

CADENCE DESIGN SYSTEMS INC

Form 10-Q

December 11, 2008

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

**FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 27, 2008**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 0-15867**

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

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**77-0148231**  
(I.R.S. Employer  
Identification No.)

**2655 Seely Avenue, Building 5, San Jose, California**  
(Address of Principal Executive Offices)

**95134**  
(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  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  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

On November 29, 2008, 256,278,936 shares of the registrant's common stock, \$0.01 par value, were outstanding.

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**EXPLANATORY NOTE**

On December 11, 2008, Cadence Design Systems, Inc., or Cadence, restated its unaudited Condensed Consolidated Financial Statements as of and for the three months ended March 29, 2008 and as of and for the three and six months ended June 28, 2008. The restatement corrected revenue recognition with respect to an arrangement in which \$24.8 million of Product revenue was recognized in the first quarter of 2008 and \$1.0 million of Maintenance revenue was recognized in the second quarter of 2008, but should be recognized during the term of the arrangement, beginning in the fourth quarter of 2008. The restatement also corrected revenue recognition with respect to an arrangement in which \$12.0 million of Product revenue was recognized in the second quarter of 2008, but should be recognized during the term of the arrangement, beginning in the third quarter of 2008. In addition, Cadence made two other Product revenue adjustments that were previously disclosed in Cadence's Quarterly Report on Form 10-Q for the quarter ended June 28, 2008, initially filed with the Securities and Exchange Commission, or SEC, on July 29, 2008, and one other previously determined immaterial adjustment. See Note 2 of Cadence's Amendment No. 1 to Form 10-Q/A for the quarters ended March 29, 2008 and June 28, 2008. In addition to this Form 10-Q, Cadence is concurrently filing Amendment No. 1 to Form 10-Q/A for the quarters ended March 29, 2008 and June 28, 2008.

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****CADENCE DESIGN SYSTEMS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)****(Unaudited)****ASSETS**

|   | September 27,<br>2008 | December 29,<br>2007 |
|---|-----------------------|----------------------|
| Current Assets:   |                       |                      |
| Cash and cash equivalents   | \$ 551,753            | \$ 1,062,920         |
| Short-term investments  | 6,068                 | 15,193               |
| Receivables, net of allowances of \$3,355 and \$2,895, respectively                                     | 278,458               | 326,211              |
| Inventories   | 25,545                | 31,003               |
| Prepaid expenses and other  | 84,112                | 94,236               |
| Total current assets  | 945,936               | 1,529,563            |
| Property, plant and equipment, net of accumulated depreciation of \$636,305 and \$624,680, respectively | 359,196               | 339,463              |
| Goodwill  | 1,315,217             | 1,310,211            |
| Acquired intangibles, net   | 101,409               | 127,072              |
| Installment contract receivables  | 170,503               | 238,010              |
| Other assets  | 356,527               | 326,831              |
| Total Assets  | \$ 3,248,788          | \$ 3,871,150         |

**LIABILITIES AND STOCKHOLDERS EQUITY**

|  |         |            |
|--|---------|------------|
| Current Liabilities:                     |         |            |
| Convertible notes                        | \$ ---- | \$ 230,385 |
| Accounts payable and accrued liabilities | 259,062 | 289,934    |
| Current portion of deferred revenue      | 245,901 | 265,168    |
| Total current liabilities                | 504,963 | 785,487    |
| Long-Term Liabilities:                   |         |            |
| Long-term portion of deferred revenue    | 124,703 | 136,655    |
| Convertible notes                        | 500,178 | 500,000    |
| Other long-term liabilities              | 413,993 | 368,942    |

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|   |              |              |
|---|--------------|--------------|
| Total long-term liabilities                     | 1,038,874    | 1,005,597    |
| Stockholders' Equity:                           |              |              |
| Common stock and capital in excess of par value | 1,546,278    | 1,516,493    |
| Treasury stock, at cost                         | (730,301)    | (619,125)    |
| Retained earnings                               | 868,255      | 1,162,441    |
| Accumulated other comprehensive income          | 20,719       | 20,257       |
| Total stockholders' equity                      | 1,704,951    | 2,080,066    |
| Total Liabilities and Stockholders' Equity      | \$ 3,248,788 | \$ 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    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| Revenue:   |                       |                       |                       |                       |
| Product  | \$ 107,572            | \$ 273,799            | \$ 422,365            | \$ 775,496            |
| Services   | 32,873                | 31,225                | 98,763                | 95,963                |
| Maintenance  | 92,043                | 95,900                | 290,151               | 285,611               |
| <b>Total revenue</b>                               | <b>232,488</b>        | <b>400,924</b>        | <b>811,279</b>        | <b>1,157,070</b>      |
| Costs and Expenses:                                |                       |                       |                       |                       |
| Cost of product                                    | 11,829                | 13,823                | 39,241                | 42,302                |
| Cost of services                                   | 25,677                | 23,364                | 78,083                | 70,421                |
| Cost of maintenance                                | 13,910                | 15,217                | 42,889                | 45,635                |
| Marketing and sales                                | 91,075                | 97,163                | 274,016               | 297,924               |
| Research and development                           | 112,486               | 125,391               | 357,929               | 365,418               |
| General and administrative                         | 32,937                | 40,747                | 105,608               | 123,166               |
| Amortization of acquired intangibles               | 5,626                 | 4,739                 | 17,206                | 13,661                |
| Restructuring and other charges (credits)          | 48,120                | (7,066)               | 47,765                | (9,584)               |
| Write-off of acquired in-process technology        | ----                  | 2,678                 | 600                   | 2,678                 |
| <b>Total costs and expenses</b>                    | <b>341,660</b>        | <b>316,056</b>        | <b>963,337</b>        | <b>951,621</b>        |
| Income (loss) from operations                      | (109,172)             | 84,868                | (152,058)             | 205,449               |
| Interest expense                                   | (3,180)               | (2,849)               | (9,055)               | (9,373)               |
| Other income (expense), net                        | (7,714)               | 14,201                | (3,701)               | 47,938                |
| Income (loss) before provision for income taxes    | (120,066)             | 96,220                | (164,814)             | 244,014               |
| Provision for income taxes                         | 49,000                | 23,488                | 50,269                | 67,265                |
| <b>Net income (loss)</b>                           | <b>\$ (169,066)</b>   | <b>\$ 72,732</b>      | <b>\$ (215,083)</b>   | <b>\$ 176,749</b>     |
| Basic net income (loss) per share                  | \$ (0.67)             | \$ 0.27               | \$ (0.84)             | \$ 0.65               |
| Diluted net income (loss) per share                | \$ (0.67)             | \$ 0.24               | \$ (0.84)             | \$ 0.60               |
| Weighted average common shares outstanding basic   | 252,915               | 272,977               | 256,119               | 272,354               |
| Weighted average common shares outstanding diluted | 252,915               | 299,506               | 256,119               | 297,783               |

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)

|   | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|
|   | September 27,<br>2008 | September 29,<br>2007 |
| Cash and Cash Equivalents at Beginning of Period  | \$ 1,062,920          | \$ 934,342            |
| <b>Cash Flows from Operating Activities:</b>  |                       |                       |
| Net income (loss)   | (215,083)             | 176,749               |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities:  |                       |                       |
| Depreciation and amortization   | 97,719                | 96,798                |
| Stock-based compensation  | 57,678                | 78,828                |
| Equity in loss from investments, net  | 823                   | 2,504                 |
| (Gain) loss on investments, net   | 11,440                | (16,608)              |
| (Gain) loss on sale and leaseback of land and buildings                                   | 350                   | (12,606)              |
| Write-down of investment securities   | 10,666                | 2,550                 |
| Write-off of acquired in-process technology   | 600                   | 2,678                 |
| Non-cash restructuring and other charges (credits)  | 222                   | (7,106)               |
| Tax benefit of call options   | 7,034                 | 7,036                 |
| Deferred income taxes   | (11,020)              | 4,848                 |
| Proceeds from the sale of receivables, net  | 48,124                | 163,549               |
| Provisions (recoveries) for losses (gains) on trade accounts receivable and sales returns | 383                   | (975)                 |
| Other non-cash items  | (1,258)               | 8,525                 |
| Changes in operating assets and liabilities, net of effect of acquired businesses:        |                       |                       |
| Receivables   | 21,489                | 9,053                 |
| Installment contract receivables  | 46,198                | (273,301)             |
| Inventories   | 5,486                 | (681)                 |
| Prepaid expenses and other  | (3,421)               | (23,229)              |
| Other assets  | (1,849)               | (2,027)               |
| Accounts payable and accrued liabilities  | (41,582)              | (35,516)              |
| Deferred revenue  | (32,243)              | 9,411                 |
| Other long-term liabilities   | 35,972                | 18,448                |
| <b>Net cash provided by operating activities</b>  | <b>37,728</b>         | <b>208,928</b>        |
| <b>Cash Flows from Investing Activities:</b>  |                       |                       |
| Proceeds from the sale of available-for-sale securities                                   | 53,783                | 6,468                 |
| Purchases of available-for-sale securities  | (62,447)              | ----                  |
| Proceeds from the sale of long-term investments   | 3,250                 | 6,323                 |
| Proceeds from the sale of property, plant and equipment                                   | ----                  | 46,500                |
| Purchases of property, plant and equipment  | (81,112)              | (57,405)              |
| Purchases of software licenses  | (1,199)               | ----                  |

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|   |            |            |
|---|------------|------------|
| Investment in venture capital partnerships and equity investments   | (4,053)    | (3,214)    |
| Cash paid in business combinations and asset acquisitions, net of cash acquired, and acquisition of intangibles | (20,621)   | (74,117)   |
| Net cash used for investing activities  | (112,399)  | (75,445)   |
| Cash Flows from Financing Activities:   |            |            |
| Principal payments on term loan   | ----       | (28,000)   |
| Proceeds from receivable sale financing   | 17,970     | ----       |
| Payment of convertible notes due 2023   | (230,207)  | ----       |
| Tax benefit from employee stock transactions  | 427        | 20,727     |
| Proceeds from issuance of common stock  | 48,116     | 249,006    |
| Stock received for payment of employee taxes on vesting of restricted stock                                     | (3,693)    | (11,735)   |
| Purchases of treasury stock   | (273,950)  | (372,416)  |
| Other   | ----       | 8,558      |
| Net cash used for financing activities  | (441,337)  | (133,860)  |
| Effect of exchange rate changes on cash and cash equivalents  | 4,841      | 1,622      |
| Increase (decrease) in cash and cash equivalents  | (511,167)  | 1,245      |
| Cash and Cash Equivalents at End of Period  | \$ 551,753 | \$ 935,587 |

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

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**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, or the Exchange Act, 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. Cadence's fiscal year end is the Saturday closest to December 31. Fiscal 2007 was a 52-week year and fiscal 2008 will be a 53-week year ending on January 3, 2009.

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 nine months ended September 27, 2008. Therefore, the adoption of SFAS No. 159 did not impact Cadence's consolidated financial position, results of operations or cash flows.

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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 nine months ended September 27, 2008 and September 29, 2007 were as follows:

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|  | (In thousands)        |                       |                       |                       |
| Stock options                          | \$ 5,809              | \$ 9,069              | \$ 20,036             | \$ 29,166             |
| Restricted stock and stock bonuses     | 4,955                 | 12,022                | 27,007                | 41,531                |
| ESPP                                   | 3,870                 | 3,028                 | 10,635                | 8,131                 |
| Total stock-based compensation expense | \$ 14,634             | \$ 24,119             | \$ 57,678             | \$ 78,828             |
| Income tax benefit                     | \$ 3,533              | \$ 7,312              | \$ 15,036             | \$ 26,488             |

**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 nine months ended September 27, 2008 and September 29, 2007 were as follows:

|                         | Three Months Ended    |                       | Nine Months Ended     |                       |
|-------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                         | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| Dividend yield          | N/A                   | None                  | None                  | None                  |
| Expected volatility     | N/A                   | 27.0%                 | 42.9%                 | 23.2%                 |
| Risk-free interest rate | N/A                   | 4.26%                 | 2.76%                 | 4.68%                 |

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|  |     |    |      |    |      |    |      |
|--|-----|----|------|----|------|----|------|
| Expected life (in years)                       | N/A |    | 4.4  |    | 4.5  |    | 4.4  |
| Weighted average fair value of options granted | N/A | \$ | 6.41 | \$ | 4.22 | \$ | 5.14 |

Cadence did not grant any stock options during the three months ended September 27, 2008. 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 the time of grant. Cadence has not historically paid dividends; thus the expected dividend yield used in the calculation is zero.



**Table of Contents****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 nine months ended September 27, 2008 and September 29, 2007 were as follows:

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| Weighted average fair value of restricted stock granted | \$ 8.02               | \$ 20.65              | \$ 11.02              | \$ 20.59              |

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.

During the three months ended September 27, 2008, Cadence modified the performance goals related to its performance-based restricted stock awards. On the modification date, Cadence evaluated the likelihood of achievement of both the original performance goals and the modified performance goals. For the performance-based restricted stock awards in which the original performance goal was unlikely to be achieved, Cadence reversed the previously recorded stock-based compensation expense of \$6.5 million, calculated the fair value of the restricted stock award on the modification date, and will record the stock-based compensation expense to the extent that the modified performance goals are expected to be achieved over the remaining weighted average requisite service period of 1.0 years. The fair value of the modified performance-based restricted stock awards was \$6.2 million, or \$7.34 per share. For the performance-based restricted stock awards in which both the original performance goal and the modified performance goal were determined to be likely to be achieved, the original grant date fair value will continue to be recorded as stock-based compensation expense as if no modification had occurred.

As noted in Note 16 below, certain executive officers resigned from their positions at Cadence in October 2008. Pursuant to the resignations and the terms of the respective employment agreements of these executive officers, the performance-based restricted shares have either been forfeited or will vest subject to the terms of those agreements. Cadence will record additional stock-based compensation expense during the three months ending January 3, 2009 relating to the accelerated vesting, which will be offset by the reversal of previously recorded stock-based compensation expense relating to the performance-based awards that were forfeited.

Stock-based compensation expense (credits) related to the performance-based restricted stock grants for the three and nine months ended September 27, 2008 and September 29, 2007 was as follows:

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |

(In thousands)

|   |    |         |    |       |    |         |    |       |
|---|----|---------|----|-------|----|---------|----|-------|
| Stock-based compensation expense (credits)<br>related to performance-based grants | \$ | (5,402) | \$ | 1,868 | \$ | (1,471) | \$ | 5,501 |
|---|----|---------|----|-------|----|---------|----|-------|

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

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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 three months ended September 27, 2008, Cadence agreed to make the period's payment of \$2.9 million in cash. During the nine months ended September 27, 2008, Cadence agreed to make both of the period's payments totaling \$5.6 million in cash. Under the terms of this performance-based bonus plan, future payments may be made in cash or stock. Stock-based compensation expense related to these performance-based bonus plans and the shares issued for the three and nine months ended September 27, 2008 and September 29, 2007 were as follows:

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|  | (In thousands)        |                       |                       |                       |
| Stock-based compensation expense related to performance-based bonus plan | \$ 1,742              | \$ 1,423              | \$ 4,569              | \$ 8,212              |
| Shares issued for performance-based bonus plan                           | ----                  | 169                   | ----                  | 421                   |

**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 1<sup>st</sup> and August 1<sup>st</sup> of each year and the purchase dates under the ESPP are January 31<sup>st</sup> and July 31<sup>st</sup> of each year.

Shares of Cadence's common stock issued under the ESPP for the three and nine months ended September 27, 2008 and September 29, 2007 were as follows:

|   | Three Months Ended                       |                       | Nine Months Ended     |                       |
|---|--|-----------------------|-----------------------|-----------------------|
|   | September 27,<br>2008                    | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|   | (In thousands, except per share amounts) |                       |                       |                       |
| Cadence shares issued under the ESPP                              | 3,358                                    | 1,279                 | 6,076                 | 3,200                 |
| Cash received from the exercise of purchase rights under the ESPP | 21,093                                   | \$ 21,383             | 44,547                | \$ 43,964             |
| Weighted average fair value of purchase rights granted            | \$ 6.28                                  | \$ 16.71              | \$ 7.33               | \$ 13.74              |

Stock-based 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 nine months ended September 27, 2008 and September 29, 2007 were as follows:

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| Dividend yield  | None                  | None                  | None                  | None                  |
| Expected volatility                                       | 50.3%                 | 27.0%                 | 48.0%                 | 24.6%                 |
| Risk-free interest rate                                   | 1.88%                 | 4.96%                 | 1.95%                 | 5.08%                 |
| Expected life (in years)                                  | 0.50                  | 0.50                  | 0.48                  | 0.50                  |
| Weighted average fair value of purchase<br>rights granted | \$ 2.09               | \$ 5.01               | \$ 2.40               | \$ 4.74               |

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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 September 27, 2008:

|                                  |                           | Fair Value Measurements as of September 27, 2008: |            |         |         |
|----------------------------------|---------------------------|---|------------|---------|---------|
|                                  |                           | Total   | Level 1    | Level 2 | Level 3 |
|                                  |                           | (In thousands)                                    |            |         |         |
| <u>Assets</u>                    |                           |   |            |         |         |
| Cash equivalents                 | Money market mutual funds | \$ 425,395  | \$ 425,395 | \$ ---- | \$ ---- |
| Available-for-sale securities    |                           | 3,082   | 3,018      | ----    | 64      |
| Time deposits                    |                           | 2,986   | 2,986      | ----    | ----    |
| Trading securities held in NQDCs |                           | 47,862  | 47,862     | ----    | ----    |
| Total Assets                     |                           | \$ 479,325  | \$ 479,261 | \$ ---- | \$ 64   |

|                                     |  | Fair Value Measurements as of September 27, 2008: |         |            |         |
|-------------------------------------|--|---|---------|------------|---------|
|                                     |  | Total   | Level 1 | Level 2    | Level 3 |
|                                     |  | (In thousands)                                    |         |            |         |
| <u>Liabilities</u>                  |  |   |         |            |         |
| Foreign currency exchange contracts |  | \$ (1,135)  | \$ ---- | \$ (1,135) | \$ ---- |

|                   |    |         |    |      |    |         |    |      |
|-------------------|----|---------|----|------|----|---------|----|------|
| Total Liabilities | \$ | (1,135) | \$ | ---- | \$ | (1,135) | \$ | ---- |
|-------------------|----|---------|----|------|----|---------|----|------|

**Available-for-sale Securities**

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.

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It is Cadence's policy to review the fair value of available-for-sale 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 table summarizes Cadence's available-for-sale securities as of September 27, 2008 and December 29, 2007:

|                    | Cost           | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
|--------------------|----------------|------------------------------|-------------------------------|------------|
|                    | (In thousands) |                              |                               |            |
| September 27, 2008 | \$ 4,024       | \$ ----                      | \$ (942)                      | \$ 3,082   |
| 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 September 27, 2008:

|                               | Fair<br>Value  | Less than 12 Months<br>Gross<br>Unrealized<br>Losses |
|-------------------------------|----------------|--|
|                               | (In thousands) |  |
| Available-for-sale securities | \$ 1,395       | \$ (942)   |

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 \$2.4 million during the three months ended September 27, 2008 and \$7.8 million during the nine months ended September 27, 2008. This impairment is included in Other income (expense), net in the Condensed Consolidated Statement of Operations. Cadence did not recognize an other-than-temporary impairment of available-for-sale securities during the three or nine months ended September 29, 2007.

Net recognized gains (losses) from the sale of available-for-sale securities for the three and nine months ended September 27, 2008 and September 29, 2007 were as follows:

| Three Months Ended    |                       | Nine Months Ended     |                       |
|-----------------------|-----------------------|-----------------------|-----------------------|
| September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| (In thousands)        |                       |                       |                       |
|                       |                       |                       |                       |

|   |    |         |    |       |    |         |    |       |
|---|----|---------|----|-------|----|---------|----|-------|
| Gains (losses) on sale of available-for-sale securities | \$ | (9,379) | \$ | 2,093 | \$ | (7,945) | \$ | 4,404 |
|---|----|---------|----|-------|----|---------|----|-------|

During the nine months ended September 27, 2008, Cadence purchased approximately 4.3 million shares of Mentor Graphics Corporation, or Mentor Graphics, common stock in connection with its proposed acquisition of Mentor Graphics. Subsequent to the announcement of Cadence's withdrawal of the proposed acquisition of Mentor Graphics and during the three months ended September 27, 2008, Cadence sold its entire equity interest in Mentor Graphics at a loss of \$9.4 million.

**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 did not record write-downs due to other-than-temporary declines in value of non-marketable securities for the three months ended September 27, 2008, but did record \$2.0 million for the three months ended September 29, 2007. Cadence recorded write-downs due to other-than-temporary declines in value of



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non-marketable securities carried on the cost basis of \$2.9 million for the nine months ended September 27, 2008 and \$2.6 million for the nine months ended September 29, 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 of 1933, as amended, or the Securities Act, for resale to qualified institutional buyers pursuant to SEC Rule 144A of the Securities Act, or 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 the 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 and provided that Cadence's stock price is greater than \$18.00 per share, 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:

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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 September 27, 2008, none of the conditions allowing the holders of the Convertible Senior Notes to convert had been met.

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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 \$11.7 million as of September 27, 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 \$5.2 million as of September 27, 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 were amortized to interest expense using the straight-line method over five years. In connection with the issuance of the Convertible Senior Notes in December 2006, Cadence repurchased \$189.6 million principal amount of the 2023 Notes, and in August 2008, Cadence repurchased \$230.2 million principal amount of the 2023 Notes upon the election of the holders of the 2023 Notes and pursuant to the terms of the 2023 Notes, for a total consideration of \$230.8 million, reducing the outstanding 2023 Note balance to \$0.2 million as of September 27, 2008. Concurrently with the issuance of the 2023 Notes, Cadence entered into hedge and warrant transactions, all of which expired during the nine months ended September 27, 2008 and no settlement was required.

### **NOTE 5. INCOME TAXES**

**Earnings of Foreign Subsidiaries**

During the three months ended September 27, 2008, Cadence repatriated \$200.0 million of earnings from a foreign subsidiary, earnings which had previously been considered to be indefinitely reinvested outside the United States and for which deferred taxes had not been previously provided. Cadence currently expects that an additional \$117.9 million of previously untaxed earnings from foreign subsidiaries will not be indefinitely reinvested outside

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of the United States. As a result, Cadence has accrued a tax expense of \$71.0 million during the three and nine months ended September 27, 2008 to provide for the potential U.S., state and foreign income taxes on these repatriations. Cadence intends to indefinitely reinvest the remainder of its undistributed earnings of its foreign subsidiaries, which Cadence estimates to be \$29.0 million for the year ending January 3, 2009, to meet both the working capital and long-term capital needs of its subsidiaries and of Cadence.

## **Internal Revenue Service Examinations**

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.

## **Unrecognized Tax Benefits**

During the nine months ended September 27, 2008, Cadence recognized a \$7.9 million decrease in the net liabilities for unrecognized tax benefits based on new information received during the period, which Cadence accounted for as a \$7.9 million increase in the balance of Common stock and capital in excess of par value.

Cadence believes that it is reasonably possible that the total amounts of unrecognized tax benefits for its transfer pricing arrangements with its 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 Cadence's measurement of the tax benefits to be recognized upon effective settlement with the IRS. Because of the uncertain impact of any potential settlement guidelines, Cadence cannot currently provide an estimate of the range of the reasonably possible change.

Cadence also believes that it is reasonably possible that the total amounts of unrecognized tax benefits related to the value of stock options included in its cost sharing arrangements with its 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 Appeals for the Ninth Circuit. Cadence believes 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.

## **NOTE 6. RESTRUCTURING AND OTHER CHARGES**

During the three months ended September 27, 2008, Cadence determined that it would initiate a plan of restructuring intended to decrease costs by reducing its workforce throughout the company, and that the expenses associated with that reduction were both probable and estimable. Cadence recorded Restructuring and other charges of approximately \$48.1 million during the three months ended September 27, 2008, which included estimated severance payments, severance-related benefits and costs for outplacement services for at least 625 employees. Cadence expects to record an additional \$17.0 million to \$22.0 million in restructuring costs during the three

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months ending January 3, 2009 related to other aspects of this restructuring that were not probable as of September 27, 2008, or that should be recorded as the expense is incurred. Cadence accounted for the termination and benefits charges associated with this Restructuring in accordance with SFAS No. 112, Employers Accounting for Postemployment Benefits An Amendment of FASB Statements No. 5 and 43.

As of September 27, 2008, Cadence had not made any payments in connection with this restructuring plan, and the entire \$48.1 million is included in Accounts payable and accrued liabilities in its Condensed Consolidated Balance Sheet. Due to varying regulations in the jurisdictions and countries in which Cadence operates, Cadence expects substantially all termination benefits to be paid by January 2, 2010.

In connection with this restructuring initiative, Cadence has recorded estimated provisions for severance payments, severance-related benefits and outplacement costs. Cadence regularly evaluates the adequacy of its restructuring accrual, and adjusts the balance based on changes in estimates and assumptions. Cadence may incur future charges for changes in estimates related to amounts previously recorded and for additional activities under this restructuring.

**NOTE 7. GOODWILL AND ACQUIRED INTANGIBLES**

**Goodwill**

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, Cadence conducts a goodwill impairment analysis annually and as necessary if changes in facts and circumstances indicate that the fair value of Cadence's reporting unit may be less than its carrying amount. Cadence's goodwill impairment test consists of the two steps required by SFAS No. 142. The first step requires that Cadence compare the estimated fair value of its single reporting unit to the carrying value of the reporting unit's net assets, including goodwill. If the fair value of the reporting unit is greater than the carrying value of its net assets, goodwill is not considered to be impaired and no further testing is required. If the fair value of the reporting unit is less than the carrying value of its net assets, Cadence would be required to complete the second step of the test by analyzing the fair value of its goodwill. If the carrying value of the goodwill exceeds its fair value, an impairment charge is recorded.

To determine the reporting unit's fair value, Cadence uses a combination of the income and market valuation approaches. In determining its overall conclusion of reporting unit fair value, Cadence considers the estimated values derived from both the income and market valuation approaches and weighs the values from each approach equally.

The income approach provides an estimate of fair value based on discounted expected future cash flows. These expected future cash flows are based on Cadence's estimated market segment growth rates, assumed market segment share growth rates, estimated costs and appropriate discount rates based on the reporting unit's weighted average cost of capital. Cadence's estimates of market segment growth, market segment share growth and costs are based on historical data, various internal estimates and a variety of external sources, and are developed as part of Cadence's routine long-range planning process.

The market approach provides an estimate of the fair value of Cadence's one reporting unit using various price or market multiples applied to the reporting unit's operating results and then applying an appropriate control premium. The control premium is determined by considering control premiums offered as part of acquisitions in both Cadence's market segment and comparable market segments.

The most recent goodwill impairment analysis was completed during the three months ended September 27, 2008, and Cadence determined that no indicators of impairment existed as of September 27, 2008. However, subsequent to September 27, 2008, Cadence observed possible impairment indicators including a further deterioration in the market in which Cadence operates and a decrease in its market capitalization. As such, Cadence determined indicators exist

subsequent to September 27, 2008 that indicate that the fair value of Cadence's reporting unit may be less than its carrying amount. Accordingly, Cadence will complete an interim goodwill impairment test during the three months ending January 3, 2009. If the fair value of the reporting unit is determined to be less than its carrying value, Cadence will complete step two of the goodwill impairment test by evaluating the fair value of its goodwill as required by SFAS No. 142 and record an impairment charge, if necessary.



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The changes in the carrying amount of goodwill for the nine months ended September 27, 2008 were as follows:

|   | (In thousands) |
|---|----------------|
| Balance as of December 29, 2007                       | \$ 1,310,211   |
| Goodwill resulting from acquisition during the period | 3,074          |
| Additions due to earnouts                             | 1,682          |
| Tax benefits allocable to goodwill                    | (83)           |
| Other   | 333            |
| Balance as of September 27, 2008                      | \$ 1,315,217   |

**Acquired Intangibles, net**

Acquired intangibles with finite lives as of September 27, 2008 were as follows:

|                                    | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization<br>(In thousands) | Acquired<br>Intangibles, net |
|------------------------------------|-----------------------------|---|------------------------------|
| Existing technology and backlog    | \$ 655,467                  | \$ (619,979)                                  | \$ 35,488                    |
| Agreements and relationships       | 100,814                     | (62,507)                                      | 38,307                       |
| Distribution rights                | 30,100                      | (15,803)                                      | 14,297                       |
| Tradenames, trademarks and patents | 29,867                      | (16,550)                                      | 13,317                       |
| Total acquired intangibles         | \$ 816,248                  | \$ (714,839)                                  | \$ 101,409                   |

During the nine months ended September 27, 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. During the nine months ended September 27, 2008, Cadence made cash payments of \$13.4 million for previously completed business combinations and acquisitions of intangibles, \$5.5 million for business combinations completed during the nine months ended September 27, 2008 and \$1.7 million for earnouts related to previously completed business combinations that were earned during the nine months ended September 27, 2008.

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

|  | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization<br>(In thousands) | Acquired<br>Intangibles, net |
|--|-----------------------------|---|------------------------------|
|--|-----------------------------|---|------------------------------|

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|                                    |            |              |            |
|------------------------------------|------------|--------------|------------|
| 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 |

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Amortization of acquired intangibles for the three and nine months ended September 27, 2008 and September 29, 2007 was as follows:

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|  | (In thousands)        |                       |                       |                       |
| Cost of product                            | \$ 4,080              | \$ 6,049              | \$ 13,525             | \$ 16,825             |
| Cost of services                           | 3                     | 3                     | 9                     | 9                     |
| Cost of maintenance                        | 1,045                 | 1,212                 | 3,135                 | 3,656                 |
| Amortization of acquired intangibles       | 5,626                 | 4,739                 | 17,206                | 13,661                |
| Total amortization of acquired intangibles | \$ 10,754             | \$ 12,003             | \$ 33,875             | \$ 34,151             |

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                | \$ 10,343      |
| 2009                                 | 35,172         |
| 2010                                 | 22,857         |
| 2011                                 | 17,554         |
| 2012                                 | 12,064         |
| Thereafter                           | 3,419          |
| Total estimated amortization expense | \$ 101,409     |

**NOTE 8. 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.

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.

See also Note 16 Subsequent Events.

### **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 typically 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.

**Table of Contents****NOTE 9. 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 nine months ended September 27, 2008 and September 29, 2007 were as follows:

|   | Three Months Ended                       |                       | Nine Months Ended     |                       |
|---|--|-----------------------|-----------------------|-----------------------|
|   | September 27,<br>2008                    | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|   | (In thousands, except per share amounts) |                       |                       |                       |
| <b>Basic:</b>   |  |                       |                       |                       |
| Net income (loss)                                       | \$ (169,066)                             | \$ 72,732             | \$ (215,083)          | \$ 176,749            |
| Weighted average common shares outstanding              | 252,915                                  | 272,977               | 256,119               | 272,354               |
| Basic net income (loss) per share                       | \$ (0.67)                                | \$ 0.27               | \$ (0.84)             | \$ 0.65               |
| <b>Diluted:</b>   |  |                       |                       |                       |
| Net income (loss)                                       | \$ (169,066)                             | \$ 72,732             | \$ (215,083)          | \$ 176,749            |
| Effect of dilutive securities:                          |  |                       |                       |                       |
| Amortization of 2023 Notes transaction fees, net of tax | ----                                     | 219                   | ----                  | 657                   |
| Net income (loss) as adjusted                           | \$ (169,066)                             | \$ 72,951             | \$ (215,083)          | \$ 177,406            |
|   | 252,915                                  | 272,977               | 256,119               | 272,354               |

Weighted average common and potential  
common shares used to calculate basic net  
income (loss) per share

|                                  |      |        |      |        |
|----------------------------------|------|--------|------|--------|
| Convertible Senior Notes         | ---- | 449    | ---- | 122    |
| 2023 Notes                       | ---- | 14,721 | ---- | 14,721 |
| Options                          | ---- | 8,845  | ---- | 8,217  |
| Restricted stock and ESPP shares | ---- | 2,514  | ---- | 2,369  |

Weighted average common and potential  
common shares used to calculate diluted  
net income (loss) per share

|  |         |         |         |         |
|--|---------|---------|---------|---------|
|  | 252,915 | 299,506 | 256,119 | 297,783 |
|--|---------|---------|---------|---------|

|                                     |    |        |    |      |    |        |    |      |
|-------------------------------------|----|--------|----|------|----|--------|----|------|
| Diluted net income (loss) per share | \$ | (0.67) | \$ | 0.24 | \$ | (0.84) | \$ | 0.60 |
|-------------------------------------|----|--------|----|------|----|--------|----|------|

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The following table presents the potential shares of Cadence's common stock outstanding for the three and nine months ended September 27, 2008 and September 29, 2007 that were not included in the computation of diluted net income (loss) per share because the effect of including these shares would have been anti-dilutive:

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|   | (In thousands)        |                       |                       |                       |
| Options to purchase shares of common stock<br>(various expiration dates through 2017)   | 39,257                | 10,995                | 39,257                | 11,840                |
| Non-vested shares of restricted stock   | 7,673                 | ----                  | 7,673                 | ----                  |
| 2023 Notes  | 11                    | ----                  | 11                    | ----                  |
| Warrants to purchase shares of common<br>stock related to the Convertible Senior Notes<br>(various expiration dates through 2014) | 23,640                | 23,640                | 23,640                | 23,640                |
| Warrants to purchase shares of common<br>stock related to the 2023 Notes (various<br>expiration dates through May 2008)           | ----                  | 14,717                | ----                  | 14,717                |
| Total potential common shares excluded  | 70,581                | 49,352                | 70,581                | 50,197                |

**NOTE 10. STOCK REPURCHASE PROGRAMS**

As of September 27, 2008, Cadence's Board of Directors had authorized the following programs to repurchase shares of Cadence's common stock in the open market:

| Authorization Date | Amount     | Remaining<br>Authorization<br>(In thousands) |
|--------------------|------------|--|
| December 2006      | \$ 500,000 | \$ ----                                      |
| February 2008      | 500,000    | 354,386                                      |
| August 2008        | 500,000    | 500,000                                      |

The shares repurchased under Cadence's stock repurchase programs during the three and nine months ended September 27, 2008 and September 29, 2007 were as follows:

|                                  | Three Months Ended    |                       | Nine Months Ended     |                       |
|----------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|                                  | (In thousands)        |                       |                       |                       |
| Shares repurchased               | 7,260                 | 12,000                | 27,034                | 17,900                |
| Total cost of repurchased shares | \$ 57,714             | \$ 250,961            | \$ 273,950            | \$ 372,416            |





**Table of Contents****NOTE 11. RETAINED EARNINGS**

The changes in retained earnings for the three and nine months ended September 27, 2008 were as follows:

|                                  | Three Months<br>Ended<br>(In thousands) |
|----------------------------------|---|
| Balance as of June 28, 2008      | \$ 1,072,555                            |
| Net loss                         | (169,066)                               |
| Re-issuance of treasury stock    | (35,234)                                |
| Balance as of September 27, 2008 | \$ 868,255                              |

  

|                                  | Nine Months<br>Ended<br>(In thousands) |
|----------------------------------|--|
| Balance as of December 29, 2007  | \$ 1,162,441                           |
| Net loss                         | (215,083)                              |
| Re-issuance of treasury stock    | (79,103)                               |
| Balance as of September 27, 2008 | \$ 868,255                             |

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 \$35.2 million and \$79.1 million during the three and nine months ended September 27, 2008, respectively.

**NOTE 12. 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 nine months ended September 27, 2008 and September 29, 2007 was as follows:

| Three Months Ended    |                       | Nine Months Ended     |                       |
|-----------------------|-----------------------|-----------------------|-----------------------|
| September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |

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(In thousands)

|   |              |           |              |            |
|---|--------------|-----------|--------------|------------|
| Net income (loss)   | \$ (169,066) | \$ 72,732 | \$ (215,083) | \$ 176,749 |
| Foreign currency translation gain (loss), net of related tax effects  | (417)        | 5,354     | 2,221        | 7,676      |
| 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 | (6,677)      | (2,330)   | (1,759)      | (4,024)    |
| Other   | ----         | 16        | ----         | (916)      |
| Comprehensive income (loss)   | \$ (176,160) | \$ 75,772 | \$ (214,621) | \$ 179,485 |

**Table of Contents****NOTE 13. OTHER INCOME (EXPENSE), NET**

Cadence's Other income (expense), net, for the three and nine months ended September 27, 2008 and September 29, 2007 was as follows:

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|  | (In thousands)        |                       |                       |                       |
| Interest income  | \$ 3,989              | \$ 12,609             | \$ 17,823             | \$ 37,472             |
| Gains on sale of non-marketable securities   | ----                  | 83                    | 884                   | 5,642                 |
| Gains (losses) on sale of available-for-sale securities (Note 3)   | (9,379)               | 2,093                 | (7,945)               | 4,404                 |
| Gains (losses) on sale of non-marketable securities in Cadence's non-qualified deferred compensation trust | (331)                 | 2,339                 | (4,379)               | 6,562                 |
| Gains (losses) on foreign exchange   | 269                   | (317)                 | 689                   | (951)                 |
| Equity in loss from investments, net   | (105)                 | (784)                 | (823)                 | (2,504)               |
| Write-down of investment securities (Note 3)   | (2,362)               | (2,000)               | (10,666)              | (2,550)               |
| Other income (expense)   | 205                   | 178                   | 716                   | (137)                 |
| Total other income (expense), net  | \$ (7,714)            | \$ 14,201             | \$ (3,701)            | \$ 47,938             |

**NOTE 14. STATEMENT OF CASH FLOWS**

The supplemental cash flow information for the nine months ended September 27, 2008 and September 29, 2007 is as follows:

|  | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|
|  | September 27,<br>2008 | September 29,<br>2007 |
|  | (In thousands)        |                       |
| Cash Paid During the Period for:                                       |                       |                       |
| Interest   | \$ 3,594              | \$ 3,930              |
| Income taxes, including foreign withholding tax                        | \$ 25,183             | \$ 12,866             |
| Non-Cash Investing and Financing Activities:                           |                       |                       |
| Stock options assumed for acquisitions                                 | \$ 1,140              | \$ ----               |
| Treasury stock issued for payment under a performance-based bonus plan | \$ ----               | \$ 8,673              |
| Unrealized gain (loss) on available-for-sale securities, net of taxes  | \$ (1,759)            | \$ (4,024)            |

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 nine months ended September 29, 2007.

**Table of Contents****NOTE 15. 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 an authorized person or persons performing functions similar to a principal executive officer, or PEO.

Cadence's PEO reviews Cadence's consolidated results within one segment. In making operating decisions, the PEO 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    |                       | Nine Months Ended     |                       |
|--------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                      | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|                                      | (In thousands)        |                       |                       |                       |
| Americas:                            |                       |                       |                       |                       |
| United States                        | \$ 91,032             | \$ 160,895            | \$ 339,801            | \$ 523,147            |
| Other Americas                       | 10,403                | 5,310                 | 25,780                | 21,889                |
| Total Americas                       | 101,435               | 166,205               | 365,581               | 545,036               |
| Europe, Middle East and Africa:      |                       |                       |                       |                       |
| Germany                              | 12,134                | 14,784                | 38,932                | 46,804                |
| Netherlands                          | 5,076                 | 44,373                | 14,947                | 45,105                |
| Other Europe, Middle East and Africa | 35,066                | 40,492                | 126,474               | 128,229               |
| Total Europe, Middle East and Africa | 52,276                | 99,649                | 180,353               | 220,138               |
| Japan and Asia:                      |                       |                       |                       |                       |
| Japan                                | 46,555                | 88,863                | 162,940               | 242,442               |
| Asia                                 | 32,222                | 46,207                | 102,405               | 149,454               |
| Total Japan and Asia                 | 78,777                | 135,070               | 265,345               | 391,896               |
| Total                                | \$ 232,488            | \$ 400,924            | \$ 811,279            | \$ 1,157,070          |

No one customer accounted for 10% or more of total revenue for the three months ended September 27, 2008 and one customer accounted for 14% of total revenue during the three months ended September 29, 2007. No one customer accounted for 10% or more of total revenue during the nine months ended September 27, 2008 or during the nine months ended September 29, 2007.

As of September 27, 2008, one customer accounted for 12%, one customer accounted for 11% and one customer 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:

|                                      | September 27,<br>2008 | As of<br>December 29,<br>2007 |
|--------------------------------------|-----------------------|-------------------------------|
|                                      | (In thousands)        |                               |
| Americas:                            |                       |                               |
| United States                        | \$ 324,312            | \$ 303,347                    |
| Other Americas                       | 47                    | 67                            |
| Total Americas                       | 324,359               | 303,414                       |
| Europe, Middle East and Africa:      |                       |                               |
| Germany                              | 1,019                 | 1,269                         |
| Other Europe, Middle East and Africa | 6,218                 | 7,733                         |
| Total Europe, Middle East and Africa | 7,237                 | 9,002                         |
| Japan and Asia:                      |                       |                               |
| Japan                                | 5,880                 | 1,070                         |
| Asia                                 | 21,720                | 25,977                        |
| Total Japan and Asia                 | 27,600                | 27,047                        |
| Total                                | \$ 359,196            | \$ 339,463                    |

**NOTE 16. SUBSEQUENT EVENTS****Executive Resignations**

On October 15, 2008, Cadence announced that Michael J. Fister had resigned as its President and Chief Executive Officer and from its Board of Directors and, in connection with the resignation, its Board of Directors formed an Interim Office of the Chief Executive, or the IOCE, to oversee the day-to-day running of Cadence's operations. The members of the IOCE are John B. Shoven, Ph.D., Chairman of the Board of Directors of Cadence, whose role as a member of the IOCE will be to provide oversight on behalf of the Board of Directors of Cadence, Lip-Bu Tan, Interim Vice Chairman of the Board of Directors of Cadence, Charlie Huang, Senior Vice President of Cadence, and Kevin S. Palatnik, Senior Vice President and Chief Financial Officer of Cadence. Mr. Huang also holds the position of Chief of Staff of the IOCE. In addition, Cadence announced the resignations of four executive officers. Pursuant to the resignations and the terms of the respective employment agreements of these executive officers, Cadence expects to take a charge of \$16.6 million during the three months ending January 3, 2009, which includes \$7.5 million of stock-based compensation related to the acceleration of restricted stock awards and stock options.

**Securities Litigation Complaints**

Three complaints were filed in the United States District Court for the Northern District of California, all alleging violations of Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated thereunder, on behalf of a

purported class of purchasers of Cadence's common stock. The first such complaint was filed on October 29, 2008, captioned *Hu v. Cadence Design Systems, Inc., Michael J. Fister, William Porter and Kevin S. Palatnik*; the second such complaint was filed on November 4, 2008, captioned *Vyas v. Cadence Design Systems, Inc., Michael J. Fister, and Kevin S. Palatnik*; and the third such complaint was filed on November 21, 2008, captioned *Collins v. Cadence Design Systems, Inc., Michael J. Fister, John B. Shoven, Kevin S. Palatnik and William Porter*. Cadence intends to vigorously defend these and any other securities lawsuits that may be filed.



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Two derivative complaints have been filed in Santa Clara County Superior Court. The first was filed on November 20, 2008, and captioned Ury Priel, derivatively on behalf of nominal defendant Cadence Design Systems, Inc. v. John B. Shoven, Lip-Bu Tan, Alberto Sangiovanni-Vincentelli, Donald L. Lucas, Sr., Roger Siboni, George Scalise, Michael J. Fister, and Doe Defendants 1-15. The second was filed on December 1, 2008, and captioned Mark Levine, derivatively on behalf of nominal defendant Cadence Design Systems, Inc. v. John B. Shoven, Lip-Bu Tan, Alberto Sangiovanni-Vincentelli, Donald L. Lucas, Sr., Roger Siboni, George Scalise, Michael J. Fister, John Swainson and Doe Defendants 1-10. These complaints purport to bring suit derivatively, on behalf of Cadence, against certain of Cadence's current and former directors for alleged breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment. Many of the allegations underlying these claims are similar or identical to the allegations in the securities class action lawsuits described above. Cadence is analyzing these derivative complaints and will respond to them appropriately.

In light of the preliminary status of these lawsuits, Cadence cannot predict the claims, allegations, class period (in the case of the class actions), or outcome of these matters. Cadence cannot provide any assurances that the final outcome of these lawsuits or any other proceedings that may arise in the future will not have a material adverse effect on its business, results of operations, or financial condition. Litigation can be time-consuming and expensive and could divert management's time and attention from Cadence's business, which could have a material adverse effect on its revenues and results of operations. The adverse resolution of any specific lawsuit or proceeding could also have a material adverse effect on Cadence's business, results of operations, financial condition, and cash flows.

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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 product development processes for electronics. 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 nine 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 and are increasingly seeking more aggressive purchasing terms and conditions. As a result of this trend, we have forecasted lower business levels for the remainder of 2008. To enable us to keep our focus on 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.

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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. 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). Our license mix is changing such that a higher proportion of licenses will require ratable revenue recognition and we expect to have fewer changes in existing contractual arrangements with existing customers, and this will result in a decrease in our expected revenue for the second half of fiscal year 2008 and for fiscal 2009. Due to the lower business levels and the change in the license mix noted above, we will recognize a net loss for fiscal year 2008.

We plan operating expense levels primarily based on forecasted revenue levels. To offset some of the impact of our expected decrease in revenue, we have implemented and plan to implement additional cost savings initiatives, including reducing headcount, decreasing employee bonuses and reducing other discretionary spending. During the three months ended September 27, 2008, we determined that we would initiate a restructuring plan to improve our operating results and to align our cost structure with expected revenue. This restructuring is intended to decrease costs by reducing our workforce throughout the company by at least 625 employees. We expect to record an additional \$17.0 million to \$22.0 million in restructuring costs during the three months ending January 3, 2009 related to other aspects of this restructuring that were not probable as of September 27, 2008, and thus should be recorded as the expense is incurred. We expect ongoing annual savings of at least \$150.0 million related to this plan of restructuring.

Because of the widespread problems in global capital markets during the three months ended September 27, 2008, we decided to repatriate \$200.0 million of earnings from a foreign subsidiary, earnings which had previously been considered to be indefinitely reinvested outside the United States and for which deferred taxes had not been previously provided. We currently expect that an additional \$117.9 million of previously untaxed earnings from foreign subsidiaries will not be indefinitely reinvested outside of the United States. As a result, we have accrued a tax expense of \$71.0 million during the three and nine months ended September 27, 2008 to provide for the potential U.S., state and foreign income taxes on these repatriations. We intend to indefinitely reinvest the remainder of undistributed earnings of our foreign subsidiaries, which we estimate to be \$29.0 million for the year ending January 3, 2009 to meet both the working capital and long-term capital needs of our subsidiaries and of Cadence.

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.

## **Withdrawal of 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

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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. On August 15, 2008, we announced that we had withdrawn our proposal to acquire all of the outstanding shares of Mentor Graphics common stock due to Mentor Graphics' failure to engage in substantive discussions on our proposal, which prevented us from confirming for our financing sources the significant synergies associated with the proposed transaction, our revised business outlook and the economic climate, which led to our conclusion that the financing terms for the proposed transaction were no longer attractive to our stockholders.

During the nine months ended September 27, 2008, we purchased approximately 4.3 million shares of Mentor Graphics common stock in connection with our proposed acquisition of Mentor Graphics. Subsequent to the withdrawal of our acquisition offer, we sold our entire equity interest in Mentor Graphics at a loss of \$9.4 million. In addition, we expensed legal and other acquisition related costs of \$3.2 million upon withdrawal of our acquisition offer.

## **Subsequent Event**

On October 15, 2008, we announced that Michael J. Fister had resigned as our President and Chief Executive Officer and from our Board of Directors and, in connection with the resignation, our Board of Directors formed an Interim Office of the Chief Executive, or the IOCE, to oversee the day-to-day running of our operations. The members of the IOCE are John B. Shoven, Ph.D., Chairman of our Board of Directors, whose role as a member of the IOCE will be to provide oversight on behalf of our Board of Directors, Lip-Bu Tan, Interim Vice Chairman of our Board of Directors, Charlie Huang, our Senior Vice President, and Kevin S. Palatnik, our Senior Vice President and Chief Financial Officer. Mr. Huang also holds the position of Chief of Staff of the IOCE. Our Board of Directors has also formed a search committee to identify qualified candidates to lead our company on a permanent basis.

## **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. Our critical accounting estimate for accounting for income taxes is described below because of our repatriation of earnings from foreign subsidiaries during the three months ended September 27, 2008, and our critical accounting estimate for accounting for restructuring charges is also described below because of our current restructuring efforts.

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.

### ***Accounting for income taxes***

We provide for the effect of income taxes in our Condensed Consolidated Financial Statements in accordance with Statement of Financial Accounting Standard, or SFAS, No. 109, "Accounting for Income Taxes" and FASB Interpretation, or FIN, No. 48, "Accounting for Uncertainty in Income Taxes" an interpretation of FASB Statement No. 109.

Under SFAS No. 109, income tax expense or benefit is recognized for the amount of taxes payable or refundable for the current year, and for deferred tax assets and liabilities for the tax consequences of events that have been recognized in an entity's financial statements or tax returns. We must make significant assumptions, judgments and estimates to determine our current provision for income taxes, our deferred tax assets and liabilities and any valuation allowance to be recorded against our deferred tax assets. Our judgments, assumptions and estimates relating to the current provision for income taxes include the geographic mix and amount of income (loss), our

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interpretation of current tax laws, and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. Our judgments also include anticipating the tax positions we will take on tax returns prior to actually preparing and filing the tax returns. Changes in our business, tax laws or our interpretation of tax laws, and developments in current and future tax audits, could significantly impact the amounts provided for income taxes in our results of operations, financial position or cash flows. Our assumptions, judgments and estimates relating to the value of our net deferred tax assets take into account predictions of the amount and category of future taxable income (loss) from various sources, including tax planning strategies that would, if necessary, be implemented to prevent a loss carryforward or tax credit carryforward from expiring unused. Actual operating results or other events that cause us to change our expectations of the amount and category of income (loss) in future years could render our current assumptions, judgments and estimates of recoverable net deferred taxes inaccurate, thus materially affecting our consolidated financial position or results of operations.

Under FIN No. 48, we may only recognize an income tax position in our financial statements that we judge is more likely than not to be sustained solely on its technical merits in a tax audit, including resolution of any related appeals or litigation processes. To make this judgment, we must interpret the application of complex and sometimes ambiguous tax laws, regulations, and practices. If an income tax position meets the more likely than not recognition threshold, then we must measure the amount of the tax benefit to be recognized by determining the largest amount of tax benefit that has a greater than a 50% likelihood of being realized upon effective settlement with a taxing authority that has full knowledge of all of the relevant facts. It is inherently difficult and subjective to estimate such amounts, as this requires us to determine the probability of various possible settlement outcomes. To determine if a tax position is effectively settled, we must also estimate the likelihood that a taxing authority would review a tax position after a tax examination had otherwise been completed. We must also determine when it is reasonably possible that the amount of unrecognized tax benefits will significantly increase or decrease in the 12 months after each reporting date. These judgments are difficult because a taxing authority may change its behavior as a result of our disclosures in our financial statements that are based on the requirements of FIN No. 48. We must re-evaluate our income tax positions on a quarterly basis to consider factors such as changes in facts or circumstances, changes in tax law, effectively settled issues under audit, and new audit activity. Such a change in recognition or measurement would result in recognition of a tax benefit or an additional charge to the tax provision.

We are also required to assess whether the earnings of our foreign subsidiaries will be indefinitely reinvested outside the United States. Because of widespread problems in global capital markets during the three months ended September 27, 2008, we decided to repatriate \$200.0 million of earnings from a foreign subsidiary, earnings which had previously been considered to be indefinitely reinvested outside the United States and for which deferred taxes had not been previously provided. We currently expect that an additional \$117.9 million of previously untaxed earnings from foreign subsidiaries will not be indefinitely reinvested outside of the United States. As a result, we have accrued a tax expense of \$71.0 million during the three and nine months ended September 27, 2008 to provide for the potential U.S., state and foreign income taxes on these repatriations. To calculate this tax expense, we were required to estimate the geographic mix of profits and losses earned by us and our subsidiaries in tax jurisdictions with a broad range of income and dividend withholding tax rates, the impact of foreign exchange rate fluctuations, and the potential outcomes of current and future tax audits. Changes in our actual or projected operating results, tax laws or our interpretation of tax laws, foreign exchange rates and developments in current and future tax audits could significantly impact the amounts provided for income taxes in our results of operations, financial position or cash flows.

***Restructuring charges***

We account for the termination and benefits portions of our restructurings in accordance with SFAS No. 112, *Employers' Accounting for Postemployment Benefits* An Amendment of FASB Statements No. 5 and 43 and we account for any facilities and asset-related portions of our restructurings in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*.



We record estimated provisions for termination and benefits costs associated with our restructuring plans when it is probable we will initiate a reduction in our workforce and when the costs associated with that reduction are estimable. In order to estimate the costs associated with these workforce reductions, we are required make certain assumptions about the size of the reduction and the resulting termination and benefits costs. These assumptions and

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estimates may change as we implement the restructuring plan and we may incur future charges or credits for changes in estimates related to amounts previously recorded.

Our restructuring plan initiatives have also required us to make a number of estimates and assumptions related to losses on excess facilities vacated or consolidated, particularly estimating when, if at all, we will be able to sublet vacated facilities and, if we do, the sublease terms. Closure and space reduction costs that are part of our restructuring charges include payments required under leases, less any applicable estimated sublease income after the facilities are abandoned, lease buyout costs and certain contractual costs to maintain facilities during the abandonment period.

We regularly evaluate the adequacy of our restructuring accrual, and adjust the balance based on changes in estimates and assumptions. We may incur future charges for new restructuring activities as well as changes in estimates to amounts previously recorded.

## **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 conditions of use for our products, such as:

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

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 duration 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).

**Table of Contents*****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.

*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 nine months ended September 27, 2008 and September 29, 2007 and the percentage change in revenue between periods:

|               | Three Months Ended                |                       |          | Nine Months Ended     |                       |          |
|---------------|-----------------------------------|-----------------------|----------|-----------------------|-----------------------|----------|
|               | September 27,<br>2008             | September 29,<br>2007 | % Change | September 27,<br>2008 | September 29,<br>2007 | % Change |
|               | (In millions, except percentages) |                       |          |                       |                       |          |
| Product       | \$ 107.6                          | \$ 273.8              | (61)%    | \$ 422.4              | \$ 775.5              | (46)%    |
| Services      | 32.9                              | 31.2                  | 5%       | 98.8                  | 96.0                  | 3%       |
| Maintenance   | 92.0                              | 95.9                  | (4)%     | 290.1                 | 285.6                 | 2%       |
| Total revenue | \$ 232.5                          | \$ 400.9              | (42)%    | \$ 811.3              | \$ 1,157.1            | (30)%    |

Product revenue decreased in the three and nine months ended September 27, 2008, as compared to the three and nine months ended September 29, 2007, primarily because of a challenging and price-conscious economic environment, a longer sales cycle and changes to our license mix which has resulted in a higher proportion of revenue being recognized over multiple periods during the term of the license and decreased revenue recognized at the beginning of the license. As a result, product revenue decreased for all product groups, and particularly for Custom IC Design, Digital IC Design and Functional Verification during the three months ended September 27, 2008, as compared to the three months ended September 29, 2007, and for Digital IC Design, Custom IC Design, and Functional Verification products during the nine months ended September 27, 2008, as compared to the nine months ended September 29, 2007.

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

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associated with subscription licenses is recognized over multiple periods during the term of the license. Our expected revenue for the remainder of fiscal 2008 will decrease due to the slowing and price-conscious environment, as well as the changes to our license mix.

***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    |                  |                   |                      |                       |
|--------------------------|-----------------------|------------------|-------------------|----------------------|-----------------------|
|                          | September 27,<br>2008 | June 28,<br>2008 | March 29,<br>2008 | December 29,<br>2007 | September 29,<br>2007 |
| Functional Verification  | 22%                   | 25%              | 22%               | 26%                  | 20%                   |
| Digital IC Design        | 20%                   | 24%              | 24%               | 27%                  | 27%                   |
| Custom IC Design         | 26%                   | 23%              | 26%               | 25%                  | 32%                   |
| System Interconnect      | 11%                   | 10%              | 11%               | 9%                   | 7%                    |
| Design for Manufacturing | 7%                    | 7%               | 5%                | 6%                   | 6%                    |
| Services and other       | 14%                   | 11%              | 12%               | 7%                   | 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 if the customer had individually licensed each specific software solution at the outset of the arrangement.

Services and other revenue has remained relatively consistent during each of the three month periods shown in the above table. The increase in Services and other revenue as a percentage of total revenue is primarily due to the decrease in product revenue during the three months ended September 27, 2008.

***Revenue by Geography***

| Three Months Ended                |                       | %<br>Change | Nine Months Ended     |                       | %<br>Change |
|-----------------------------------|-----------------------|-------------|-----------------------|-----------------------|-------------|
| September 27,<br>2008             | September 29,<br>2007 |             | September 27,<br>2008 | September 29,<br>2007 |             |
| (In millions, except percentages) |                       |             |                       |                       |             |

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|                                   |    |       |    |       |       |    |       |    |         |       |
|-----------------------------------|----|-------|----|-------|-------|----|-------|----|---------|-------|
| United States                     | \$ | 91.0  | \$ | 160.9 | (43)% | \$ | 339.8 | \$ | 523.2   | (35)% |
| Other Americas                    |    | 10.4  |    | 5.3   | 96%   |    | 25.8  |    | 21.9    | 18%   |
| Europe, Middle East and<br>Africa |    | 52.3  |    | 99.6  | (47)% |    | 180.4 |    | 220.1   | (18)% |
| Japan                             |    | 46.6  |    | 88.9  | (48)% |    | 162.9 |    | 242.4   | (33)% |
| Asia                              |    | 32.2  |    | 46.2  | (30)% |    | 102.4 |    | 149.5   | (32)% |
| Total revenue                     | \$ | 232.5 | \$ | 400.9 | (42)% | \$ | 811.3 | \$ | 1,157.1 | (30)% |

**Table of Contents****Revenue by Geography as a Percent of Total Revenue**

|                                | Three Months Ended    |                       | Nine Months Ended     |                       |
|--------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| United States                  | 39%                   | 40%                   | 42%                   | 45%                   |
| Other Americas                 | 4%                    | 1%                    | 3%                    | 2%                    |
| Europe, Middle East and Africa | 23%                   | 25%                   | 22%                   | 19%                   |
| Japan                          | 20%                   | 22%                   | 20%                   | 21%                   |
| Asia                           | 14%                   | 12%                   | 13%                   | 13%                   |
| 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 September 27, 2008 and one customer accounted for 14% of total revenue for the three months ended September 29, 2007. No one customer accounted for 10% or more of total revenue for the nine months ended September 27, 2008 and for the nine months ended September 29, 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    |                       | Nine Months Ended     |                       |
|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                            | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|                            | (In millions)         |                       |                       |                       |
| Cost of product            | \$ 0.1                | \$ ---                | \$ 0.2                | \$ 0.1                |
| Cost of services           | 1.1                   | 1.0                   | 3.2                   | 2.9                   |
| Cost of maintenance        | 0.7                   | 0.6                   | 2.1                   | 1.9                   |
| Marketing and sales        | 3.9                   | 5.5                   | 13.0                  | 17.6                  |
| Research and development   | 8.7                   | 10.9                  | 27.9                  | 36.5                  |
| General and administrative | 0.1                   | 6.1                   | 11.3                  | 19.8                  |
| Total                      | \$ 14.6               | \$ 24.1               | \$ 57.7               | \$ 78.8               |



During the three months ended September 27, 2008, stock-based compensation expense decreased \$9.5 million, as compared to the three months ended September 29, 2007, primarily due to:

A decrease of \$7.1 million in stock-based compensation expense for restricted stock and stock bonuses, primarily due to the reversal of \$6.5 million of stock-based compensation expense related to the modification of certain performance-based restricted stock awards; and

A decrease of \$3.2 million in stock-based 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-based compensation expense primarily due to an increase in purchase rights granted under our ESPP during the current period.

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During the nine months ended September 27, 2008, stock-based compensation expense decreased \$21.1 million, as compared to the nine months ended September 29, 2007, primarily due to:

A decrease of \$14.5 million in stock-based compensation expense for restricted stock and stock bonuses, primarily due to the reversal of \$6.5 million of stock-based compensation expense related to the modification of certain performance-based restricted stock awards, new grants of restricted stock being valued at a lower stock price and a decrease in stock bonuses; and

A decrease of \$9.1 million in stock-based 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 \$2.5 million in stock-based compensation expense primarily due to an increase in purchase rights granted under our ESPP during the current period.

We expect an increase in stock-based compensation for the three months ending January 3, 2009, primarily due to the acceleration of options for certain executives who resigned in October 2008.

**Cost of Revenue**

|             | Three Months Ended                |                       |          | Nine Months Ended     |                       |          |
|-------------|-----------------------------------|-----------------------|----------|-----------------------|-----------------------|----------|
|             | September 27,<br>2008             | September 29,<br>2007 | % Change | September 27,<br>2008 | September 29,<br>2007 | % Change |
|             | (In millions, except percentages) |                       |          |                       |                       |          |
| Product     | \$ 11.8                           | \$ 13.8               | (14)%    | \$ 39.2               | \$ 42.3               | (7)%     |
| Services    | \$ 25.7                           | \$ 23.4               | 10%      | \$ 78.1               | \$ 70.4               | 11%      |
| Maintenance | \$ 13.9                           | \$ 15.2               | (9)%     | \$ 42.9               | \$ 45.6               | (6)%     |

**Cost of Revenue as a Percent of Related Revenue**

|             | Three Months Ended    |                       | Nine Months Ended     |                       |
|-------------|-----------------------|-----------------------|-----------------------|-----------------------|
|             | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| Product     | 11%                   | 5%                    | 9%                    | 5%                    |
| Services    | 78%                   | 75%                   | 79%                   | 73%                   |
| Maintenance | 15%                   | 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:

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|                                      | Three Months Ended    |                       | Nine Months Ended     |                       |
|--------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                      | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|                                      | (In millions)         |                       |                       |                       |
| Product related costs                | \$ 7.7                | \$ 7.8                | \$ 25.7               | \$ 25.5               |
| Amortization of acquired intangibles | 4.1                   | 6.0                   | 13.5                  | 16.8                  |
| Total Cost of product                | \$ 11.8               | \$ 13.8               | \$ 39.2               | \$ 42.3               |

During the three months ended September 27, 2008, Cost of product decreased \$2.0 million, as compared to the three months ended September 29, 2007, primarily due to a decrease of \$1.9 million in amortization of acquired intangible assets because certain acquired intangibles became fully amortized during the period.

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During the nine months ended September 27, 2008, Cost of product decreased \$3.1 million, as compared to the nine months ended September 29, 2007, primarily due to:

A decrease of \$3.3 million in amortization of acquired intangible assets because certain acquired intangible assets became fully amortized during the period; and

A decrease of \$1.5 million in amortization of license costs related to third party technology; partially offset by

An increase of \$3.2 million in hardware costs attributable primarily to increased hardware sales during the first half of 2008.

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 September 27, 2008, Cost of services increased \$2.3 million, as compared to the three months ended September 29, 2007, primarily due to an increase of \$1.0 million in salary, benefits and other employee-related costs.

During the nine months ended September 27, 2008, Cost of services increased \$7.7 million, as compared to the nine months ended September 29, 2007, primarily due to:

An increase of \$2.8 million in facilities and other infrastructure costs;

An increase of \$2.7 million in salary, benefits and other employee-related costs; and

During the nine months ended September 29, 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 nine months ended September 27, 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. During the three months ended September 27, 2008, Cost of maintenance decreased \$1.3 million, as compared to the three months ended September 29, 2007, primarily due to a decrease of \$1.4 million in salary, benefits and other employee-related costs. During the nine months ended September 27, 2008, Cost of maintenance decreased \$2.7 million, as compared to the nine months ended September 29, 2007, primarily due to a decrease in salary, benefits and other employee-related costs.

**Operating Expenses**

|                            | Three Months Ended                |                       |          | Nine Months Ended     |                       |          |
|----------------------------|-----------------------------------|-----------------------|----------|-----------------------|-----------------------|----------|
|                            | September 27,<br>2008             | September 29,<br>2007 | % Change | September 27,<br>2008 | September 29,<br>2007 | % Change |
|                            | (In millions, except percentages) |                       |          |                       |                       |          |
| Marketing and sales        | \$ 91.1                           | \$ 97.2               | (6)%     | \$ 274.0              | \$ 297.9              | (8)%     |
| Research and development   | 112.5                             | 125.4                 | (10)%    | 357.9                 | 365.4                 | (2)%     |
| General and administrative | 32.9                              | 40.7                  | (19)%    | 105.6                 | 123.2                 | (14)%    |
| Total operating expenses   | \$ 236.5                          | \$ 263.3              | (10)%    | \$ 737.5              | \$ 786.5              | (6)%     |



**Table of Contents*****Operating Expenses as a Percent of Total Revenue***

|                            | Three Months Ended    |                       | Nine Months Ended     |                       |
|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                            | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| Marketing and sales        | 39%                   | 24%                   | 34%                   | 26%                   |
| Research and development   | 48%                   | 31%                   | 44%                   | 32%                   |
| General and administrative | 14%                   | 10%                   | 13%                   | 11%                   |

**Operating Expense Summary**

Operating expenses decreased \$26.8 million during the three months ended September 27, 2008, as compared to the three months ended September 29, 2007, primarily due to:

- A decrease of \$17.6 million in salary, benefits and other employee-related costs;
- A decrease of \$9.8 million in stock-based compensation; and
- A decrease of \$3.2 million in losses on the sale of installment contract receivables; partially offset by
- An increase of \$2.3 in legal and other professional service costs.

Operating expenses decreased \$49.0 million during the nine months ended September 27, 2008, as compared to the nine months ended September 29, 2007, primarily due to:

- A decrease of \$31.3 million in salary, benefits and other employee-related costs;
- A decrease of \$21.7 million in stock-based compensation;
- A decrease of \$6.9 million in travel and customer conference costs; and
- A decrease of \$5.4 million in losses on the sale of installment contract receivables; partially offset by
- An increase of \$8.8 million in facilities and other infrastructure costs; and
- During the nine months ended September 29, 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 nine months ended September 27, 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 and the Japanese yen, increased operating expenses by \$2.2 million in the three months ended September 27, 2008, as compared to the three months ended September 29, 2007, and increased operating expenses by \$12.0 million in the nine months ended September 27, 2008, as compared to the nine months ended September 29, 2007.

**Marketing and Sales**

Marketing and sales expense decreased \$6.1 million during the three months ended September 27, 2008, as compared to the three months ended September 29, 2007, primarily due to:

A decrease of \$7.6 million in salary, benefits and other employee-related costs;  
A decrease of \$1.6 million in stock-based compensation; and  
A decrease of \$1.2 million in facilities and other infrastructure costs; partially offset by  
An increase of \$1.4 million in professional services costs; and  
An increase of \$1.0 million in other marketing activities.

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Marketing and sales expense decreased \$23.9 million during the nine months ended September 27, 2008, as compared to the nine months ended September 29, 2007, primarily due to:

- A decrease of \$22.3 million in salary, benefits and other employee-related costs;
- A decrease of \$5.0 million in travel and customer conference costs; and
- A decrease of \$4.6 million in stock-based compensation; partially offset by
- An increase of \$1.4 million in professional services costs;
- An increase of \$1.3 million in facilities and other infrastructure costs; and

During the nine months ended September 29, 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 nine months ended September 27, 2008.

## **Research and Development**

Research and development expense decreased \$12.9 million during the three months ended September 27, 2008, as compared to the three months ended September 29, 2007, primarily due to:

- A decrease of \$8.4 million in salary, benefits and other employee-related costs;
- A decrease of \$2.3 million in professional services costs; and
- A decrease of \$2.2 million in stock-based compensation.

Research and development expense decreased \$7.5 million during the nine months ended September 27, 2008, as compared to the nine months ended September 29, 2007, primarily due to:

- A decrease of \$8.6 million in stock-based compensation;
- A decrease of \$4.5 million in professional services costs;
- A decrease of \$4.2 million in salary, benefits and other employee-related costs; and
- A decrease of \$2.1 million in travel costs; partially offset by
- An increase of \$5.4 million in facilities and other infrastructure costs; and

During the nine months ended September 29, 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 nine months ended September 27, 2008.

## **General and Administrative**

General and administrative expense decreased \$7.8 million during the three months ended September 27, 2008, as compared to the three months ended September 29, 2007, primarily due to:

- A decrease of \$6.0 million in stock-based compensation;
- A decrease of \$3.2 million in losses on the sale of installment contract receivables; and
- A decrease of \$1.5 million in salary, benefits and other employee-related costs; partially offset by
- An increase of \$3.2 million in legal and other professional services costs primarily related to our proposed acquisition of all of the outstanding shares of Mentor Graphics common stock, which we withdrew during the three months ended September 27, 2008; and
- An increase of \$1.4 million in facilities and other infrastructure costs.

General and administrative expense decreased \$17.6 million during the nine months ended September 27, 2008, as compared to the nine months ended September 29, 2007, primarily due to:



A decrease of \$8.5 million in stock-based compensation;  
A decrease of \$5.4 million in losses on the sale of installment contract receivables;  
A decrease of \$4.8 million in salary, benefits and other employee-related costs; and  
A decrease of \$3.0 million in depreciation, computer equipment lease costs and maintenance costs associated with third party software; partially offset by  
An increase of \$2.1 million in facilities and infrastructure costs;  
An increase of \$1.3 million in legal and other professional services costs; and  
And increase of \$1.0 million in bad debt expense.

**Table of Contents*****Amortization of Acquired Intangibles***

|                                      | Three Months Ended    |                       | Nine Months Ended     |                       |
|--------------------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                                      | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|                                      | (In millions)         |                       |                       |                       |
| Amortization of acquired intangibles | \$ 5.6                | \$ 4.7                | \$ 17.2               | \$ 13.7               |

Amortization of acquired intangibles increased \$0.9 million during the three months ended September 27, 2008, as compared to the three months ended September 29, 2007, primarily due to:

An increase of \$1.5 million of amortization for intangibles acquired in 2007 and 2008; partially offset by 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 \$3.5 million during the nine months ended September 27, 2008, as compared to the nine months ended September 29, 2007, primarily due to:

An increase of \$4.9 million of amortization for intangibles acquired in 2007 and 2008; partially offset by A decrease of \$1.4 million of amortization for intangible assets from prior year acquisitions that became fully amortized during 2007 and 2008.

***Restructuring and Other Charges***

During the three months ended September 27, 2008, we determined that we would initiate a plan of restructuring intended to decrease costs by reducing our workforce throughout the company, and that the expenses associated with that reduction were both probable and estimable. We recorded Restructuring and other charges of approximately \$48.1 million during the three months ended September 27, 2008 that included estimated severance payments, severance-related benefits and costs for outplacement services for at least 625 employees. We expect to record an additional \$17.0 million to \$22.0 million in restructuring costs during the three months ending January 3, 2009 related to other aspects of this restructuring that were not probable as of September 27, 2008, or that should be recorded as the expense is incurred. We expect ongoing annual savings of at least \$150.0 million related to this plan of restructuring.

As of September 27, 2008, we had not made any payments in connection with this restructuring plan and the entire \$48.1 million is included in Accounts payable and accrued liabilities in our Condensed Consolidated Balance Sheet. Due to varying regulations in the jurisdictions and countries in which we operate, we expect substantially all termination benefits to be paid by January 2, 2010.

In connection with this restructuring initiative, we have recorded estimated provisions for termination benefits and outplacement costs. We regularly evaluate the adequacy of our restructuring accrual, and adjust the balance based on changes in estimates and assumptions. We may incur future charges for changes in estimates related to amounts previously recorded and for additional activities under this restructuring.

Because the restructuring charges and related benefits are derived from management's estimates made during the formulation of the restructurings, based on then-currently available information, our restructuring activities may not achieve the benefits anticipated on the timetable or at the level contemplated. Demand for our products and services

and, ultimately, our future financial performance, is difficult to predict with any degree of certainty. Accordingly, additional actions, including further restructuring of our operations, may be required in the future.

***Write-off of Acquired In-process Technology***

In connection with the acquisition completed during the nine months ended September 27, 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

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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 the technologies have reached a state of technological and commercial feasibility.

**Interest Expense**

|                  | Three Months Ended    |                       | Nine Months Ended     |                       |
|------------------|-----------------------|-----------------------|-----------------------|-----------------------|
|                  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|                  | (In millions)         |                       |                       |                       |
| Interest expense | \$ 3.2                | \$ 2.8                | \$ 9.1                | \$ 9.4                |

During the three and nine months ended September 27, 2008 and September 29, 2007, the primary component of interest expense was the Convertible Senior Notes. The increase in interest expense for the three months ended September 27, 2008, as compared to the three months ended September 29, 2007, was primarily due to the 0.25% premium paid upon redemption of the majority of our 2023 Notes. The decrease in interest expense for the nine months ended September 27, 2008, as compared to the nine months ended September 29, 2007, was primarily due to the repayment in full of our Term Loan during the three months ended March 31, 2007.

**Other Income (Expense), net**

Other income (expense), net, for the three and nine months ended September 27, 2008 and September 29, 2007 was as follows:

|  | Three Months Ended    |                       | Nine Months Ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|  | (In millions)         |                       |                       |                       |
| Interest income  | \$ 4.0                | \$ 12.6               | \$ 17.8               | \$ 37.5               |
| Gains on sale of non-marketable securities   | ---                   | 0.1                   | 0.9                   | 5.6                   |
| Gains (losses) on sale of available-for-sale securities  | (9.4)                 | 2.1                   | (7.9)                 | 4.4                   |
| Gains (losses) on sale of non-marketable and trading securities in Cadence's non-qualified deferred compensation trust | (0.3)                 | 2.3                   | (4.4)                 | 6.6                   |
| Gains (losses) on foreign exchange   | 0.3                   | (0.3)                 | 0.7                   | (1.0)                 |
| Equity losses from investments   | (0.1)                 | (0.8)                 | (0.8)                 | (2.5)                 |
| Write-down of investments  | (2.4)                 | (2.0)                 | (10.7)                | (2.6)                 |
| Other income (expense)   | 0.2                   | 0.2                   | 0.7                   | (0.1)                 |
| Total other income (expense), net  | \$ (7.7)              | \$ 14.2               | \$ (3.7)              | \$ (47.9)             |

Interest income decreased \$8.6 million and \$19.7 million for the three and nine months ended September 27, 2008, respectively, as compared to the three and nine months ended September 29, 2007. The decrease was due to lower average cash balances and lower interest rates during the three and nine months ended September 27, 2008.

During the three and nine months ended September 27, 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 \$2.4 million and \$7.8 million, respectively.

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During the nine months ended September 27, 2008, we purchased approximately 4.3 million shares of Mentor Graphics common stock in connection with our proposed acquisition of Mentor Graphics. Subsequent to the announcement of our withdrawal of the proposed acquisition of Mentor Graphics during the three months ended September 27, 2008, we sold our entire equity interest in Mentor Graphics at a loss of \$9.4 million.

***Income Taxes***

The following table presents the provision for income taxes and the effective tax rate for the three and nine months ended September 27, 2008 and September 29, 2007:

|                            | Three Months Ended                |                       | Nine Months Ended     |                       |
|----------------------------|-----------------------------------|-----------------------|-----------------------|-----------------------|
|                            | September 27,<br>2008             | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
|                            | (In millions, except percentages) |                       |                       |                       |
| Provision for income taxes | \$ 49.0                           | \$ 23.5               | \$ 50.3               | \$ 67.3               |
| Effective tax rate         | (40.8)%                           | 24.4%                 | (30.5)%               | 27.6%                 |

Because of the widespread problems in global capital markets during the three months ended September 27, 2008, we decided to repatriate \$200.0 million of earnings from a foreign subsidiary, earnings which had previously been considered to be indefinitely reinvested outside the United States and for which deferred taxes had not been previously provided. We currently expect that an additional \$117.9 million of previously untaxed earnings from foreign subsidiaries will not be indefinitely reinvested outside of the United States. As a result, we have accrued a tax expense of \$71.0 million during the three and nine months ended September 27, 2008 to provide for the potential U.S., state and foreign income taxes on these repatriations. We intend to indefinitely reinvest the remainder of undistributed earnings of our foreign subsidiaries, which we estimate to be \$29.0 million for the year ending January 3, 2009 to meet both the working capital and long-term capital needs of our subsidiaries and of Cadence.

Our negative effective tax rate for the three and nine months ended September 27, 2008 primarily reflects the period-specific tax expense of \$71.0 million related to our repatriations of foreign earnings which is partially offset by the tax benefit of losses in certain tax jurisdictions. Our effective tax rates were negative for the three and nine months ended September 27, 2008 as compared to the positive effective tax rates for the three and nine months ended September 29, 2007, primarily due to the Loss before provision for income taxes and the period-specific tax expense of \$71.0 million related to our repatriations of foreign earnings for the three and nine months ended September 27, 2008.

We expect to recognize a pre-tax loss for the year and we estimate our annual effective tax rate for the fiscal year ending January 3, 2009 to be approximately (15.0)%. We anticipate having a negative effective tax rate primarily as a result of the tax expense on our repatriations of foreign earnings, tax expense of our foreign subsidiaries and interest expense on our unrecognized tax benefits, which will be partially offset by the tax benefit of losses recognized in certain tax jurisdictions. Subsequent to our quarter ended September 27, 2008, the U.S. federal research tax credit was enacted retroactively to January 1, 2008 for a period of two years. We currently estimate that the reinstatement of the federal research tax credit will provide an incremental effective tax rate benefit of approximately 2.0% for the fiscal year ending January 3, 2009. Our effective tax rate for the year ended December 29, 2007 was 18.6%.

During the nine months ended September 27, 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

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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 Appeals 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 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 our results of operations, financial position or cash flows in the applicable period or periods.

**Liquidity and Capital Resources**

|   | As of                 |                      |
|---|-----------------------|----------------------|
|   | September 27,<br>2008 | December 29,<br>2007 |
|   | (In millions)         |                      |
| Cash, cash equivalents and Short-term investments | \$ 557.8              | \$ 1,078.1           |
| Net working capital                               | 441.0                 | 744.1                |

Nine Months Ended  
September 27, September 29,



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|                                       | 2008          | 2007     |
|---------------------------------------|---------------|----------|
|                                       | (In millions) |          |
| Cash provided by operating activities | \$ 37.7       | \$ 208.9 |
| Cash used for investing activities    | (112.4)       | (75.4)   |
| Cash used for financing activities    | (441.3)       | (133.9)  |

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***Cash and cash equivalents and Short-term investments***

As of September 27, 2008, our principal sources of liquidity consisted of \$557.8 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 nine months ended September 27, 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 nine months ended September 27, 2008 were:

- Payments relating to payroll, product, services and other operating expenses;
- Principal payments of the 2023 Notes;
- Payments to former shareholders of acquired businesses;
- Purchases of property, plant and equipment; and
- Purchases of treasury stock as part of our stock repurchase program.

***Net working capital***

Net working capital decreased \$303.1 million as of September 27, 2008, as compared to December 29, 2007, primarily due to:

- A decrease of \$511.2 million in Cash and cash equivalents; and
- A decrease of \$47.8 million in Receivables, net; partially offset by
- A decrease of \$230.4 million in Convertible notes;
- A decrease of \$30.9 million in Accounts payable and accrued liabilities; and
- A decrease of \$19.3 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. As a result of challenges currently affecting the economy of the United States and other parts of the world, our customers may experience adverse changes in their business and as a result, may delay or default their payment obligations. If our customers are not successful in generating sufficient revenue or are precluded from securing financing, they may not be able to pay, or may delay payment of, accounts receivable that are owed to us, although these obligations are generally not cancelable. Our customers' inability to fulfill payment obligations may adversely affect our cash flow. Additionally, our customers may seek to renegotiate pre-existing contractual commitments. Though we have not, to date, experienced a material level of defaults, any material payment default by our customers or significant reductions in existing contractual commitments would have a material adverse effect on our financial condition and operating results.

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 nine months ended September 27, 2008, we transferred accounts receivable, net of the losses on the sale of the receivables, totaling \$48.1 million, which approximated fair value, to financing institutions on a non-recourse basis, as compared to \$163.5 million for the nine months ended September 29, 2007. As a result of the credit losses recorded by banks over the last twelve months and the current financial crisis experienced by banks, 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

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the reduced level of sale of receivables, we expect Cash flows from operating activities to be approximately \$75.0 million for fiscal 2008, if financial institutions will continue to acquire qualifying accounts receivable assets at the levels we currently expect.

Net cash provided by operating activities of \$37.7 million for the nine months ended September 27, 2008 was primarily comprised of:

- A decrease of \$115.8 million in Receivables, net and Installment contract receivables, net of sales of receivables, due to the payment terms set forth in our license agreements; and
- An increase of \$36.0 million in Other long-term liabilities; partially offset by
- Net loss, net of non-cash related expenses, of \$40.4 million;
- A decrease of \$32.2 million in cash received for deferred revenue; and
- A decrease of \$41.6 million in Accounts payable and other accrued liabilities.

Net cash provided by operating activities of \$208.9 million for the nine months ended September 29, 2007 was primarily comprised of:

- Net income, net of non-cash related expenses, of \$343.2 million; partially offset by
- An increase of \$100.7 million in Receivables, net and Installment contract receivables, net of sales of receivables, due to the payment terms set forth in our license agreements;
- A decrease of \$35.5 million in Accounts payable and other accrued liabilities; and
- An increase of \$23.2 million in Prepaid expenses and other.

During the three months ended September 27, 2008, we determined that we would initiate a plan of restructuring intended to decrease costs by reducing our workforce throughout the company by at least 625 employees. Because the restructuring was probable and the costs were estimable during the three months ended September 27, 2008, we recorded restructuring and other charges of \$48.1 million during that period. We expect to incur an additional \$17.0 million to \$22.0 million of restructuring and other charges during the three months ended January 3, 2009. As of September 27, 2008, we had not made any payments in connection with this restructuring plan. We expect to make payments of approximately \$22.0 million during the three months ended January 3, 2009 and we expect substantially all termination benefits to be paid by January 2, 2010. We expect ongoing annual savings of at least \$150.0 million related to this plan of restructuring.

***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 securities;
- 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 securities and long-term investments.

Net cash used for investing activities was \$112.4 million for the nine months ended September 27, 2008, as compared to \$75.4 million for the nine months ended September 29, 2007. The change was primarily due to:

- An increase of \$62.4 million in Purchases of available-for-sale securities;
- An increase of \$23.7 million of Purchases of property, plant and equipment, including payments associated with our construction of a new building on our San Jose campus; and

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A decrease of \$46.5 million of Proceeds from the sale of property, plant and equipment; partially offset by  
An increase of \$47.3 million of Proceeds from the sale of available-for-sale securities.

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 \$9.2 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 September 27, 2008, we may be obligated to pay up to an aggregate of \$57.5 million in cash during the next 47 months if certain defined performance goals are achieved in full. Of this amount, up to \$48.5 million would be expensed as compensation expense in our Condensed Consolidated Statements of Operations and up to \$9.0 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 nine months ended September 27, 2008 consisted primarily of the issuance of common stock under certain employee plans, purchases of treasury stock and the repurchase of our Zero Coupon Zero Yield Senior Convertible Notes Due 2023, or the 2023 Notes, upon the election of the holders of the 2023 Notes and pursuant to the terms of the 2023 Notes.

Net cash used for financing activities increased by \$307.5 million during the nine months ended September 27, 2008, as compared to the nine months ended September 29, 2007. The increase was primarily due to:

- An increase of \$230.2 million in principal payments of our 2023 Notes; and
- A decrease of \$200.9 million in Proceeds from the sale of common stock due to a decreased number of options exercised during the nine months ended September 27, 2008; partially offset by
- A decrease of \$98.5 million in Purchases of treasury stock; and
- A decrease of \$28.0 million of payments on our Term Loan, the repayment of which was completed in March 2007; and
- An increase of \$18.0 million in Proceeds from receivable sale financing.

We record a gain or loss on re-issuance of treasury stock based on the total proceeds received in the transaction. During the nine months ended September 27, 2008, we recorded losses on the re-issuance of treasury stock of \$79.1 million as a component of Retained earnings.

As of September 27, 2008, we have \$854.4 million remaining under our stock repurchase programs as authorized by our Board of Directors.

### ***Other factors affecting liquidity and capital resources***

#### **Income Taxes**

During the three months ended September 27, 2008, we repatriated \$200.0 million of earnings from a foreign subsidiary, earnings which had previously been considered to be indefinitely reinvested outside the United States and for which deferred taxes had not been previously provided. We currently expect to repatriate an additional \$117.9 million of previously untaxed earnings from foreign subsidiaries in future periods. We expect that our available net operating losses and foreign tax credits will offset any current year income taxes related to the dividends to be paid during fiscal 2008. We intend to indefinitely reinvest the remainder of our undistributed earnings of our foreign subsidiaries which we estimate to be approximately \$29.0 million for the year ending January 3, 2009, to meet both the working capital and long-term capital needs of its subsidiaries and of Cadence.

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.

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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 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 the 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 and provided that our stock price is greater than \$18.00 per share, 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 depository 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 September 27, 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.

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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 \$11.7 million as of September 27, 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 \$5.2 million as of September 27, 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 were being amortized to interest expense using the straight-line method over five years. In connection with the issuance of the Convertible Senior Notes in December 2006, we repurchased \$189.6 million principal amount of the 2023 Notes and in August 2008, we repurchased \$230.2 million principal amount of the 2023 Notes upon election of the holders of the 2023 Notes and pursuant to the terms of the 2023 Notes, for total consideration of \$230.8 million, reducing the outstanding 2023 Note balance to \$0.2 million as of September 27, 2008. Concurrently with the issuance of the 2023 Notes, we entered into hedge and warrant transactions, all of which expired during the nine months ended September 27, 2008 and no settlement was required.

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.

**Table of Contents****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 September 27, 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 September 27, 2008.

|                                    | Carrying<br>Value<br>(In millions) | Average<br>Interest Rate |
|------------------------------------|------------------------------------|--------------------------|
| Interest-Bearing Instruments:      |                                    |                          |
| Cash equivalents variable rate     | \$ 425.4                           | 2.11%                    |
| Cash variable rate                 | 72.4                               | 0.93%                    |
| Cash fixed rate                    | 36.9                               | 0.91%                    |
| Total interest-bearing instruments | \$ 534.7                           | 1.87%                    |

***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 September 27, 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 November 2008.

|                        | Notional<br>Principal<br>(In millions) | Weighted<br>Average<br>Contract<br>Rate |
|------------------------|--|---|
| Forward Contracts:     |  |   |
| Japanese yen           | \$ 47.5                                | 107.18                                  |
| British pound sterling | 30.7                                   | 0.57                                    |
| European union euro    | 13.9                                   | 0.71                                    |
| Indian rupee           | 9.2                                    | 45.10                                   |
| Israeli shekel         | 8.8                                    | 3.60                                    |
| Canada                 | 7.0                                    | 1.07                                    |
| Other                  | 19.9                                   | N/A                                     |
| Total                  | \$ 137.0                               |   |
| Estimated fair value   | \$ (1.1)                               |   |

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.

### 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.

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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 \$3.1 million as of September 27, 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 have recently been, and could continue to 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 \$24.2 million as of September 27, 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**

Consistent with good corporate governance practices, the Audit Committee of our Board of Directors, with the assistance of special counsel and other advisors, conducted an investigation of the events that led to restatement of our financial results discussed in the Explanatory Note to this Quarterly Report on Form 10-Q. Upon the completion of this investigation, the Audit Committee concluded that the circumstances that led to the restatement were not the result of illegal conduct on the part of any of our directors, officers, or other employees. We also 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 our Chief of Staff of our Interim Office of the Chief Executive, or IOCE Chief of Staff, and our 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 September 27, 2008.

As previously disclosed in this report and in our Current Report on Form 8-K filed with the SEC on October 20, 2008, our Chief Executive Officer resigned on October 15, 2008, and in connection with the resignation, our Board of Directors formed an Interim Office of the Chief Executive, or the IOCE, to oversee the day-to-day running of our operations. The members of the IOCE are John B. Shoven, Ph.D., Chairman of our Board of Directors, whose role as a member of the IOCE is to provide oversight on behalf of our Board of Directors, Lip-Bu Tan, Interim Vice



Chairman of our Board of Directors, Charlie Huang, our Senior Vice President, and Kevin S. Palatnik, our Senior Vice President and CFO. Mr. Huang also holds the position of IOCE Chief of Staff, and performs functions similar to a principal executive officer.

The evaluation of our disclosure controls and procedures included a review of our processes and the effect on the information generated for use in this Quarterly Report on Form 10-Q. In the course of this evaluation, we sought

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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.

In the course of the evaluation of our disclosure controls and procedures, our management identified a material weakness in internal control over financial reporting. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting that creates a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

There was a material weakness in our internal controls over the application of revenue recognition criteria required by SOP 97-2 Software Revenue Recognition in the context of multiple-element software arrangements.

The material weakness relates to both the insufficient design and ineffective operation of certain internal controls over the recognition of revenue from term license agreements. Specifically, the material weakness is comprised of the following components:

Controls were not adequately designed to facilitate communication of all information pertinent to the negotiations with customers between the sales and sales finance organizations and the personnel responsible for determining the appropriate recognition of the revenue related to such license agreements. As a result, controls relative to the sales and sales finance organizations reviewing, analyzing and evaluating available information pertinent to revenue recognition for term license agreements were not operating effectively.

Controls were not adequately designed to detect or prevent the inappropriate issuance of evaluation licenses to customers for incubation technology. Incubation technology is not commercially available for release.

As a result of the material weakness in internal control over financial reporting, our management did not detect that revenue from three term license arrangements was improperly recognized. The correction of the revenue associated with these term license agreements resulted in the following: (i) the restatement of our previously issued condensed consolidated financial statements for the three month period ended March 29, 2008; (ii) the restatement of our previously issued condensed consolidated financial statements for the three and six month periods ended June 28, 2008; and (iii) adjustments to the preliminary condensed consolidated financial statements for the three and nine month periods ended September 27, 2008. The restatements are more fully described in the Explanatory Note to Amendment No. 1 to the Quarterly Reports on Form 10-Q/A for the periods ended March 29, 2008 and June 28, 2008 and in Note 2 to the Condensed Consolidated Financial Statements therein.

Based on the evaluation as of September 27, 2008, including the identification of the material weakness, our IOCE Chief of Staff and our CFO have concluded that our disclosure controls and procedures were not effective as of September 27, 2008 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 IOCE Chief of Staff and CFO, as appropriate to allow timely decisions regarding required disclosure.

***Remediation Steps to Address Material Weakness***

To address the material weakness described above, we have commenced the implementation of improvements to our internal controls. Specifically, we have taken and are taking the following actions, which our management

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believes have improved, and will continue to improve, our internal control over financial reporting, and our disclosure controls and procedures:

Individuals who are part of the sales process will be required to take enhanced comprehensive, ongoing compliance training specific to our policies and procedures;

We will require additional analysis, communication, and accompanying documentation from our sales and sales finance organizations relating to recognition of revenue for term license agreements, with particular emphasis on transactions when factors are present that increase the risk that the transaction could be deemed to be a subset of a multiple element arrangement;

We will enhance our existing processes and controls with respect to evaluation licenses that are applied to all technology being evaluated by customers; and

We will make certain personnel changes and increase supervision and training to effectuate the changes discussed above.

Our management believes that the actions described above will remediate the material weakness we have identified and strengthen our internal control over financial reporting. We expect that the material weakness will be fully remediated prior to January 3, 2009; however, there can be no assurance that remediation will be completed by that date.

If we fail to remediate our material weakness promptly and effectively, there is an increased risk that a material misstatement in our interim or annual financial statement may occur.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the quarter ended September 27, 2008 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Inherent Limitations on Effectiveness of Internal Control over Financial Reporting and Disclosure Controls and Procedures**

Our management, including the IOCE Chief of Staff 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. An internal control, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the internal control are met. Further, the design of an internal control must reflect the fact that there are resource constraints, and the benefits of the control 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.

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**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 resolved 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.

See also Note 16 to our Condensed Consolidated Financial Statements regarding litigation filed subsequent to September 27, 2008.

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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.

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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 nine months ended September 27, 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. Our license mix has changed such that a higher proportion of licenses require ratable revenue recognition and will result in a decrease in our expected revenue for the second half of fiscal year 2008 and for fiscal year 2009.

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 stock price has been subject to fluctuations and has experienced a significant decline, and may continue to be subject to fluctuations and decline.***



The market price of our common stock has recently experienced significant fluctuations and may continue to fluctuate in the future, and as a result you could lose the value of your investment. The market price of our common stock may be affected by a number of factors, such as:

- Announcements of our quarterly operating results and revenue and earnings forecasts that fail to meet or are inconsistent with earlier projections or the expectations of our investors or securities analysts;
- Changes in our revenue and earnings estimates;
- Announcements of a restructuring plan;
- Changes in management;

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Accounting charges relating to the impairment of goodwill;  
A gain or loss of a significant customer;  
Announcements of new products by us, our competitors or our customers; and  
Market conditions in the electronics systems and semiconductor industries.

In addition, equity markets in general have experienced extreme price and volume fluctuations and the market prices of many technology companies have decreased substantially, particularly electronic systems and semiconductor companies. Such price and volume fluctuations may continue to adversely affect the market price of our common stock for reasons unrelated to our business or operating results.

***Litigation arising in connection with the restatement of our financial statements could adversely affect our financial condition or operations.***

As of December 9, 2008, we had three securities class action lawsuits pending against us and current and former members of management and two derivative lawsuits pending against our current and former directors. The lawsuits are described in Note 16 Subsequent Events in our unaudited Condensed Consolidated Financial Statements.

The three securities class action complaints allege violations of Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated thereunder, on behalf of a purported class of purchasers of our common stock. The first such complaint was filed on October 29, 2008, captioned Hu v. Cadence Design Systems, Inc., Michael J. Fister, William Porter and Kevin S. Palatnik; the second such complaint was filed on November 4, 2008, captioned Vyas v. Cadence Design Systems, Inc., Michael J. Fister, and Kevin S. Palatnik; and the third such complaint was filed on November 21, 2008, captioned Collins v. Cadence Design Systems, Inc., Michael J. Fister, John B. Shoven, Kevin S. Palatnik and William Porter. We intend to vigorously defend these and any other securities lawsuits that may be filed.

Two additional complaints purport to bring suit derivatively, on behalf of our company, against certain of our current and former directors for alleged breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment. Many of the allegations underlying these claims are similar or identical to the allegations in the securities class action lawsuits described above. The first such complaint was filed on November 20, 2008, and captioned Ury Priel, derivatively on behalf of Nominal Defendant Cadence Design Systems, Inc. v. John B. Shoven, Lip-Bu Tan, Alberto Sangiovanni-Vincentelli, Donald L. Lucas, Sr., Roger Siboni, George Scalise, Michael J. Fister, and Doe Defendants 1-15. The second such complaint was filed on December 1, 2008, and captioned Mark Levine, derivatively on behalf of Nominal Defendant Cadence Design Systems, Inc. v. John B. Shoven, Lip-Bu Tan, Alberto Sangiovanni-Vincentelli, Donald L. Lucas, Sr., Roger Siboni, George Scalise, Michael J. Fister, John Swaison and Doe Defendants 1-10. We are analyzing these derivative complaints and will respond to them appropriately.

In light of the preliminary status of these lawsuits, we cannot predict the claims, allegations, class period (in the case of the class actions), or outcome of these matters. In addition, we cannot provide any assurances that the final outcome of these lawsuits or any other proceedings that may arise in the future will not have a material adverse effect on our business, results of operations, or financial condition. Litigation can be time-consuming and expensive and could divert management's time and attention from our business, which could have a material adverse effect on our revenues and results of operations. The adverse resolution of any specific lawsuit or proceeding could also have a material adverse effect on our business, results of operations, financial condition, and cash flows.

***Matters relating to or arising from our recent restatement and weaknesses in our internal controls could have a material adverse effect on our business, operating results and financial condition.***

In connection with the restatement of our financial statements for the periods ended March 29, 2008 and June 28, 2008 and our reassessment of our disclosure controls and procedures under Item 307 of Regulation S-K, management has concluded that as of March 29, 2008, June 28, 2008 and September 27, 2008, our disclosure controls and procedures were not effective and that we had a material weakness in our internal control over financial reporting. Please refer to Part I Item 4 of this Quarterly Report on Form 10-Q for further discussion of the ineffectiveness of and material weakness in our controls. Should we be unable to remediate such material weakness promptly and effectively, it could harm our operating results, result in a material misstatement of our financial

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statements, cause us to fail to meet our financial reporting obligations or prevent us from providing reliable and accurate financial reports or avoiding or detecting fraud. This, in turn, could result in a loss of investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our stock price. Our restatement and related litigation and other adverse publicity could have a material adverse effect on our business and operating results.

***Our operating results and revenue could be adversely affected by customer payment delays and defaults or modifications of licenses or supplier modifications in response to the economic environment.***

As a result of challenges currently affecting the economy of the United States and other parts of the world, our customers may experience adverse changes in their business and, as a result, may delay or default on their payment obligations or modify or cancel plans to license our products, and our suppliers may significantly and quickly increase their prices or reduce their output. If our customers are not successful in generating sufficient revenue or are precluded from securing financing, they may not be able to pay, or may delay payment of, accounts receivable that are owed to us, although these obligations are generally not cancelable. Our customers' inability to fulfill payment obligations may adversely affect our revenue and cash flow. Additionally, our customers may seek to renegotiate pre-existing contractual commitments. Though we have not, to date, experienced a material level of defaults, any material payment default by our customers or significant reductions in existing contractual commitments would have a material adverse effect on our financial condition and operating results.

***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 depend upon our management team and key employees, and our management changes or our failure to attract, train, motivate and retain management and key employees in a timely manner may make us less competitive in our industries and therefore harm our results of operations.***

Our business depends upon the efforts and abilities of our executive officers and other key employees, including key development personnel. From time to time, there may be changes in our management team resulting from the hiring and departure of executive officers. On October 15, 2008, we announced the formation of an Interim Office of the Chief Executive to oversee the day-to-day running of our operations and the resignations of our President and Chief Executive Officer, Executive Vice President and Chief Administrative Officer, Executive Vice President - Worldwide Field Operations, Executive Vice President - Products and Technologies Organization and Executive Vice President - Corporate Affairs. As we undergo this transition, we may experience disruption in our business which may harm our results of operations and our relationships with our employees, customers and suppliers may be adversely affected. In addition, our competitors may seek to use this transition and the related potential disruptions to gain a competitive advantage over us. Although our Board of Directors has formed a search committee to identify qualified candidates for Chief Executive Officer, we cannot ascertain whether we will find qualified candidates quickly or at all.

Competition for highly skilled executive officers and 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, and pay significant base salaries and cash bonuses, which could harm our operating results. The high cost of training new employees, not fully utilizing

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these employees, or losing trained employees to competing employers could also reduce our gross margins and harm our business or 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 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.***

We announced on November 5, 2008 that we initiated a plan of restructuring in an effort to align our cost structure with expected revenue. This restructuring would be intended to decrease costs throughout our company. We cannot assure you that we will be able to successfully complete and realize the expected benefits of our restructuring plan, such as improvements in operating margins and cash flows anticipated in the restructuring periods contemplated. The restructuring plan may involve higher costs or a longer timetable than we currently anticipate or it may fail to improve our results of operations as we anticipate. Our inability to realize these benefits may result in an inefficient business structure that could negatively impact our results of operations. We also expect our restructuring plan to cause us to incur substantial costs related to severance and other employee-related costs. Our restructuring plan may also subject us to litigation risks and expenses. Some of the employees whose employment we may terminate may have valuable knowledge or expertise, the loss of which may adversely affect our operations. In addition, our restructuring plan may have other consequences, such as attrition beyond our planned reduction in workforce or a negative impact on employee morale and our competitors may seek to gain a competitive advantage over us. Together with our changes in management, the restructuring plan could also cause our remaining employees to leave or result in reduced productivity by our remaining employees, which in turn may affect our revenue and other operating results in the future.

***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 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.

***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;

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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 have acquired and expect to acquire other companies and businesses and may not realize the expected benefits of these acquisitions.***

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;

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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 September 27, 2008, we may be obligated to pay up to an aggregate of \$57.5 million in cash during the next 47 months if certain performance goals related to one or more of the criteria mentioned above are achieved in full. Of this amount, up to \$48.5 million would be expensed as compensation expense in our Condensed Consolidated Statements of Operations and up to \$9.0 million would be added to the purchase price of the acquisitions and will be recorded in Goodwill in our Condensed Consolidated 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.

***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.

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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.

***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.

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***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.

Disruptions in the financial markets may adversely impact the availability and cost of financing transactions and the installment contract sales that we have already arranged. As a result of the credit losses recorded by banks over the last twelve months and the current financial crisis experienced by banks, 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. 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.

***If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings.***

We review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in our industry. We could be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, which could materially adversely impact our results of operations.

***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 61% for the three months ended September 27, 2008 and 60% for the three months ended September 29, 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.

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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

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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 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;

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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 September 27, 2008, we had \$500.2 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  
\$0.2 million related to our Zero Coupon Zero Yield Senior Convertible Notes Due 2023, or the 2023 Notes.

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; or  
Place us at a possible competitive disadvantage relative to less leveraged competitors and competitors that have greater access to capital resources.

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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. Because of the widespread problems in global capital markets and financial institutions, compounded by the increasingly challenging and price-conscious economic environment and our lower levels of business, we may not be able to secure additional funding in the capital markets. 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 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.

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

The terms of the Convertible Senior Notes permit the holders to convert the Convertible Senior Notes into shares of our common stock. 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 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.

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 the 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

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foregoing circumstances. As of September 27, 2008, none of the conditions allowing holders of the Convertible Senior Notes to convert had been met.

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 Convertible Senior Noteholders, under certain circumstances we may be required to repurchase the Convertible Senior Notes in cash or shares of our common stock.***

Under the terms of the Convertible Senior Notes, we may be required to repurchase 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 Convertible Senior Notes. The repurchase price for the Convertible Senior Notes in the event of a fundamental change must be paid solely in cash. This repayment obligation 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 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, with the objective of reducing the potential dilutive effect of issuing our common stock upon conversion of the Convertible Senior 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 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 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. 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.

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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.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

In February 2008, 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. In August 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 an additional \$500.0 million in the aggregate. The following table sets forth the repurchases we made during the three months ended September 27, 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) |
|--------------------|-----------------------------------|-------------------------|--|--|
| June 29, 2008      |                                   |                         |  |  |
| August 2, 2008     | 8,173                             | \$ 8.38                 | ----   | \$ 412.1   |
| August 3, 2008     |                                   |                         |  |  |
| August 30, 2008    | 3,933,731                         | \$ 7.99                 | 3,913,000  | \$ 880.8   |
| August 31, 2008    |                                   |                         |  |  |
| September 27, 2008 | 3,369,763                         | \$ 7.90                 | 3,346,700  | \$ 854.4   |
| Total              | 7,311,667                         | \$ 7.95                 | 7,259,700  |  |

\* 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**

None.

**Item 5. Other Information**

None.

**Table of Contents****Item 6. Exhibits**

(a) The following exhibits are filed herewith:

| Exhibit Number | Exhibit Title  | Form | Incorporated by Reference |             |             | Provided Herewith |
|----------------|--|------|---------------------------|-------------|-------------|-------------------|
|                |  |      | File No.                  | Exhibit No. | Filing Date |                   |
| 3.01           | Amended and Restated Bylaws, as amended and effective July 29, 2008.   | 8-K  | 001-10606                 | 3.1         | 8/1/2008    |                   |
| 10.01          | Form of Indemnity Agreement between the Registrant and its directors and executive officers, as amended and restated.  |      |                           |             |             | X                 |
| 10.02          | Form of Incentive Stock Award Agreement for performance-based Incentive Stock Awards granted prior to July 29, 2008, as amended and restated, under the Registrant's 1987 Stock Incentive Plan, as amended and restated. |      |                           |             |             | X                 |
| 10.03          | Form of Incentive Stock Award Agreement for performance-based Incentive Stock Awards to be granted subsequent to July 29, 2008, under the Registrant's 1987 Stock Incentive Plan, as amended and restated.               |      |                           |             |             | X                 |
| 10.04          | First Amendment to Amended and Restated Residential Lease, effective as of July 29, 2008, among 849 College Avenue, Inc., a subsidiary of the Registrant, Kevin Bushby and Elizabeth Bushby.                             |      |                           |             |             | X                 |
| 10.05          | Employment Agreement, effective as of July 29, 2008, between the Registrant and Michael J. Fister.   |      |                           |             |             | X                 |
| 10.06          | Executive Transition and Release Agreement, effective as of October 15, 2008, between the Registrant and Michael J. Fister.  |      |                           |             |             | X                 |
| 10.07          | Employment Agreement, effective as of July 29, 2008, between the Registrant and William Porter.  |      |                           |             |             | X                 |
| 10.08          | Executive Transition and Release Agreement, effective as of October 15, 2008, between the Registrant and William Porter.   |      |                           |             |             | X                 |
| 10.09          | Agreement, effective as of October 15, 2008, between the Registrant and William Porter.  |      |                           |             |             | X                 |
| 10.10          | Employment Agreement, effective as of July 29, 2008, between the Registrant and Kevin Bushby.  |      |                           |             |             | X                 |
| 10.11          | Executive Transition and Release Agreement, effective as of October 15, 2008, between the Registrant and Kevin Bushby.   |      |                           |             |             | X                 |

|       |  |   |
|-------|--|---|
| 10.12 | Agreement, effective as of October 15, 2008,<br>between the Registrant and Kevin Bushby.                   | X |
| 10.13 | Employment Agreement, effective as of<br>July 29, 2008, between the Registrant and<br>James S. Miller, Jr. | X |

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| 10.14             | Executive Transition and Release Agreement, effective as of October 15, 2008, between the Registrant and James S. Miller, Jr.  |                           |          |                                    | X                    |
| 10.15             | Agreement, effective as of October 15, 2008, between the Registrant and James S. Miller, Jr.   |                           |          |                                    | X                    |
| 10.16             | Employment Agreement, effective as of July 29, 2008, between the Registrant and Kevin S. Palatnik.   |                           |          |                                    | X                    |
| 10.17             | Amended and Restated First Amendment to Employment Agreement, effective as of October 15, 2008, between the Registrant and R.L. Smith McKeithen.   |                           |          |                                    | X                    |
| 31.01             | Certification of the Registrant's Senior Vice President and Member and Chief of Staff of the Interim Office of the Chief Executive (Person Performing Functions Similar to a Principal Executive Officer of the Registrant), pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.   |                           |          |                                    | X                    |
| 31.02             | Certification of the Registrant's Principal Financial Officer, pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.   |                           |          |                                    | X                    |
| 32.01             | Certification of the Registrant's Senior Vice President and Member and Chief of Staff of the Interim Office of the Chief Executive (Person Performing Functions Similar to a Principal Executive Officer of the Registrant), 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 Principal Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |                           |          |                                    | X                    |

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**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: December 11, 2008

By: /s/ Charlie Huang  
Charlie Huang  
Senior Vice President and Member and Chief of Staff  
of the Interim Office of the Chief Executive  
(Person Performing Functions Similar to a Principal  
Executive Officer of the Registrant)

DATE: December 11, 2008

By: /s/ Kevin S. Palatnik  
Kevin S. Palatnik  
Senior Vice President and Chief Financial Officer

**Table of Contents****EXHIBIT INDEX**

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