local currency. On the other hand, when a foreign currency increases in value relative to the United States dollar, it takes more United States dollars to purchase the same amount of the foreign currency. As we use the foreign currency to pay for payroll costs and other operating expenses in our international operations, this results in an increase in operating expenses.

Exposure to foreign currency transaction risk can arise when transactions are conducted in a currency different from the functional currency of one of our subsidiaries. A subsidiary s functional currency is generally the currency in which it primarily conducts its operations, including product pricing, expenses and borrowings. Although we attempt to reduce the impact of foreign currency fluctuations, significant exchange rate movements may hurt our results of operations as expressed in United States dollars.

Our international operations may also be subject to other risks, including:

- The adoption or expansion of government trade restrictions;
- Limitations on repatriation of earnings;
- Limitations on the conversion of foreign currencies;
- Reduced protection of intellectual property rights in some countries;
- Recessions in foreign economies;
- Longer collection periods for receivables and greater difficulty in collecting accounts receivable;
- Difficulties in managing foreign operations;
- Political and economic instability;
- Unexpected changes in regulatory requirements;
- Tariffs and other trade barriers; and
- United States and other governments licensing requirements for exports, which may lengthen the sales cycle or restrict or prohibit the sale or licensing of certain products.

We have offices throughout the world, including key research and development facilities outside of the United States. Our operations are dependent upon the connectivity of our operations throughout the world. Activities that interfere with our international connectivity, such as computer hacking or the introduction of a virus into our computer systems, could significantly interfere with our business operations.

Our operating results could be adversely affected as a result of changes in our effective tax rates.

Our future effective tax rates could be adversely affected by the following:

- Earnings being lower than anticipated in countries where we are taxed at lower rates as compared to the United States federal and state statutory tax rates;
- An increase in expenses not deductible for tax purposes, including certain stock-based compensation, write-offs of acquired in-process technology and impairment of goodwill;

- Changes in the valuation of our deferred tax assets;
- Changes in tax laws or the interpretation of such tax laws;
- Changes in judgment from the evaluation of new information that results in a recognition, derecognition, or change in measurement of a tax position taken in a prior period;
- Increases to interest expenses classified in the financial statements as income taxes;
- New accounting standards or interpretations of such standards;
- A change in our decision to indefinitely reinvest foreign earnings outside the United States; or
- Results of tax examinations by the IRS and state and foreign tax authorities.

Any significant change in our future effective tax rates could adversely impact our results of operations for future periods.

We have received an examination report from the IRS proposing deficiencies in certain of our tax returns, and the outcome of current and future tax examinations may have a material adverse effect on our results of operations and cash flows.

The IRS and other tax authorities regularly examine our income tax returns. In July 2006, the IRS completed its field examination of our federal income tax returns for the tax years 2000 through 2002 and issued an RAR in which the IRS proposed to assess an aggregate tax deficiency for the three-year period of approximately $324.0 million. In November 2006, the IRS revised the proposed aggregate tax deficiency for the three-year period to be approximately $318.0 million. The IRS is contesting our qualification for deferred recognition of certain proceeds received from restitution and settlement in connection with litigation during the period. The proposed tax deficiency for this item is approximately $152.0 million. The remaining proposed tax deficiency of approximately $166.0 million is primarily related to proposed adjustments to our transfer pricing arrangements with foreign subsidiaries and to our deductions for foreign trade income. The IRS may make similar claims against our transfer pricing arrangements and deductions for foreign trade income in future examinations. We have filed a timely protest with the IRS and will seek resolution of the issues through the Appeals Office.

We believe that the proposed IRS adjustments are inconsistent with applicable tax laws and we are vigorously challenging these proposed adjustments. The RAR is not a final Statutory Notice of Deficiency but the IRS imposes interest on the proposed deficiencies until the matters are resolved. Interest is compounded daily at rates published and adjusted quarterly by the IRS and have been between 4% and 10% since 2001. The IRS is currently examining our federal income tax returns for the tax years 2003 through 2005.

Significant judgment is required in applying the principles of FIN No. 48 and SFAS No. 109. The calculation of our provision for income taxes involves dealing with uncertainties in the application of complex tax laws and regulations. In determining the adequacy of our provision for income taxes, we regularly assess the potential settlement outcomes resulting from income tax examinations. However, the final outcome of tax examinations, including the total amount payable or the timing of any such payments upon resolution of these issues, cannot be estimated with certainty. In addition, we cannot be certain that such amount will not be materially different than that which is reflected in our historical income tax provisions and accruals. Should the IRS or other tax authorities assess additional taxes as a result of a current or a future examination, we may be required to record charges to operations in future periods that could have a material impact on the results of operations, financial position or cash flows in the applicable period or periods.

Forecasting our estimated annual effective tax rate is complex and subject to uncertainty, and material differences between forecasted and actual tax rates could have a material impact on our results of operations.

Forecasts of our income tax position and resultant effective tax rate are complex and subject to uncertainty because our income tax position for each year combines the effects of estimating our annual income or loss, the mix of profits

and losses earned by us and our subsidiaries in tax jurisdictions with a broad range of income tax rates, as well as benefits from available deferred tax assets, the impact of various accounting rules and changes to these rules and results of tax audits. To forecast our global tax rate, pre-tax profits and losses by jurisdiction are estimated and tax expense by jurisdiction is calculated. If our estimate of the pre-tax profit and losses, the mix of our profits and losses, our ability to use deferred tax assets, the results of tax audits, or effective tax rates by jurisdiction is different

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than those estimates, our actual tax rate could be materially different than forecasted, which could have a material impact on our results of operations.

Failure to obtain export licenses could harm our business by rendering us unable to ship products and transfer our technology outside of the United States.

We must comply with regulations of the United States and of certain other countries in shipping our software products and transferring our technology outside the United States and to foreign nationals. Although we have not had any significant difficulty complying with such regulations so far, any significant future difficulty in complying could harm our business, operating results or financial condition.

Errors or defects in our products and services could expose us to liability and harm our reputation.

Our customers use our products and services in designing and developing products that involve a high degree of technological complexity, each of which has its own specifications. Because of the complexity of the systems and products with which we work, some of our products and designs can be adequately tested only when put to full use in the marketplace. As a result, our customers or their end users may discover errors or defects in our software or the systems we design, or the products or systems incorporating our design and intellectual property may not operate as expected. Errors or defects could result in:

- Loss of customers;
- Loss of market segment share;
- Failure to attract new customers or achieve market acceptance;
- Diversion of development resources to resolve the problem;
- Loss of or delay in revenue;
- Increased service costs; and
- Liability for damages.

If we become subject to unfair hiring claims, we could be prevented from hiring needed employees, incur liability for damages and incur substantial costs in defending ourselves.

Companies in our industry whose employees accept positions with competitors frequently claim that these competitors have engaged in unfair hiring practices or that the employment of these persons would involve the disclosure or use of trade secrets. These claims could prevent us from hiring employees or cause us to incur liability for damages. We could also incur substantial costs in defending ourselves or our employees against these claims, regardless of their merits. Defending ourselves from these claims could also divert the attention of our management away from our operations.

Our business is subject to the risk of earthquakes.

Our corporate headquarters, including certain of our research and development operations and certain of our distribution facilities, is located in the Silicon Valley area of Northern California, which is a region known to experience seismic activity. If significant seismic activity were to occur, our operations may be interrupted, which would adversely impact our business and results of operations.

We maintain research and development and other facilities in parts of the world that are not as politically stable as the United States, and as a result we may face a higher risk of business interruption from acts of war or terrorism than businesses located only or primarily in the United States.

We maintain international research and development and other facilities, some of which are in parts of the world that are not as politically stable as the United States. Consequently, we may face a greater risk of business interruption as a result of terrorist acts or military conflicts than businesses located domestically. Furthermore, this potential harm is exacerbated given that damage to or disruptions at our international research and development facilities could have an adverse effect on our ability to develop new or improve existing products as compared to other businesses which may only have sales offices or other less critical operations abroad. We are not insured for losses or interruptions caused by acts of war or terrorism.

Risks Related to Our Securities and Indebtedness

Our debt obligations expose us to risks that could adversely affect our business, operating results or financial condition, and could prevent us from fulfilling our obligations under such indebtedness.

We have a substantial level of debt. As of June 28, 2008, we had $730.4 million of outstanding indebtedness as follows:

- $250.0 million related to our 1.375% Convertible Senior Notes Due 2011, or the 2011 Notes;
- $250.0 million related to our 1.500% Convertible Senior Notes Due 2013, or the 2013 Notes and, together with the 2011 Notes, the Convertible Senior Notes; and
- $230.4 million related to our Zero Coupon Zero Yield Senior Convertible Notes Due 2023, or the 2023 Notes.

If the proposed acquisition of Mentor Graphics is successful, we currently expect to incur in excess of $1.0 billion of new debt capital.

The level of our current or future indebtedness, among other things, could:

- Make it difficult for us to satisfy our payment obligations on our debt as described below;
- Make us more vulnerable in the event of a downturn in our business;
- Reduce funds available for use in our operations;
- Make it difficult for us to incur additional debt or obtain any necessary financing in the future for working capital, capital expenditures, debt service, acquisitions or general corporate purposes;
- Impose operating or financial covenants on us;
- Limit our flexibility in planning for or reacting to changes in our business;
- Make us more vulnerable in the event of an increase in interest rates if we must incur new debt to satisfy our obligations under the Convertible Senior Notes or the 2023 Notes; or
- Place us at a possible competitive disadvantage relative to less leveraged competitors and competitors that have greater access to capital resources.

If we experience a decline in revenue due to any of the factors described in this section entitled Risk Factors, or otherwise, we could have difficulty paying amounts due on our indebtedness. In the case of the 2023 Notes, although they mature in 2023, the holders of the 2023 Notes may require us to repurchase for cash all or any portion of the 2023 Notes on August 15, 2008 for 100.25% of the principal amount, August 15, 2013 for 100.00% of the principal amount and August 15, 2018 for 100.00% of the principal amount. As a result, although the 2023 Notes mature in 2023, the holders may require us to repurchase the 2023 Notes at an additional premium in 2008, which makes it probable that we will be required to repurchase the 2023 Notes in 2008 if they have not first been repurchased by us or are not otherwise converted.

If we are prohibited from paying our outstanding indebtedness, we could try to obtain the consent of the lenders under those arrangements to make such payment, or we could attempt to refinance the borrowings that contain the restrictions. If we do not obtain the necessary consents or refinance the borrowings, we may be unable to satisfy our outstanding indebtedness. Any such failure would constitute an event of default under our indebtedness, which could, in turn, constitute a default under the terms of any other indebtedness then outstanding.

If we are unable to generate sufficient cash flow or otherwise obtain funds necessary to make required payments, or if we fail to comply with the various requirements of our indebtedness, we would be in default, which would permit the holders of our indebtedness to accelerate the maturity of the indebtedness and could cause defaults under our other

indebtedness as well. Any default under our indebtedness could have a material adverse effect on our business, operating results and financial condition. In addition, a material default on our indebtedness could suspend our eligibility to register securities using certain registration statement forms under SEC guidelines that permit incorporation by reference of substantial information regarding us, which could potentially hinder our ability to raise capital through the issuance of our securities and will increase the costs of such registration to us.

In May 2008, the FASB issued FSP APB14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement), which will require us to recognize additional non-cash interest expense related to our Convertible Senior Notes in our Condensed Consolidated Statements of

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Operations. FSP APB 14-1 is effective for fiscal 2009 and is required to be applied retrospectively for all periods for which our Convertible Senior Notes were outstanding prior to the date of adoption. FSP APB 14-1 will have an adverse effect on our operating results and financial condition, particularly with respect to interest expense ratios commonly referred to by lenders, and could potentially hinder our ability to raise capital through the issuance of debt or equity securities.

Conversion of the 2023 Notes or the Convertible Senior Notes will dilute the ownership interests of existing stockholders.

The terms of the 2023 Notes and the Convertible Senior Notes permit the holders to convert the 2023 Notes and the Convertible Senior Notes into shares of our common stock. The 2023 Notes are convertible into our common stock initially at a conversion price of $15.65 per share, which would result in an aggregate of approximately 14.7 million shares of our common stock being issued upon conversion, subject to adjustment upon the occurrence of specified events. The terms of the Convertible Senior Notes stipulate a net share settlement, which upon conversion of the Convertible Senior Notes requires us to pay the principal amount in cash and the conversion premium, if any, in shares of our common stock based on a daily settlement amount, calculated on a proportionate basis for each day of the relevant 20 trading-day observation period. The initial conversion rate for the Convertible Senior Notes is 47.2813 shares of our common stock per $1,000 principal amount of Convertible Senior Notes, equivalent to a conversion price of approximately $21.15 per share of our common stock. The conversion price is subject to adjustment in some events but will not be adjusted for accrued interest, except in limited circumstances. The conversion of some or all of the 2023 Notes or the Convertible Senior Notes will dilute the ownership interest of our existing stockholders. Any sales in the public market of the common stock issuable upon conversion could adversely affect prevailing market prices of our common stock.

Prior to conversion of the 2023 Notes, if the trading price of our common stock exceeds $22.69 per share over specified periods, basic net income per share will be diluted. We may redeem for cash all or any part of the 2023 Notes on or after August 15, 2008 for 100.00% of the principal amount, except for the 2023 Notes that the holders require us to repurchase on the repurchase dates described below. The holders of the 2023 Notes may require us to repurchase for cash all or any portion of their 2023 Notes on August 15, 2008 for 100.25% of the principal amount, on August 15, 2013 for 100.00% of the principal amount or on August 15, 2018 for 100.00% of the principal amount, by providing to the paying agent a written repurchase notice. On July 16, 2008, we filed a Tender Offer Statement on Schedule TO with the SEC and made available to the holders of the 2023 Notes, through the Depository Trust Company, documents specifying the terms, conditions and procedures for requiring us to repurchase all or a portion of the 2023 Notes on August 15, 2008 for 100.25% of the principal amount.

Each $1,000 of principal of the 2023 Notes is initially convertible into 63.879 shares of our common stock, subject to adjustment upon the occurrence of specified events. Holders of the 2023 Notes may convert their 2023 Notes prior to maturity only if:

- The price of our common stock reaches $22.69 during certain periods of time specified in the 2023 Notes;
- Specified corporate transactions occur;
- The 2023 Notes have been called for redemption; or
- The trading price of the 2023 Notes falls below a certain threshold.

As a result, although the 2023 Notes mature in 2023, the holders may require us to repurchase their notes at an additional premium in 2008, which makes it probable that we will be required to repurchase the 2023 Notes in 2008 if they have not first been repurchased by us or are not otherwise converted. As of June 28, 2008, none of the conditions allowing holders of the 2023 Notes to convert had been met.

Each $1,000 of principal of the Convertible Senior Notes is initially convertible into 47.2813 shares of our common stock, subject to adjustment upon the occurrence of specified events. Holders of the Convertible Senior Notes may convert their notes at their option on any day prior to the close of business on the scheduled trading day

immediately preceding December 15, 2011 in the case of the 2011 Notes and December 15, 2013 in the case of the 2013 Notes, in each case only if:

- The price of our common stock reaches $27.50 during certain periods of time specified in the Convertible Senior Notes;
- Specified corporate transactions occur; or
- The trading price of the Convertible Senior Notes falls below a certain threshold.

On and after November 2, 2011, in the case of the 2011 Notes, and November 1, 2013, in the case of 2013 Notes, until the close of business on the scheduled trading day immediately preceding the maturity date of such Convertible Senior Notes, holders may convert their Convertible Senior Notes at any time, regardless of the foregoing circumstances. As of June 28, 2008, none of the conditions allowing holders of the Convertible Senior Notes to convert had been met.

Although the conversion price of the 2023 Notes is currently $15.65 per share, the hedge and warrant transactions that we entered into in connection with the issuance of the 2023 Notes effectively increased the conversion price of the 2023 Notes until various dates in 2008 to approximately $23.08 per share, which would result in an aggregate issuance upon conversion prior to August 15, 2008 of approximately 10.2 million shares of our common stock. We entered into hedge and warrant transactions to reduce the potential dilution from the conversion of the 2023 Notes. On various dates from February 2008 through May 2008, all of the warrants expired out of the money and no settlement was required. We cannot guarantee that such hedge instruments will fully mitigate the dilution. In addition, the existence of the 2023 Notes may encourage short selling by market participants because the conversion of the 2023 Notes could depress the price of our common stock.

Although the conversion price of the Convertible Senior Notes is currently $21.15 per share, we entered into hedge and separate warrant transactions to reduce the potential dilution from the conversion of the Convertible Senior Notes. However, we cannot guarantee that such hedges and warrant instruments will fully mitigate the dilution. In addition, the existence of the Convertible Senior Notes may encourage short selling by market participants because the conversion of the Convertible Senior Notes could depress the price of our common stock.

At the option of the 2023 Noteholders and the Convertible Senior Noteholders under certain circumstances, we may be required to repurchase the 2023 Notes and the Convertible Senior Notes, as the case may be, in cash or shares of our common stock.

Under the terms of the 2023 Notes and the Convertible Senior Notes, we may be required to repurchase the 2023 Notes and the Convertible Senior Notes following a fundamental change in our corporate ownership or structure, such as a change of control in which substantially all of the consideration does not consist of publicly traded securities, prior to maturity of the 2023 Notes and the Convertible Senior Notes, as the case may be. Following a fundamental change, in certain circumstances, we may choose to pay the repurchase price of the 2023 Notes in cash, shares of our common stock or a combination of cash and shares of our common stock. If we choose to pay all or any part of the repurchase price of the 2023 Notes in shares of our common stock, this would result in dilution to the holders of our common stock. The repurchase price for the Convertible Senior Notes in the event of a fundamental change must be paid solely in cash. These repayment obligations may have the effect of discouraging, delaying or preventing a takeover of our company that may otherwise be beneficial to investors.

Hedge and warrant transactions entered into in connection with the issuance of the Convertible Senior Notes and the 2023 Notes may affect the value of our common stock.

We entered into hedge transactions with various financial institutions, at the time of issuance of the Convertible Senior Notes and the 2023 Notes, with the objective of reducing the potential dilutive effect of issuing our common

stock upon conversion of the Convertible Senior Notes and the 2023 Notes. We also entered into separate warrant transactions with the same financial institutions. In connection with our hedge and warrant transactions, these financial institutions purchased our common stock in secondary market transactions and entered into various over-the-counter derivative transactions with respect to our common stock. These entities or their affiliates are likely to modify their hedge positions from time to time prior to conversion or maturity of the Convertible Senior Notes and the 2023 Notes by purchasing and selling shares of our common stock, other of our securities or other instruments they may wish to use in connection with such hedging. Any of these transactions and activities could adversely

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affect the value of our common stock and, as a result, the number of shares and the value of the common stock holders will receive upon conversion of the Convertible Senior Notes and the 2023 Notes. In addition, subject to movement in the price of our common stock, if the hedge transactions settle in our favor, we could be exposed to credit risk related to the other party with respect to the payment we are owed from such other party.

Rating agencies may provide unsolicited ratings on the Convertible Senior Notes that could reduce the market value or liquidity of our common stock.

We have not requested a rating of the Convertible Senior Notes from any rating agency and we do not anticipate that the Convertible Senior Notes will be rated. However, if one or more rating agencies independently elects to rate the Convertible Senior Notes and assigns the Convertible Senior Notes a rating lower than the rating expected by investors, or reduces such rating in the future, the market price or liquidity of the Convertible Senior Notes and our common stock could be harmed. Should a decline in the market price of the Convertible Senior Notes result, as compared to the price of our common stock, this may trigger the right of the holders of the Convertible Senior Notes to convert the Convertible Senior Notes into cash and shares of our common stock.

Anti-takeover defenses in our certificate of incorporation and bylaws and certain provisions under Delaware law could prevent an acquisition of our company or limit the price that investors might be willing to pay for our common stock.

Our certificate of incorporation and bylaws and certain provisions of the Delaware General Corporation Law that apply to us could make it difficult for another company to acquire control of our company. For example:

- Our certificate of incorporation allows our Board of Directors to issue, at any time and without stockholder approval, preferred stock with such terms as it may determine. No shares of preferred stock are currently outstanding. However, the rights of holders of any of our preferred stock that may be issued in the future may be superior to the rights of holders of our common stock.
- Section 203 of the Delaware General Corporation Law generally prohibits a Delaware corporation from engaging in any business combination with a person owning 15% or more of its voting stock, or who is affiliated with the corporation and owned 15% or more of its voting stock at any time within three years prior to the proposed business combination, for a period of three years from the date the person became a 15% owner, unless specified conditions are met.

All or any one of these factors could limit the price that certain investors would be willing to pay for shares of our common stock and could delay, prevent or allow our Board of Directors to resist an acquisition of our company, even if a proposed transaction were favored by a majority of our independent stockholders.

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

In December 2006, our Board of Directors authorized a program to repurchase shares of our common stock in the open market with a value of up to $500.0 million in the aggregate that was completed during the six months ended June 28, 2008. In February 2008, our Board of Directors authorized a new program to repurchase shares of our common stock in the open market with a value of up to $500.0 million in the aggregate. The following table sets forth the repurchases we made during the three months ended June 28, 2008:

Period	Total Number of Shares Purchased*	Average Price Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan or Program	Maximum Dollar Value of Shares that May Yet Be Purchased Under Publicly Announced Plan or Program* (In millions)
March 30, 2008 May 3, 2008	71,258	$ 10.80	----	$ 412.1
May 4, 2008 May 31, 2008	12,615	$ 11.23	----	$ 412.1
June 1, 2008 June 28, 2008	15,717	$ 10.79	----	$ 412.1
Total	99,590	$ 10.85	----	

* Shares purchased that were not part of our publicly announced repurchase program represent the surrender of shares of restricted stock to pay income taxes due upon vesting, and do not reduce the dollar value that may yet be purchased under our publicly announced repurchase program.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

At the Annual Meeting of Stockholders held on May 7, 2008, the stockholders of Cadence voted on the following matters:

1. A proposal to elect eight (8) directors of Cadence to serve for the following year and until their successors are elected or until such director s earlier resignation or removal was approved as set forth below.

Nominee	In Favor	Opposed	Withheld
Michael J. Fister	224,712,185	2,697,107	326,493
Donald L. Lucas	191,061,755	35,992,618	681,412

Dr. Alberto Sangiovanni-Vincentelli	218,815,611	8,558,575	361,599
George M. Scalise	204,864,846	22,515,983	354,956
Dr. John B. Shoven	204,734,545	22,616,887	384,353
Roger S. Siboni	225,158,809	2,185,558	391,418
John A.C. Swainson	224,772,589	2,544,455	418,741
Lip-Bu Tan	211,840,990	15,466,468	428,327

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2. A proposal to approve an amendment to the Amended and Restated Employee Stock Purchase Plan to increase the number of shares of common stock reserved for issuance thereunder was approved by a vote of 185,598,052 for, 2,978,478 opposed, 814,327 withheld and 38,344,928 broker non-votes.

3. A proposal to ratify the selection of KPMG LLP as Cadence s independent registered public accounting firm for the fiscal year ending January 3, 2009 was approved by a vote of 226,008,158 for, 1,407,467 opposed, 320,160 withheld and no broker non-votes.

Item 5. Other Information

None.

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Item 6. Exhibits

(a) The following exhibits are filed herewith:

Exhibit Number	Exhibit Title	Incorporated by Reference Form	File No.	Exhibit No.	Filing Date	Provided Herewith
31.01	Certification of the Registrant s Chief Executive Officer, Michael J. Fister, pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.					X
31.02	Certification of the Registrant s Chief Financial Officer, Kevin S. Palatnik, pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.					X
32.01	Certification of the Registrant s Chief Executive Officer, Michael J. Fister, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X
32.02	Certification of the Registrant s Chief Financial Officer, Kevin S. Palatnik, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.					X

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CADENCE DESIGN SYSTEMS, INC.
(Registrant)

DATE: July 29, 2008	By:	/s/ Michael J. Fister Michael J. Fister President, Chief Executive Officer and Director
DATE: July 29, 2008	By:	/s/ Kevin S. Palatnik Kevin S. Palatnik Senior Vice President and Chief Financial Officer

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EXHIBIT INDEX

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