

CADENCE DESIGN SYSTEMS INC

Form 10-Q

July 29, 2011

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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 July 2, 2011
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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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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 July 2, 2011, 269,103,195 shares of the registrant's common stock, \$0.01 par value, were outstanding.

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CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)****(Unaudited)****ASSETS**

| | July 2, 2011 | January 1, 2011 |
|---|-----------------|--------------------|
| Current Assets: | | |
| Cash and cash equivalents | \$ 665,317 | \$ 557,409 |
| Short-term investments | 3,255 | 12,715 |
| Receivables, net of allowances of \$747 and \$7,604, respectively | 150,241 | 191,893 |
| Inventories | 44,391 | 39,034 |
| 2015 Notes Hedges | 222,085 | ---- |
| Prepaid expenses and other | 79,966 | 78,355 |
| Total current assets | 1,165,255 | 879,406 |
| Property, plant and equipment, net of accumulated depreciation of \$640,380 and \$648,676, respectively | 267,758 | 285,115 |
| Goodwill | 173,752 | 158,893 |
| Acquired intangibles, net of accumulated amortization of \$77,436 and \$105,158, respectively | 178,566 | 179,198 |
| Installment contract receivables | 10,622 | 23,380 |
| 2015 Notes Hedges | ---- | 130,211 |
| Other assets | 78,672 | 75,913 |
| Total Assets | \$ 1,874,625 | \$ 1,732,116 |

LIABILITIES AND STOCKHOLDERS EQUITY

| | | |
|---|------------|------------|
| Current Liabilities: | | |
| Convertible notes | \$ 433,857 | \$ 143,258 |
| 2015 Notes Embedded Conversion Derivative | 222,085 | ---- |
| Accounts payable and accrued liabilities | 165,698 | 216,864 |
| Current portion of deferred revenue | 362,762 | 337,426 |
| Total current liabilities | 1,184,402 | 697,548 |
| Long-Term Liabilities: | | |
| Long-term portion of deferred revenue | 91,360 | 85,400 |
| Convertible notes | 128,928 | 406,404 |
| 2015 Notes Embedded Conversion Derivative | ---- | 130,211 |
| Other long-term liabilities | 138,619 | 135,899 |
| Total long-term liabilities | 358,907 | 757,914 |

Commitments and Contingencies (Note 9 and Note 14)

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| | | |
|---|--------------|--------------|
| Stockholders' Equity: | | |
| Common stock and capital in excess of par value | 1,725,660 | 1,715,541 |
| Treasury stock, at cost | (330,093) | (353,090) |
| Accumulated deficit | (1,114,847) | (1,138,853) |
| Accumulated other comprehensive income | 50,596 | 53,056 |
| Total stockholders' equity | 331,316 | 276,654 |
| Total Liabilities and Stockholders' Equity | \$ 1,874,625 | \$ 1,732,116 |

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

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

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| Revenue: | | | | |
| Product | \$ 157,938 | \$ 117,066 | \$ 299,757 | \$ 219,832 |
| Services | 29,477 | 25,258 | 57,282 | 51,178 |
| Maintenance | 95,855 | 84,740 | 192,333 | 177,992 |
| Total revenue | 283,270 | 227,064 | 549,372 | 449,002 |
| Costs and Expenses: | | | | |
| Cost of product | 20,074 | 7,123 | 34,268 | 12,415 |
| Cost of services | 20,616 | 21,556 | 40,691 | 43,481 |
| Cost of maintenance | 10,716 | 10,481 | 21,614 | 21,879 |
| Marketing and sales | 77,006 | 71,513 | 155,378 | 146,275 |
| Research and development | 99,268 | 91,880 | 200,567 | 181,310 |
| General and administrative | 25,377 | 17,058 | 44,679 | 39,892 |
| Amortization of acquired intangibles | 4,505 | 2,551 | 8,964 | 5,242 |
| Restructuring and other charges (credits) | 751 | (317) | 710 | (1,391) |
| Total costs and expenses | 258,313 | 221,845 | 506,871 | 449,103 |
| Income (loss) from operations | 24,957 | 5,219 | 42,501 | (101) |
| Interest expense | (10,768) | (7,972) | (21,754) | (15,403) |
| Other income (expense), net | 8,394 | (3,100) | 12,863 | 2,874 |
| Income (loss) before provision (benefit) for income taxes | 22,583 | (5,853) | 33,610 | (12,630) |
| Provision (benefit) for income taxes | (4,325) | (54,460) | 379 | (49,452) |
| Net income | \$ 26,908 | \$ 48,607 | \$ 33,231 | \$ 36,822 |
| Basic net income per share | \$ 0.10 | \$ 0.19 | \$ 0.13 | \$ 0.14 |
| Diluted net income per share | \$ 0.10 | \$ 0.18 | \$ 0.12 | \$ 0.14 |
| Weighted average common shares outstanding basic | 263,191 | 262,163 | 262,362 | 262,380 |
| Weighted average common shares outstanding diluted | 270,885 | 266,423 | 269,732 | 266,539 |

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

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

| | Six Months Ended | |
|--|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 |
| Cash and Cash Equivalents at Beginning of Period | \$ 557,409 | \$ 569,115 |
| Cash Flows from Operating Activities: | | |
| Net income | 33,231 | 36,822 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 46,283 | 41,333 |
| Amortization of debt discount and fees | 14,587 | 11,301 |
| Loss on extinguishment of debt | ---- | 5,321 |
| Stock-based compensation | 19,698 | 20,807 |
| Loss from equity method investments | 65 | 73 |
| Gain on investments, net | (13,741) | (6,935) |
| Non-cash restructuring and other charges | 136 | 216 |
| Write-down of investment securities | ---- | 1,500 |
| Impairment of property, plant and equipment | ---- | 427 |
| Deferred income taxes | (4,811) | (69,266) |
| Provisions (recoveries) for losses (gains) on trade and installment contract receivables | (5,885) | (12,978) |
| Other non-cash items | 2,518 | 3,124 |
| Changes in operating assets and liabilities, net of effect of acquired businesses: | | |
| Receivables | 2,455 | (25,384) |
| Installment contract receivables | 62,080 | 70,479 |
| Inventories | (6,987) | (10,923) |
| Prepaid expenses and other | 1,969 | (13,778) |
| Other assets | 1,479 | 1,397 |
| Accounts payable and accrued liabilities | (48,650) | 6,026 |
| Deferred revenue | 25,979 | 31,882 |
| Other long-term liabilities | (4,628) | 4,257 |
| Net cash provided by operating activities | 125,778 | 95,701 |
| Cash Flows from Investing Activities: | | |
| Proceeds from the sale of available-for-sale securities | 9,588 | ---- |
| Proceeds from the sale of long-term investments | 2,785 | 10,133 |
| Purchases of property, plant and equipment | (11,312) | (18,765) |
| Purchases of software licenses | ---- | (2,517) |
| Investment in venture capital partnerships and equity investments | (608) | (500) |
| Cash paid in business combinations and asset acquisitions, net of cash acquired | (22,865) | (253,951) |
| Net cash used for investing activities | (22,412) | (265,600) |

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| | | |
|---|------------|------------|
| Cash Flows from Financing Activities: | | |
| Principal payments on receivable sale financing | (2,829) | (1,719) |
| Proceeds from issuance of 2015 Notes | ---- | 350,000 |
| Payment of Convertible Senior Notes | ---- | (187,150) |
| Payment of 2015 Notes issuance costs | ---- | (9,800) |
| Purchase of 2015 Notes Hedges | ---- | (76,635) |
| Proceeds from termination of Convertible Senior Notes Hedges | ---- | 280 |
| Proceeds from sale of 2015 Warrants | ---- | 37,450 |
| Tax effect related to employee stock transactions allocated to equity | 967 | 59 |
| Proceeds from issuance of common stock | 10,302 | 8,119 |
| Stock received for payment of employee taxes on vesting of restricted stock | (7,389) | (4,114) |
| Purchases of treasury stock | ---- | (39,997) |
| Net cash provided by financing activities | 1,051 | 76,493 |
| Effect of exchange rate changes on cash and cash equivalents | 3,491 | (106) |
| Increase (decrease) in cash and cash equivalents | 107,908 | (93,512) |
| Cash and Cash Equivalents at End of Period | \$ 665,317 | \$ 475,603 |

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 United States 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 January 1, 2011. Certain prior period balances have been reclassified to conform to current period presentation.

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, financial position and cash flows for the periods and dates 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 United States 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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Cadence adopted new revenue recognition standards on the first day of fiscal 2011. See Note 3 for an additional description of Cadence's adoption of these standards.

Cadence evaluated subsequent events through the date on which this Quarterly Report on Form 10-Q was filed with the SEC.

NOTE 2. CONVERTIBLE NOTES

2.625% Cash Convertible Senior Notes Due 2015

In June 2010, Cadence issued \$350.0 million principal amount of its 2.625% Cash Convertible Senior Notes Due 2015, or the 2015 Notes. The 2015 Notes have a stated interest rate of 2.625%, mature on June 1, 2015 and may be settled only in cash. The indenture for the 2015 Notes does not contain any financial covenants. Contractual interest on the 2015 Notes began accruing in June 2010 and is payable semi-annually each December 1st and June 1st. The initial purchasers' transaction fees and expenses totaling \$10.6 million were capitalized as deferred financing costs and are amortized over the term of the 2015 Notes using the effective interest method. An aggregate of \$187.2 million of the net proceeds from the 2015 Notes was used to purchase \$100.0 million principal amount of Cadence's 1.375% Convertible Senior Notes Due December 15, 2011, or the 2011 Notes, and \$100.0 million principal amount of its 1.500%

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Convertible Senior Notes Due December 15, 2013, or the 2013 Notes, and collectively with the 2011 Notes, the Convertible Senior Notes. Cadence also used \$40.0 million of the net proceeds from the 2015 Notes to repurchase approximately 6.5 million shares of Cadence common stock.

Prior to March 1, 2015, holders may convert their 2015 Notes into cash upon the occurrence of any one of the following conditions:

During any fiscal quarter, and only during such fiscal quarter, if the closing sale price of Cadence's common stock exceeds \$9.81 for 20 or more trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding quarter;

Specified corporate transactions; or

The trading price of the 2015 Notes falls below 98% of the product of (i) the closing sale price of Cadence's common stock and (ii) the conversion rate on that date.

During the three months ended July 2, 2011, the closing sale price of Cadence's common stock exceeded \$9.81 for more than 20 of the last 30 consecutive trading days of that period. As a result, as of July 2, 2011, the 2015 Notes became convertible into cash at the election of holders of the 2015 Notes. Holders of the 2015 Notes can submit their 2015 Notes for conversion from July 2, 2011 through October 1, 2011. Because Cadence would be required to settle the 2015 Notes in cash if holders elect to convert the 2015 Notes, Cadence classified the \$287.1 million net liability of the 2015 Notes as a current liability on its Condensed Consolidated Balance Sheet as of July 2, 2011. Any gain or loss on extinguishment of the 2015 Notes would be recognized upon the cash conversion of the 2015 Notes. The 2015 Notes currently trade, and have traded during the three months ended July 2, 2011, at a substantial premium to the conversion price.

In order for the 2015 Notes to be convertible into cash in a particular fiscal quarter, a conversion condition must be met during the preceding fiscal quarter. Cadence will reassess whether this conversion condition has been met at the end of Cadence's next fiscal quarter, which ends on October 1, 2011. If the closing sale price of Cadence's common stock does not exceed \$9.81 for 20 or more of the last 30 trading days during the three months ending October 1, 2011, the conversion condition would not be met and Cadence would classify its 2015 Notes as a long-term liability on its Condensed Consolidated Balance Sheet as of that date.

From March 1, 2015 and until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their 2015 Notes into cash at any time, regardless of the occurrence of any of the foregoing conversion conditions. Cadence may not redeem the 2015 Notes prior to maturity.

The initial cash conversion rate for the 2015 Notes is 132.5205 shares of Cadence common stock per \$1,000 principal amount of 2015 Notes, equivalent to a cash conversion price of approximately \$7.55 per share of Cadence common stock, with the amount due on conversion payable in cash. Upon cash 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 cash conversion date.

If a fundamental change were to occur prior to maturity and Cadence's stock price were greater than \$6.16 per share at that time, the cash conversion rate would increase by an additional amount of up to 29.8171 shares of Cadence's common stock per \$1,000 principal amount of 2015 Notes, which amount would be paid entirely in cash to each holder that elects to convert its 2015 Notes at that time. 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

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50% of Cadence's common stock is exchanged for, converted into, acquired for or constitutes solely the right to receive, consideration. No fundamental change would occur if at least 90% of the consideration received consists of shares of common stock, or depositary receipts representing such shares, that are:

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

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

The cash conversion feature of the 2015 Notes, or the 2015 Notes Embedded Conversion Derivative, requires bifurcation from the 2015 Notes. The 2015 Notes Embedded Conversion Derivative is accounted for as a derivative liability. Because the 2015 Notes were convertible into cash as of July 2, 2011, the 2015 Notes Embedded Conversion Derivative is classified as a current liability in Cadence's Condensed Consolidated Balance Sheet as of July 2, 2011, but is classified as a long-term liability in Cadence's Condensed Consolidated Balance Sheet as of January 1, 2011. The fair value of the 2015 Notes Embedded Conversion Derivative at the time of issuance of the 2015 Notes was \$76.6 million and was recorded as the original debt discount for purposes of accounting for the debt component of the 2015 Notes. This discount is recognized as interest expense using the effective interest method over the term of the 2015 Notes. As of July 2, 2011, the estimated fair value of the 2015 Notes Embedded Conversion Derivative was \$222.1 million.

Concurrently with the issuance of the 2015 Notes, Cadence entered into hedge transactions, or the 2015 Notes Hedges, with various parties whereby Cadence has the option to receive the cash amount that may be due to 2015 Notes holders at maturity or upon conversion in excess of the \$350.0 million principal amount of the notes, subject to certain conversion rate adjustments in the 2015 Notes Indenture. These options expire on June 1, 2015 and must be settled in cash. The aggregate cost of the 2015 Notes Hedges was \$76.6 million. The 2015 Notes Hedges are accounted for as derivative assets. Because the 2015 Notes were convertible into cash as of July 2, 2011, the 2015 Notes Hedges are classified as current assets in Cadence's Condensed Consolidated Balance Sheet as of July 2, 2011, but are classified as long-term assets in Cadence's Condensed Consolidated Balance Sheet as of January 1, 2011. As of July 2, 2011, the estimated fair value of the 2015 Notes Hedges was \$222.1 million.

If the conversion condition is not met as of the end of any fiscal quarter, Cadence would classify its 2015 Notes Embedded Conversion Derivative as a long-term liability and its 2015 Notes Hedges as long-term assets in its Condensed Consolidated Balance Sheet as of that date.

The 2015 Notes Embedded Conversion Derivative and the 2015 Notes Hedges are adjusted to fair value each reporting period and unrealized gains and losses are reflected in Cadence's Condensed Consolidated Income Statements. Because the fair values of the 2015 Notes Embedded Conversion Derivative and the 2015 Notes Hedges are similar, there was no impact to Cadence's Condensed Consolidated Income Statements relating to these adjustments to fair value during the three and six months ended July 2, 2011.

In separate transactions, Cadence also sold warrants, or the 2015 Warrants, to various parties for the purchase of up to approximately 46.4 million shares of Cadence's common stock at a price of \$10.78 per share in a private placement pursuant to Section 4(2) of the Securities Act of 1933, as amended, or the Securities Act. The 2015 Warrants expire on various dates from September 2015 through December 2015 and must be settled in net shares. Cadence received \$37.5 million in cash proceeds from the sale of the

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2015 Warrants, which has been recorded as an increase in Stockholders' equity. Changes in the fair value of the 2015 Warrants will not be recognized in Cadence's Condensed Consolidated Financial Statements as long as the instruments remain classified as equity. The 2015 Warrants are included in diluted earnings per share to the extent the impact is dilutive. As of July 2, 2011, the 2015 Warrants were not dilutive.

The principal amount, unamortized debt discount and net carrying amount of the liability component of the 2015 Notes as of July 2, 2011 and January 1, 2011 were as follows:

| | As of | |
|---|-----------------|--------------------|
| | July 2, 2011 | January 1, 2011 |
| | (In thousands) | |
| Principal amount of 2015 Notes | \$ 350,000 | \$ 350,000 |
| Unamortized debt discount of 2015 Notes | (62,890) | (69,604) |
| Net liability of 2015 Notes | \$ 287,110 | \$ 280,396 |

The effective interest rate, contractual interest expense and amortization of debt discount for the 2015 Notes for the three and six months ended July 2, 2011 and July 3, 2010 were as follows:

| | Three Months Ended | | Six Months Ended | |
|-------------------------------|------------------------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In thousands, except percentages) | | | |
| Effective interest rate | 8.1% | 8.1% | 8.1% | 8.1% |
| Contractual interest expense | \$ 2,289 | \$ 427 | \$ 4,578 | \$ 427 |
| Amortization of debt discount | \$ 3,376 | \$ 592 | \$ 6,713 | \$ 592 |

As of July 2, 2011, the if-converted value of the 2015 Notes exceeded the principal amount of the 2015 Notes. The total fair value of the 2015 Notes was \$537.0 million.

1.375% Convertible Senior Notes Due December 15, 2011 and 1.500% Convertible Senior Notes Due December 15, 2013

In December 2006, Cadence issued \$250.0 million principal amount of its 2011 Notes and \$250.0 million principal amount of its 2013 Notes. The indentures for the Convertible Senior Notes do not contain any financial covenants. Contractual interest payable on the Convertible Senior Notes began accruing in December 2006 and is payable semi-annually each December 15th and June 15th. In June 2010, Cadence repurchased \$100.0 million principal amount of its 2011 Notes and \$100.0 million principal amount of its 2013 Notes, and in November 2010, Cadence repurchased in the open market \$5.5 million principal amount of its 2013 Notes. These repurchases resulted in a remaining principal balance of \$150.0 million for the 2011 Notes and \$144.5 million for the 2013 Notes. Because Cadence's 2011 Notes mature on December 15, 2011, its Condensed Consolidated Balance Sheets include a current liability of \$146.7 million as of July 2, 2011 and \$143.3 million as of January 1, 2011, representing the \$150.0 million principal amount of the 2011 Notes, net of the applicable debt discount on the respective dates. Amortization of the debt discount will continue through December 15, 2011, when the carrying value of the 2011 Notes will equal the \$150.0 million principal amount due at maturity.

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

The closing price of Cadence's common stock exceeds \$27.50 during certain periods of time specified in the Convertible Senior Notes;

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Specified corporate transactions occur; or

The trading price of the Convertible Senior Notes falls below 98% of the product of (i) the closing sale price of Cadence's common stock and (ii) the conversion rate on that date.

From November 2, 2011, in the case of the 2011 Notes, and November 1, 2013, in the case of the 2013 Notes, and 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 occurrence of any of the foregoing conditions. 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.

If a fundamental change were to occur prior to maturity and Cadence's stock price were greater than \$18.00 per share at that time, the conversion rate would increase by an additional amount of up to \$8.27 per share, which amount would be paid entirely in cash to each holder that elects to convert its Convertible Senior Notes at that time. 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 would occur if at least 90% of the consideration received consists of shares of common stock, or depositary receipts representing such shares, that are:

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

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

As of July 2, 2011, none of the conditions allowing the holders of the Convertible Senior Notes to convert had been met.

During the three months ended July 3, 2010, Cadence purchased in the open market \$100.0 million principal amount of the 2011 Notes and \$100.0 million principal amount of the 2013 Notes. During the three months ended January 1, 2011, Cadence purchased in the open market \$5.5 million principal amount of the 2013 Notes. At settlement, the fair value of the liability component immediately prior to its extinguishment is measured first, and the difference between the fair value of the aggregate consideration remitted to its holders and the fair value of the liability component immediately prior to its extinguishment is attributed to the reacquisition of the equity component.

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The components of the fiscal 2010 repurchases and related loss on early extinguishment of debt were as follows:

| | 2011 Notes | 2013 Notes (In thousands) | Total |
|---------------------------------------|---------------|------------------------------|------------|
| Principal amount repurchased | \$ 100,000 | \$ 105,539 | \$ 205,539 |
| Amount allocated to: | | | |
| Extinguishment of liability component | \$ 95,865 | \$ 90,881 | \$ 186,746 |
| Extinguishment of equity component | 2,285 | 3,333 | 5,618 |
| Total cash paid for repurchase | \$ 98,150 | \$ 94,214 | \$ 192,364 |
| Principal amount repurchased | \$ 100,000 | \$ 105,539 | \$ 205,539 |
| Unamortized debt discount | (6,958) | (15,780) | (22,738) |
| Extinguishment of liability component | (95,865) | (90,881) | (186,746) |
| Related debt issuance costs | (676) | (1,084) | (1,760) |
| Loss on early extinguishment of debt | \$ (3,499) | \$ (2,206) | \$ (5,705) |

Concurrently with the issuance of the Convertible Senior Notes, Cadence entered into hedge transactions, or the Convertible Senior Notes Hedges, with various parties whereby Cadence has the option to receive the amount of shares that may be owed to Convertible Senior Notes holders at maturity or upon conversion of the notes, subject to certain conversion rate adjustments in the Convertible Senior Notes Indenture. The aggregate cost of the Convertible Senior Notes Hedges was \$119.8 million and has been recorded as a reduction to Stockholders' equity. In connection with the purchase of a portion of the Convertible Senior Notes in June 2010 and November 2010, Cadence also sold a portion of the Convertible Senior Notes Hedges representing options to purchase approximately 9.7 million shares of Cadence's common stock and received proceeds of \$0.4 million. The estimated fair value of the remaining Convertible Senior Notes Hedges was \$2.4 million as of July 2, 2011. 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. Subsequent changes in the fair value of the Convertible Senior Notes Hedges will not be recognized in Cadence's Condensed Consolidated Financial Statements as long as the instruments remain classified as equity.

In separate transactions, Cadence also sold warrants, or the Convertible Senior Notes 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. Cadence received \$39.4 million in cash proceeds from the sale of the Convertible Senior Notes Warrants, which has been recorded as an increase in Stockholders' equity. In connection with the purchase of a portion of the Convertible Senior Notes in June 2010 and November 2010, Cadence also purchased a portion of the Convertible Senior Notes Warrants, reducing the number of shares of Cadence common stock available for purchase by 9.7 million shares at a cost of \$0.1 million. The Convertible Senior Notes 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. Changes in the fair value of the Convertible Senior Notes Warrants will not be recognized in Cadence's Condensed Consolidated Financial Statements as long as the instruments remain classified as equity. The remaining warrants are included in diluted earnings per share to the extent the impact is dilutive. As of July 2, 2011, the Convertible Senior Notes Warrants were not dilutive.

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The carrying amount of the equity component of the Convertible Senior Notes and the principal amount, unamortized debt discount and net carrying amount of the liability component of the Convertible Senior Notes as of July 2, 2011 and January 1, 2011 were as follows:

| | July 2, 2011 | As of January 1, 2011 |
|---|-----------------|-----------------------------|
| | (In thousands) | |
| Equity component of Convertible Senior Notes | \$ 111,375 | \$ 111,375 |
| Principal amount of Convertible Senior Notes | \$ 294,461 | \$ 294,461 |
| Unamortized debt discount of Convertible Senior Notes | (18,964) | (25,373) |
| Liability component of Convertible Senior Notes | \$ 275,497 | \$ 269,088 |

The effective interest rate, contractual interest expense and amortization of debt discount for the Convertible Senior Notes for the three and six months ended July 2, 2011 and July 3, 2010, were as follows:

| | Three Months Ended | | Six Months Ended | |
|-------------------------------|------------------------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In thousands, except percentages) | | | |
| Effective interest rate | 6.3% | 6.3% | 6.3% | 6.3% |
| Contractual interest expense | \$ 1,053 | \$ 1,649 | \$ 2,106 | \$ 3,440 |
| Amortization of debt discount | \$ 3,212 | \$ 4,706 | \$ 6,409 | \$ 9,801 |

As of July 2, 2011, the if-converted value of the Convertible Senior Notes does not exceed the principal amount of the Convertible Senior Notes and the total fair value of the Convertible Senior Notes, including the equity component, was \$289.4 million.

Zero Coupon Zero Yield Senior Convertible Notes Due 2023

In August 2003, Cadence issued \$420.0 million principal amount of its Zero Coupon Zero Yield Senior Convertible Notes Due 2023, or the 2023 Notes. As of July 2, 2011, the remaining balance and the total fair value of the 2023 Notes was \$0.2 million.

NOTE 3. REVENUE RECOGNITION

Cadence adopted new revenue recognition accounting standards on the first day of fiscal 2011 for revenue arrangements that include both hardware and software elements. These new standards require companies to account for product or service deliverables separately rather than as one combined unit in a multiple element arrangement, or MEA. Under these new standards, hardware products containing software components and nonsoftware components that function together to deliver the hardware product's essential functionality are excluded from the pre-existing software revenue standards. In addition, hardware components of a tangible product containing software components are always excluded from the pre-existing software revenue standards. The residual method is no longer allowed when allocating consideration for arrangements under these new accounting standards.

An MEA is any arrangement that includes or contemplates rights to a combination of software or hardware products, software license types, services, training or maintenance in a single arrangement. From time to time, Cadence may include individual deliverables in separately priced and separately executed contracts with the same customer. Cadence evaluates all relevant facts and circumstances in determining

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whether the separate contracts should be accounted for individually as distinct arrangements or whether the separate contracts are, in substance, an MEA. Significant judgment can be involved in determining whether a group of contracts might be so closely related that they are, in effect, part of a single arrangement.

For a single transaction or MEA that includes software and nonsoftware elements, Cadence allocates consideration to all deliverables based on their relative standalone selling prices. In these circumstances, the new accounting standards establish a hierarchy to determine the standalone selling price to be used for allocating consideration to deliverables as follows:

Vendor-specific objective evidence of fair value, or VSOE;

Third-party evidence of selling price, or TPE; and

Best estimate of the selling price, or ESP.

The new accounting standards do not generally change the separate elements identified in Cadence's revenue transactions. For MEAs that contain software and nonsoftware elements, Cadence allocates the consideration to software or software-related elements as a group, and to any nonsoftware element separately based on the standalone selling price hierarchy. The consideration allocated to each element is then recognized as revenue when the basic revenue recognition criteria are met for each element. Once the consideration is allocated to the group of software and software-related elements, it then follows the recognition principles of pre-existing software accounting guidance. The most significant impact of the adoption of the new revenue recognition accounting standards is the timing of revenue recognition for Cadence's hardware products when sold with other hardware products or with software licenses for which revenue is recognized ratably. Using the residual method under the pre-existing accounting standards, revenue was recognized when all undelivered elements had vendor-specific objective evidence of fair value, or VSOE. In an arrangement that included multiple hardware products, revenue for the delivered hardware products was required to be deferred until the final hardware product was delivered. In these arrangements, the time period between shipment of the first hardware product and the last hardware product can vary, generally ranging from one to four quarters. Under the newly adopted accounting standards, the consideration allocated to each hardware product will be recognized as revenue upon the respective delivery of each hardware product. In addition, if a hardware product is sold with nonessential software licenses, hardware revenue will no longer be required to be recognized ratably over the software license term.

Cadence adopted these new accounting standards on a prospective basis. Therefore, revenue will continue to be recognized in future periods under the pre-existing accounting standards for arrangements that were entered into on or prior to January 1, 2011. Cadence began applying the new accounting standards for arrangements entered into or materially modified on or after January 2, 2011. If Cadence had accounted for arrangements entered into on or after January 2, 2011 under the pre-existing accounting standards, revenue for the three months ended July 2, 2011 would have been \$3.1 million more than reported and revenue for the six months ended July 2, 2011 would have been \$2.1 million less than reported. Changes in assumptions or judgments or changes to the elements in an arrangement could cause a material increase or decrease in the amount of revenue that Cadence reports in a particular period. Cadence has established VSOE for certain service offerings based upon the pricing of these elements when sold separately. VSOE for maintenance is based upon the customer's stated annual renewal rate. Cadence has not established VSOE for any of its products, for annual maintenance that is not cancellable by the customer, or for maintenance of less than 12 months.

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TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, Cadence's offerings contain significant differentiation such that comparable pricing of products with similar functionality cannot be obtained. Furthermore, Cadence is unable to reliably determine what similar competitor products' selling prices are when those products are sold on a stand-alone basis. Therefore, Cadence typically is not able to obtain TPE and TPE is not used to determine any standalone selling prices.

Cadence calculates the ESP of its hardware products based on its pricing practices, including the historical average prices charged for comparable hardware products. Cadence's process for determining ESP for its software deliverables without VSOE or TPE takes into account multiple factors that vary depending upon the unique facts and circumstances related to each deliverable. Key external and internal factors considered in developing the ESPs include, but are not limited to, prices charged by Cadence for similar arrangements, historical pricing practices and the nature of the product. In addition, when developing ESPs, Cadence may consider other factors as appropriate including the pricing of competitive alternatives if they exist, and product-specific business objectives.

Cadence generally has a minimum of two deliverables contained in arrangements involving the sale of its hardware. The first deliverable is the hardware product and software essential to the functionality of the hardware product delivered at the time of sale, and the second deliverable is the right to receive maintenance on the hardware product and the hardware product's essential software. Cadence allocates consideration between these deliverables based on the relative standalone selling price for each deliverable. Consideration allocated to the hardware product and the related essential software is recognized as revenue at the time of delivery provided all other conditions for revenue recognition have been met. Consideration allocated to the maintenance is deferred and recognized as revenue on a straight-line basis over the respective maintenance terms.

Cadence accounts for MEAs that consist only of software or software-related products in accordance with industry-specific accounting guidance for software and software-related transactions. If VSOE exists for all undelivered elements, the consideration is allocated using the residual method. Under the residual method, the VSOE of the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized up-front as the software products are delivered. If VSOE does not exist for all elements to support the allocation of the total fee among all elements of the arrangement, or if VSOE does not exist for all undelivered elements to apply the residual method, revenue is recognized ratably over the term of the undelivered elements.

NOTE 4. ACQUISITIONS

For each of Cadence's acquisitions, the results of operations and the estimated fair value of the assets acquired and liabilities assumed have been included in Cadence's Condensed Consolidated Financial Statements from the date of the acquisition.

2011 Acquisition

During the three months ended July 2, 2011, Cadence acquired a company and recorded \$14.2 million of goodwill, and \$13.2 million of intangible assets with a weighted average life of 7 years. The \$14.2 million of goodwill recorded in connection with this acquisition is not expected to be deductible for income tax purposes. The fair value of the intangible assets was determined using the income approach with significant inputs that are not observable in the market. Key assumptions include the economy in general and conditions and demands specific to electronic design automation software development with expected

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future cash flows from revenues, the timing of the expected future cash flows and discount rates consistent with the level of risk.

Denali Software, Inc.

In June 2010, Cadence acquired Denali Software, Inc., or Denali. Denali was a privately-held provider of electronic design automation software and intellectual property used in system-on-chip design and verification. Cadence acquired Denali to expand its portfolio to provide system component modeling and intellectual property integration. The aggregate initial purchase price was \$296.8 million, which was paid in cash. Of the \$12.6 million of purchase price payments that were deferred on the acquisition date, \$1.3 million remains unpaid as of July 2, 2011 and is conditioned upon certain Denali shareholders remaining employees of Cadence over the stated retention periods. Of the \$12.6 million deferred purchase price, Cadence expensed \$10.2 million during fiscal 2010, \$0.8 million during the six months ended July 2, 2011 and Cadence will expense the remaining \$1.6 million over the stated retention periods. The financial information in the table below summarizes the combined results of operations of Cadence and Denali, on a pro forma basis, as though the companies had been combined as of the beginning of the three and six months ended July 3, 2010. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place on January 3, 2010 or of results that may occur in the future.

| | Three Months Ended July 3, 2010 | Six Months Ended July 3, 2010 |
|---------------|---|--|
| | (In thousands) | |
| Total revenue | \$231,792 | \$ 460,897 |
| Net income | \$ 36,756 | \$ 11,508 |

Acquisition-Related Contingent Consideration

Cadence accounts for business combinations with acquisition dates on or before January 3, 2009 under the purchase method in accordance with Statement of Financial Accounting Standard, or SFAS, No. 141, Business Combinations, and contingent consideration is added to Goodwill as it is paid. See Note 5 for the amount of Goodwill recorded during the six months ended July 2, 2011 in connection with acquisitions accounted for under SFAS No. 141. Cadence accounts for business combinations with acquisition dates after January 3, 2009 under the acquisition method in accordance with the Accounting Standards Codification and contingent consideration is recorded at fair value on the acquisition date.

In connection with Cadence's business combinations and asset acquisitions completed before July 2, 2011, Cadence may be obligated to make payments based on, or subject to the satisfaction of, certain performance metrics. If performance is such that these payments are fully achieved, Cadence may be obligated to pay up to an aggregate of \$27.2 million in cash during the next 58 months, of which up to \$19.8 million would be expensed in Cadence's Condensed Consolidated Income Statements.

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The changes in the carrying amount of goodwill during the six months ended July 2, 2011 were as follows:

| | Gross Carrying Amount (In thousands) |
|--|---|
| Balance as of January 1, 2011 | \$ 158,893 |
| Goodwill resulting from the acquisition during the period (Note 4) | 14,221 |
| Additions due to contingent consideration (Note 4) | 638 |
| Balance as of July 2, 2011 | \$ 173,752 |

Acquired Intangibles, net

Acquired intangibles with finite lives as of July 2, 2011 were as follows, excluding intangibles that were fully amortized as of January 1, 2011:

| | Gross Carrying Amount | Accumulated Amortization (In thousands) | Acquired Intangibles, net |
|------------------------------------|-----------------------------|---|---------------------------------|
| Existing technology and backlog | \$ 82,600 | \$ (11,330) | \$ 71,270 |
| Agreements and relationships | 117,119 | (21,091) | 96,028 |
| Distribution rights | 30,100 | (24,080) | 6,020 |
| Tradenames, trademarks and patents | 26,183 | (20,935) | 5,248 |
| Total acquired intangibles | \$ 256,002 | \$ (77,436) | \$ 178,566 |

Acquired intangibles with finite lives as of January 1, 2011 were as follows, excluding intangibles that were fully amortized as of January 2, 2010:

| | Gross Carrying Amount | Accumulated Amortization (In thousands) | Acquired Intangibles, net |
|------------------------------------|-----------------------------|---|---------------------------------|
| Existing technology and backlog | \$ 91,800 | \$ (27,350) | \$ 64,450 |
| Agreements and relationships | 135,773 | (36,579) | 99,194 |
| Distribution rights | 30,100 | (22,575) | 7,525 |
| Tradenames, trademarks and patents | 26,183 | (18,654) | 7,529 |
| Total acquired intangibles | \$ 283,856 | \$ (105,158) | \$ 178,698 |

As of January 1, 2011, Cadence also had \$0.5 million of in-process research and development intangibles that had an indefinite useful life. These intangibles were placed into service during the six months ended July 2, 2011.

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Amortization of acquired intangibles for the three and six months ended July 2, 2011 and July 3, 2010 was as follows:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In thousands) | | | |
| Cost of product | \$ 2,483 | \$ 591 | \$ 4,679 | \$ 1,211 |
| Cost of maintenance | ---- | ---- | ---- | 1,045 |
| Amortization of acquired intangibles | 4,505 | 2,551 | 8,964 | 5,242 |
| Total amortization of acquired intangibles | \$ 6,988 | \$ 3,142 | \$ 13,643 | \$ 7,498 |

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

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

| | (In thousands) |
|--------------------------------------|----------------|
| 2011 remaining period | \$ 12,984 |
| 2012 | 25,435 |
| 2013 | 21,927 |
| 2014 | 19,151 |
| 2015 | 18,837 |
| Thereafter | 80,232 |
| Total estimated amortization expense | \$ 178,566 |

NOTE 6. FINANCIAL INSTRUMENTS**Fair Value of Financial Instruments**

Inputs to 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. Cadence recognizes transfers between levels of the hierarchy based on the fair values of the respective financial instruments at the end of the reporting period in which the transfer occurred. There were no transfers between levels of the fair value hierarchy during the six months ended July 2, 2011.

The fair value of Cadence's cash and cash equivalents, short-term investments, receivables, accounts payable and foreign currency forward exchange contracts approximate their carrying value due to the short-term nature of these instruments. The fair values of Cadence's long-term investments and installment contract receivables approximate their carrying values based upon current market rates of interest. The fair

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values of Cadence's 2015 Notes and Convertible Senior Notes are influenced by interest rates, Cadence's stock price and stock price volatility and are determined by market trading. The fair values of the embedded conversion derivative and hedge transaction associated with Cadence's 2015 Notes are determined using an option pricing model based on observable inputs, including Cadence's stock price, stock price volatility and risk-free interest rates. See Note 2 for the fair value of Cadence's 2015 Notes, Convertible Senior Notes, 2023 Notes, and Cadence's convertible notes hedges and warrants.

On a quarterly basis, Cadence measures at fair value certain financial assets and liabilities. The fair value of financial assets and liabilities was determined using the following levels of inputs as of July 2, 2011:

| Fair Value Measurements as of July 2, 2011: | | | | |
|--|-------------------|-------------------|-------------------|----------------|
| | Total | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | |
| <u>Assets</u> | | | | |
| Cash equivalents Money market funds | \$ 532,346 | \$ 532,346 | \$ ---- | \$ ---- |
| Available-for-sale securities | 3,240 | 3,240 | ---- | ---- |
| Trading securities held in Non-Qualified Deferred Compensation Plan (NQDC) | 27,063 | 27,063 | ---- | ---- |
| 2015 Notes Hedges | 222,085 | ---- | 222,085 | ---- |
| Foreign currency exchange contracts | 490 | ---- | 490 | ---- |
| Time deposits | 15 | 15 | ---- | ---- |
| Total Assets | \$ 785,239 | \$ 562,664 | \$ 222,575 | \$ ---- |
| | Total | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | |
| <u>Liabilities</u> | | | | |
| Acquisition-related contingent consideration | \$ 162 | \$ ---- | \$ ---- | \$ 162 |
| 2015 Notes Embedded Conversion Derivative | 222,085 | ---- | 222,085 | ---- |
| Total Liabilities | \$ 222,247 | \$ ---- | \$ 222,085 | \$ 162 |

The 2015 Notes Hedges and the 2015 Notes Embedded Conversion Derivative are classified as Level 2 because these assets and liabilities are not actively traded and are valued using standard pricing methodologies that use observable market data for all inputs. The fair values of the 2015 Notes Hedges and 2015 Notes Embedded Conversion Derivative are determined using an option pricing model based on observable inputs, such as implied volatility of Cadence's common stock, risk-free interest rate and other factors. The foreign currency exchange contracts are classified as Level 2 because the fair value of these contracts is determined based on observable foreign currency exchange rates.

Cadence acquired intangible assets of \$13.2 million in connection with a business combination during the six months ended July 2, 2011. The fair value of these intangible assets was estimated using Level 3 inputs. See Note 4 for an additional description of this business combination and the key inputs used in the valuation.

Cadence vacated or consolidated certain facilities in connection with restructuring plans initiated in 2010 and recorded lease losses of \$1.5 million during the six months ended July 2, 2011, which are included in Restructuring and other charges (credits) in Cadence's Condensed Consolidated Income Statements. The fair value of these lease losses was estimated using Level 3 inputs. See Note 7 for an additional description of Cadence's lease loss estimates.

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The fair value of financial assets and liabilities was determined using the following levels of inputs as of January 1, 2011:

| | Fair Value Measurements as of January 1, 2011: | | | |
|--|--|-------------------|-------------------|----------------|
| | Total | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | |
| Assets | | | | |
| Cash equivalents Money market funds | \$ 463,681 | \$ 463,681 | \$ ---- | \$ ---- |
| Available-for-sale securities | 12,702 | 12,702 | ---- | ---- |
| Trading securities held in NQDCs | 28,738 | 28,738 | ---- | ---- |
| 2015 Notes Hedges | 130,211 | ---- | 130,211 | ---- |
| Foreign currency exchange contracts | 1,559 | ---- | 1,559 | ---- |
| Time deposits | 13 | 13 | ---- | ---- |
| Total Assets | \$ 636,904 | \$ 505,134 | \$ 131,770 | \$ ---- |
| | Total | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | |
| Liabilities | | | | |
| Acquisition-related contingent consideration | \$ 966 | \$ ---- | \$ ---- | \$ 966 |
| 2015 Notes Embedded Conversion Derivative | 130,211 | ---- | 130,211 | ---- |
| Total Liabilities | \$ 131,177 | \$ ---- | \$ 130,211 | \$ 966 |

Marketable Securities

During the three months ended July 2, 2011, Cadence sold available-for-sale securities and received \$8.1 million in proceeds, net of \$0.4 million of transaction costs, and recognized a gain of \$8.0 million as Other income, net, in its Condensed Consolidated Income Statements.

During the six months ended July 2, 2011, Cadence sold available-for-sale securities and received \$9.6 million in proceeds, net of \$0.4 million of transaction costs, and recognized a gain of \$8.0 million as Other income, net, in its Condensed Consolidated Income Statements.

The cost basis of Cadence's remaining marketable securities was \$1.9 million as of July 2, 2011. The cost basis of Cadence's marketable securities as of January 1, 2011 was \$3.2 million.

Non-Marketable Securities

Cadence uses either the cost or equity method of accounting to account for its long-term, non-marketable investment securities included in Other assets in its Condensed Consolidated Balance Sheets. During the six months ended July 2, 2011, Cadence sold its interest in one of its equity method investments and recognized a gain of \$2.7 million as Other income, net in its Condensed Consolidated Income Statements.

During the three months ended July 2, 2011, a \$2.0 million convertible note Cadence held was converted into non-marketable equity securities. Cadence will account for this investment under the cost method.

The carrying value of Cadence's non-marketable securities was \$11.8 million as of July 2, 2011 and \$9.3 million as of January 1, 2011.

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NOTE 7. RESTRUCTURING AND OTHER CHARGES

During the fourth quarter of fiscal 2010, Cadence initiated a restructuring plan, or the 2010 Restructuring Plan, which it announced in February 2011. Cadence initiated restructuring plans in each year from 2001 through 2005, in 2008 and in 2009, which are referred to collectively as the Other Restructuring Plans. Cadence initiated the 2010 Restructuring Plan, and the Other Restructuring Plans, collectively known as the Restructuring Plans, in an effort to operate more efficiently.

As of July 2, 2011, Cadence's total amount accrued for the Restructuring Plans was \$7.5 million, consisting of \$0.8 million of severance and severance-related benefits and \$6.7 million of estimated lease losses. The estimated lease losses will be adjusted in the future based on changes in the assumptions used to estimate the lease losses. The lease losses could be as high as \$10.0 million and will be influenced by rental rates and the amount of time it takes to find suitable tenants to sublease the facilities. Of the \$7.5 million accrued as of July 2, 2011, \$2.1 million was included in Accounts payable and accrued liabilities and \$5.4 million was included in Other long-term liabilities on Cadence's Condensed Consolidated Balance Sheet.

Cadence regularly evaluates the adequacy of its lease loss, severance and related benefits accruals, and adjusts the balances based on actual costs incurred or changes in estimates and assumptions. Cadence may incur future charges to reflect actual costs incurred or for changes in estimates related to amounts previously recorded under the Restructuring Plans.

2010 Restructuring Plan

Since initiating the 2010 Restructuring Plan, Cadence has recorded total Restructuring and other charges associated with the 2010 Restructuring Plan of \$14.0 million. Of the \$14.0 million, \$8.3 million is comprised of estimated severance payments, severance-related benefits and costs for outplacement services, \$3.7 million is related to asset impairment charges and \$2.0 million is related to lease loss accruals.

Total severance and termination benefits of \$7.8 million were paid to employees before July 2, 2011. Approximately \$0.8 million of severance and termination benefits is expected to be paid after July 2, 2011, all of which is included in Accounts payable and accrued liabilities in Cadence's Condensed Consolidated Balance Sheet as of July 2, 2011. Because of varying regulations in the jurisdictions and countries in which Cadence operates, these workforce reductions are expected to be completed and realized by the end of fiscal 2011.

Cadence recorded Restructuring and other charges related to lease loss accruals of \$0.8 million during the three months ended July 2, 2011 and \$1.5 million during the six months ended July 2, 2011 for facilities that Cadence vacated or consolidated during the three and six months ended July 2, 2011. Cadence also recorded credits of \$0.2 million during the three months ended July 2, 2011 and \$0.8 million during the six months ended July 2, 2011 for severance and related benefits costs that were less than previously estimated.

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The following table presents activity for the 2010 Restructuring Plan for the three months ended July 2, 2011:

| | Severance and Benefits | Excess Facilities (In thousands) | Total |
|--|------------------------------|--|----------|
| Balance, April 2, 2011 | \$ 2,177 | \$ 974 | \$ 3,151 |
| Restructuring and other charges (credits), net | (159) | 781 | 622 |
| Non-cash charges | ---- | 1 | 1 |
| Cash payments | (1,275) | (373) | (1,648) |
| Effect of foreign currency translation | 27 | 16 | 43 |
| Balance, July 2, 2011 | \$ 770 | \$ 1,399 | \$ 2,169 |

The following table presents activity for the 2010 Restructuring Plan for the six months ended July 2, 2011:

| | Severance and Benefits | Excess Facilities (In thousands) | Total |
|--|------------------------------|--|----------|
| Balance, January 1, 2011 | \$ 9,095 | \$ 434 | \$ 9,529 |
| Restructuring and other charges (credits), net | (763) | 1,539 | 776 |
| Non-cash charges | ---- | 3 | 3 |
| Cash payments | (7,760) | (591) | (8,351) |
| Effect of foreign currency translation | 198 | 14 | 212 |
| Balance, July 2, 2011 | \$ 770 | \$ 1,399 | \$ 2,169 |

Other Restructuring Plans

The following table presents activity for the Other Restructuring Plans for the three months ended July 2, 2011:

| | Severance and Benefits | Excess Facilities Other (In thousands) | Total | |
|--|------------------------------|---|-------|----------|
| Balance, April 2, 2011 | \$ 26 | \$ 5,356 | \$ 5 | \$ 5,387 |
| Restructuring and other charges (credits), net | (2) | 131 | ---- | 129 |
| Non-cash charges | ---- | 71 | ---- | 71 |
| Cash payments | (2) | (288) | ---- | (290) |
| Effect of foreign currency translation | ---- | 42 | ---- | 42 |
| Balance, July 2, 2011 | \$ 22 | \$ 5,312 | \$ 5 | \$ 5,339 |

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The following table presents activity for the Other Restructuring Plans for the six months ended July 2, 2011:

| | Severance and Benefits | Excess Facilities | Other | Total |
|--|------------------------------|----------------------|-------|----------|
| | (In thousands) | | | |
| Balance, January 1, 2011 | \$ 103 | \$ 5,434 | \$ 5 | \$ 5,542 |
| Restructuring and other charges (credits), net | (77) | 11 | ---- | (66) |
| Non-cash charges | ---- | 134 | ---- | 134 |
| Cash payments | (4) | (528) | ---- | (532) |
| Effect of foreign currency translation | ---- | 261 | ---- | 261 |
| Balance, July 2, 2011 | \$ 22 | \$ 5,312 | \$ 5 | \$ 5,339 |

NOTE 8. ACCOUNTS RECEIVABLE AND ALLOWANCES FOR DOUBTFUL ACCOUNTS

Cadence's Receivables, net balance on its Condensed Consolidated Balance Sheets includes invoiced accounts receivable and the current portion of unbilled installment contract receivables. Installment contract receivables represent amounts Cadence has recorded as revenue for which payments from a customer are due over time. Cadence's accounts receivable and installment contract receivables were initially recorded at fair value. Cadence discounts the total product portion of the agreements to reflect the interest component of the transaction and amortizes the interest component of the transaction. The interest component is recognized as Product revenue over the period in which payments are made and balances are outstanding, using the effective interest method. Cadence determines the discount rate at the outset of the arrangement based upon the current credit rating of the customer. Cadence resets the discount rate periodically considering changes in prevailing interest rates but does not adjust previously discounted balances. Cadence's long-term Installment contract receivables balance on its Condensed Consolidated Balance Sheets includes installment contract receivable balances to be invoiced at future dates more than one year after each balance sheet date.

Cadence's accounts receivable and installment contract receivables balances as of July 2, 2011 and January 1, 2011 were as follows:

| | As of | |
|---|-----------------|--------------------|
| | July 2, 2011 | January 1, 2011 |
| | (In thousands) | |
| Accounts receivable | \$ 111,798 | \$ 112,494 |
| Installment contract receivables, short-term | 39,190 | 87,003 |
| Installment contract receivables, long-term | 10,622 | 23,380 |
| Total accounts receivable and installment contract receivables | 161,610 | 222,877 |
| Less allowance for doubtful accounts | (747) | (7,604) |
| Total accounts receivable, net and installment contract receivables | \$ 160,863 | \$ 215,273 |

Each fiscal quarter, Cadence analyzes the creditworthiness of its customers, historical experience, changes in customer demand and the overall economic climate in the industries that Cadence serves. Additionally, Cadence makes judgments as to its ability to collect outstanding receivables, and provides allowances for the portion of receivables when collection is not probable. Provisions are made based upon a specific review of customer receivables and are recorded in operating expenses. Cadence recorded recoveries of its allowance for doubtful accounts of \$0.7 million during the three months ended July 2, 2011 and \$5.9 million during the six months ended July 2, 2011 as a

result of collections on certain receivables that were included in Cadence's allowance for doubtful accounts as of January 1, 2011. Cadence recorded recoveries of its allowance for doubtful accounts of \$10.2 million during the three months ended July 3,

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2010 and \$12.7 million during the six months ended July 3, 2010 as a result of collections on certain receivables that were included in Cadence's allowance for doubtful accounts as of January 2, 2010.

Cadence's customers are primarily concentrated within the semiconductor sector. As of July 2, 2011, no single customer accounted for more than 10% of Cadence's total Receivables, net and Installment contract receivables. As of January 1, 2011, one customer accounted for 19% of Cadence's total Receivables, net and Installment contract receivables. As of July 2, 2011, approximately 40% of Cadence's total Receivables, net and Installment contract receivables were attributable to the ten customers with the largest balances of Receivables, net and Installment contract receivables. As of January 1, 2011, approximately half of Cadence's total Receivables, net and Installment contract receivables were attributable to the ten customers with the largest balances of Receivables, net and Installment contract receivables.

The following table presents the change in Cadence's allowance for doubtful accounts for the six months ended July 2, 2011:

| | As of January 1, 2011 | Addition Charged (Credited) to Costs and Expenses | Charged (Credited) to Other Accounts | Deductions (1) | As of July 2, 2011 |
|---------------------------------|-----------------------------|---|---|-------------------|--------------------------|
| Allowance for doubtful accounts | \$ 7,604 | \$ (5,885) | \$ ---- | \$ (972) | \$ 747 |

(1) Uncollectible accounts written-off, net of recoveries.

Cadence believes that its allowance for doubtful accounts is adequate, but Cadence will continue to monitor customer liquidity and other economic conditions, which may result in changes to Cadence's estimates regarding its allowance for doubtful accounts. The adequacy of the allowance for doubtful accounts is evaluated by Cadence at least quarterly, and any adjustments to the allowance for doubtful accounts resulting from these evaluations could be material to Cadence's Condensed Consolidated Financial Statements.

NOTE 9. INCOME TAXES

Cadence determined that uncertain tax positions that were subject to the Internal Revenue Service, or IRS, examination of Cadence's federal income tax returns for the tax years 2003 through 2005 were effectively settled during the three and six months ended July 2, 2011. Cadence recognized a benefit for income taxes of \$4.3 million during the three months ended July 2, 2011, including the impact of the effective settlement and the release of deferred tax asset valuation allowance, primarily resulting from the increase in deferred tax liabilities from the intangible assets held by the company acquired during the three months ended July 2, 2011, which was partially offset by tax expense on certain Cadence foreign subsidiaries and interest expense on unrecognized tax benefits. Cadence recognized a provision for income taxes of \$0.4 million during the six months ended July 2, 2011, including tax expense on certain Cadence foreign subsidiaries and interest expense on unrecognized tax benefits, which was mostly offset by the impact of the effective settlement and the \$5.0 million release of deferred tax asset valuation allowance primarily resulting from the increase in deferred tax liabilities from the intangible assets held by the company that was acquired during the three months ended July 2, 2011.

Table of Contents**Internal Revenue Service Examinations**

The IRS and other tax authorities regularly examine Cadence's income tax returns. Cadence's federal income tax returns beginning with the 2003 tax year remain subject to examination by the IRS.

In May 2009, the IRS completed its field examination of Cadence's federal income tax returns for the tax years 2003 through 2005 and issued a Revenue Agent's Report, or RAR, in which the IRS proposed to assess an aggregate deficiency for the three-year period of \$94.1 million. In August 2009, the IRS revised the proposed aggregate tax deficiency for the three-year period to \$60.7 million. The IRS contested Cadence's transfer pricing arrangements with its foreign subsidiaries and deductions for foreign trade income. In June 2011, the Appeals Office of the IRS, or the Appeals Office, provided Cadence with copies of the settlement agreements that were executed by the Appeals Office resolving the previously disputed tax positions. While the statute of limitations for the IRS to audit the tax returns remains open, Cadence considers the tax positions to be effectively settled because the IRS has completed its examination procedures and Cadence believes that there is a remote possibility that the IRS will re-examine the settled tax positions. As a result of this effective settlement, Cadence recognized a benefit for income taxes of \$5.7 million in the Condensed Consolidated Income Statements for the three and six months ended July 2, 2011.

The IRS is currently examining Cadence's federal income tax returns for the tax years 2006 through 2009.

The calculation of Cadence's provision (benefit) for income taxes requires significant judgment and involves dealing with uncertainties in the application of complex tax laws and regulations. In determining the adequacy of the provision (benefit) for income taxes, Cadence regularly assesses 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, Cadence cannot be certain that such amount will not be materially different from the amount that is reflected in its historical income tax provisions and accruals. Should the IRS or other tax authorities assess additional taxes as a result of the current or a future examination, Cadence may be required to record charges to operations in future periods that could have a material impact on its results of operations, financial position or cash flows in the applicable period or periods.

NOTE 10. NET INCOME PER SHARE

Basic net income per share is computed by dividing net income during the period by the weighted average number of shares of common stock outstanding, less unvested restricted stock awards. None of Cadence's outstanding grants of restricted stock contain nonforfeitable dividend rights. Diluted net income per share is impacted by 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 for the diluted net loss per share calculation.

Cadence accounts for the effect of the Convertible Senior Notes in diluted net income per share, using the if-converted method of accounting, under the assumption that the conversion spread, if any, will be settled in stock. Under that method, 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. During the three and six months ended July 2, 2011 and July 3, 2010, no shares are included in diluted net income per share for the Convertible Senior Notes.

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The calculations for basic and diluted net income per share for the three and six months ended July 2, 2011 and July 3, 2010 are as follows:

| | Three Months Ended | | Six Months Ended | |
|---|--|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In thousands, except per share amounts) | | | |
| Net income | \$ 26,908 | \$ 48,607 | \$ 33,231 | \$ 36,822 |
| Weighted average common shares used to calculate basic net income per share | 263,191 | 262,163 | 262,362 | 262,380 |
| 2023 Notes | 11 | 11 | 11 | 11 |
| Options | 3,766 | 1,482 | 3,487 | 1,275 |
| Restricted stock | 3,740 | 2,522 | 3,744 | 2,658 |
| Employee stock purchase plan (ESPP) | 177 | 245 | 128 | 215 |
| Weighted average common shares used to calculate diluted net income per share | 270,885 | 266,423 | 269,732 | 266,539 |
| Basic net income per share | \$ 0.10 | \$ 0.19 | \$ 0.13 | \$ 0.14 |
| Diluted net income per share | \$ 0.10 | \$ 0.18 | \$ 0.12 | \$ 0.14 |

The following table presents the potential shares of Cadence's common stock outstanding for the three and six months ended July 2, 2011 and July 3, 2010 that were excluded from the computation of diluted net income per share because the effect of including these shares in the computation of diluted net income per share would have been anti-dilutive:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In thousands) | | | |
| 2015 Warrants (various expiration dates through 2015) | 46,382 | 46,382 | 46,382 | 46,382 |
| Options to purchase shares of common stock (various expiration dates through 2021) | 18,812 | 22,209 | 18,564 | 23,441 |
| Convertible Senior Note Warrants (various expiration dates through 2014) | 14,184 | 14,184 | 14,184 | 14,184 |
| Non-vested shares of restricted stock | 9 | 2,156 | 25 | 3,460 |
| Total potential common shares excluded | 79,387 | 84,931 | 79,155 | 87,467 |

Table of Contents**NOTE 11. ACCUMULATED DEFICIT**

The changes in accumulated deficit for the three and six months ended July 2, 2011 were as follows:

| | Three Months Ended (In thousands) |
|------------------------------|---|
| Balance as of April 2, 2011 | \$ (1,139,018) |
| Net income | 26,908 |
| Reissuance of treasury stock | (2,737) |
| Balance as of July 2, 2011 | \$ (1,114,847) |

| | Six Months Ended (In thousands) |
|-------------------------------|---------------------------------------|
| Balance as of January 1, 2011 | \$ (1,138,853) |
| Net income | 33,231 |
| Reissuance of treasury stock | (9,225) |
| Balance as of July 2, 2011 | \$ (1,114,847) |

When treasury stock is reissued at a price higher than its cost, the difference is recorded as a component of Capital in excess of par in the Condensed Consolidated Balance Sheets. When treasury stock is reissued at a price lower than its cost, the difference is recorded as a component of Capital in excess of par to the extent that there are treasury stock gains to offset the losses. If there are no treasury stock gains in Capital in excess of par, the losses upon reissuance of treasury stock are recorded as a component of Accumulated deficit in the Condensed Consolidated Balance Sheets.

NOTE 12. OTHER COMPREHENSIVE INCOME

Other comprehensive income includes foreign currency translation gains and losses, unrealized gains and losses on available-for-sale marketable securities, and changes in defined benefit plan liabilities, net of related tax effects. These items have been excluded from net income and are reflected instead in Stockholders' Equity. Cadence's comprehensive income during the three and six months ended July 2, 2011 and July 3, 2010 was as follows:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In thousands) | | | |
| Net income | \$ 26,908 | \$ 48,607 | \$ 33,231 | \$ 36,822 |
| Foreign currency translation gain (loss), net of related tax effects | 5,725 | (5,117) | 5,605 | (3,913) |
| Changes in unrealized holding gains or losses on available-for-sale securities, net of reclassification adjustment for realized gains and losses and net of related tax effects | (7,709) | (314) | (8,078) | 704 |
| Changes in defined benefit plan liabilities, net of related tax effects | 45 | 42 | 13 | 98 |
| Comprehensive income | \$ 24,969 | \$ 43,218 | \$ 30,771 | \$ 33,711 |

Table of Contents**NOTE 13. STOCK REPURCHASE PROGRAMS**

Cadence's Board of Directors has authorized the following programs to repurchase shares of Cadence's common stock in the open market, which remained in effect on July 2, 2011:

| Authorization Date | Amount | Remaining Authorization |
|-------------------------------|------------|-------------------------|
| | | (In thousands) |
| February 2008 | \$ 500,000 | \$ 314,389 |
| August 2008 | \$ 500,000 | 500,000 |
| Total remaining authorization | | \$ 814,389 |

The shares repurchased under Cadence's stock repurchase programs and the total cost of repurchased shares during the three and six months ended July 2, 2011 and July 3, 2010 were as follows:

| | Three and Six Months Ended | |
|----------------------------------|----------------------------|--------------|
| | July 2, 2011 | July 3, 2010 |
| | (In thousands) | |
| Shares repurchased | --- | 6,493 |
| Total cost of repurchased shares | \$ --- | \$ 39,997 |

NOTE 14. CONTINGENCIES**Legal Proceedings**

From time to time, Cadence is involved in various disputes and litigation that arise in the ordinary course of business. These include disputes and lawsuits related to intellectual property, indemnification obligations, 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. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based on Cadence's judgments using 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.

During fiscal 2008, three complaints were filed in the United States District Court for the Northern District of California, or District Court, 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*. On March 4, 2009, the District Court entered an order consolidating these three complaints and captioning the consolidated case *In re Cadence Design Systems, Inc. Securities Litigation*. The District Court also named a lead plaintiff and lead counsel for the consolidated litigation. The lead plaintiff filed its consolidated amended complaint on April 24, 2009, naming Cadence, Michael J. Fister, Kevin S. Palatnik, William Porter and Kevin Bushby as defendants, and alleging violations of Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated

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thereunder, on behalf of a purported class of purchasers of Cadence's common stock who traded Cadence's common stock between April 23, 2008 and December 10, 2008, or the Alleged Class Period. The amended complaint alleged that Cadence and the individual defendants made statements during the Alleged Class Period regarding Cadence's financial results that were false and misleading because Cadence had recognized revenue that should have been recognized in subsequent periods. The amended complaint requested certification of the action as a class action, unspecified damages, interest and costs, and unspecified equitable relief. On June 8, 2009, Cadence and the other defendants filed a motion to dismiss the amended complaint. On September 11, 2009, the District Court held that the plaintiffs had failed to allege a valid claim under the relevant legal standards and granted the defendants' motion to dismiss the amended complaint. The District Court gave the plaintiffs leave to file another amended complaint, and the plaintiffs did so on October 13, 2009. The amended complaint filed on October 13, 2009 names the same defendants, asserts the same causes of action, and seeks the same relief as the earlier amended complaint. Cadence moved to dismiss the October 13, 2009 amended complaint. The District Court denied the motion to dismiss on March 2, 2010. On July 7, 2010, the parties agreed, and the District Court ordered, that the litigation be stayed in order to facilitate mediation. On February 11, 2011, the parties to the securities litigation agreed to settle the securities litigation for consideration of \$38.0 million, of which approximately \$22.2 million will be paid by Cadence's insurance carriers, with the balance to be paid by Cadence. Cadence agreed to this settlement without admitting any wrongdoing on the part of the company or any of its current or former directors or executive officers, and the settlement is subject to approval by the District Court.

During the three months ended July 2, 2011, Cadence paid \$16.4 million into a securities litigation settlement fund, which amount included Cadence's portion of the settlement consideration of \$15.8 million and \$0.6 million of accrued interest. As of July 2, 2011, \$6.7 million had been paid into the securities litigation settlement fund by Cadence's insurance carriers. Subsequent to July 2, 2011, Cadence's insurance carriers paid the remaining \$15.5 million into the securities litigation settlement fund.

During fiscal 2008, two derivative complaints were filed in Santa Clara County Superior Court, or Superior Court. The first was filed on November 20, 2008, 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 consolidated securities class action lawsuits described above, and the claims also include allegations that the individual defendants approved compensation based on inflated financial results. The plaintiffs request unspecified damages, restitution, equitable relief and their reasonable attorneys fees, experts' fees, costs and expenses on behalf of Cadence against the individual defendants. A motion to consolidate these complaints was granted on January 20, 2009, and the cases were captioned *In re Cadence Design Systems, Inc. Derivative Litigation*. The consolidated cases were then stayed by agreement of the parties. The plaintiffs filed a consolidated amended derivative complaint on June 1, 2010. The consolidated amended derivative complaint names as defendants Cadence (as a nominal defendant), James S. Miller, R.L. Smith McKeithen, John B. Shoven, Lip-Bu Tan, Alberto Sangiovanni-Vincentelli, Donald L. Lucas, Sr., Roger S. Siboni, George Scalise, Michael J. Fister, John A.C. Swainson, Kevin S. Palatnik, William Porter and Kevin Bushby. The consolidated amended derivative complaint alleges purported causes of action for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment (which is asserted against certain defendants). Many of the factual allegations of the consolidated amended derivative complaint are similar to those alleged in the First

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Amended Complaint in the securities class action case described above. In addition, the claims include allegations that the director defendants made inappropriate personnel decisions with respect to the former officers and that the former officers were unjustly enriched. The consolidated derivative complaint seeks unspecified monetary damages and equitable relief, disgorgement of profits and compensation, and costs and attorneys' fees.

On April 28, 2010, a derivative complaint was filed in the District Court, captioned Walter Hamilton, derivatively on behalf of nominal defendant Cadence Design Systems, Inc. v. Michael J. Fister, William Porter, James S. Miller, Jr., Kevin Bushby, R.L. Smith McKeithen, Lip-Bu Tan, Alberto Sangiovanni-Vincentelli, John B. Shoven, Donald L. Lucas, George M. Scalise, Roger S. Siboni, John A.C. Swainson and KPMG LLP. This complaint purports to bring suit derivatively, on behalf of Cadence, against certain of Cadence's current and former officers and directors for breach of fiduciary duty, abuse of control, gross mismanagement, and waste of corporate assets, against the former executive defendants for unjust enrichment, and against Cadence's independent auditors for professional negligence and breach of contract. Many of the allegations underlying these claims are similar or identical to the allegations in the consolidated securities class action lawsuits described above. In addition, the claims include allegations that the director defendants made inappropriate personnel decisions with respect to the former officers and that the former officers were unjustly enriched, as well as allegations that Cadence's independent auditors performed allegedly inadequate audits. The complaint seeks unspecified monetary relief, injunctive relief relating to certain corporate governance matters, and attorneys' costs and fees. On June 28, 2010, the plaintiff dismissed Cadence's independent auditors from the case, without prejudice.

On August 17, 2010, two complaints were filed in the District Court: one captioned George Powers, derivatively on behalf of Cadence Design Systems, Inc. v. Michael J. Fister, Kevin Bushby, R.L. Smith McKeithen, James S. Miller, Jr., William Porter, James J. Cowie, Kevin S. Palatnik, John B. Shoven, PhD, Donald L. Lucas and Roger S. Siboni; the other captioned Arash Samani, derivatively on behalf of Cadence Design Systems, Inc. v. Michael J. Fister, Kevin Bushby, R.L. Smith McKeithen, James S. Miller, Jr., William Porter, James J. Cowie, Kevin S. Palatnik, John B. Shoven, PhD, Donald L. Lucas and Roger S. Siboni. These complaints are virtually identical to one another, and purport to bring suit derivatively, on behalf of Cadence, against certain of Cadence's current and former officers and directors for breach of fiduciary duty. Many of the allegations underlying this claim are similar or identical to the allegations in the consolidated securities class action lawsuits described above. The complaints seek unspecified monetary and equitable relief, as well as attorneys' fees and costs.

These cases were stayed while the parties participated in the mediation process. On February 8, 2011, the parties to these derivative cases agreed to settle all of them in exchange for certain corporate governance changes that Cadence has agreed to put in place, along with an agreement that an application by plaintiffs' counsel to the Court for an attorneys' fee of approximately \$1.8 million is appropriate. The fee will be paid by Cadence's insurance carriers if it is approved by the court. Cadence agreed to this settlement without admitting any wrongdoing on the part of the company or any of its current or former directors or executive officers. This settlement is subject to court approval.

Other Contingencies

Cadence provides its customers with a warranty on sales of hardware products, generally for a 90-day period. Cadence did not incur any significant costs related to warranty obligations during the three and six months ended July 2, 2011 and July 3, 2010.

Cadence's product license and services agreements typically include a limited indemnification provision for claims from third parties relating to Cadence's intellectual property. If the potential loss from

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any indemnification claim is considered probable and the amount or the range of loss can be estimated, Cadence accrues a liability for the estimated loss. The indemnification is generally limited to the amount paid by the customer. Cadence did not incur any losses from indemnification claims in the three and six months ended July 2, 2011 and July 3, 2010.

NOTE 15. STATEMENT OF CASH FLOWS

The supplemental cash flow information for the six months ended July 2, 2011 and July 3, 2010 is as follows:

| | Six Months Ended | |
|--|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 |
| | (In thousands) | |
| Cash Paid During the Period for: | | |
| Interest | \$ 6,708 | \$ 3,594 |
| Income taxes, including foreign withholding tax | \$ 9,209 | \$ 7,052 |
| Non-cash Investing and Financing Activities: | | |
| Stock options assumed for acquisition | \$ 1,600 | \$ ---- |
| Available-for-sale securities received from customer | \$ 160 | \$ ---- |

NOTE 16. OTHER INCOME (EXPENSE), NET

Cadence's Other income (expense), net, for the three and six months ended July 2, 2011 and July 3, 2010 was as follows:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In thousands) | | | |
| Interest income | \$ 324 | \$ 302 | \$ 697 | \$ 550 |
| Gains on sale of marketable securities | 7,979 | ---- | 8,044 | ---- |
| Gains on sale of non-marketable securities | 108 | 242 | 2,729 | 4,756 |
| Gains on trading securities in the NQDC trust | 1,177 | 1,102 | 2,912 | 2,179 |
| Gains (losses) on foreign exchange | (1,246) | 1,998 | (1,725) | 2,190 |
| Equity losses from investments | (35) | (46) | (65) | (73) |
| Write-down of investments | ---- | (1,500) | ---- | (1,500) |
| Loss on early extinguishment of debt (Note 2) | ---- | (5,321) | ---- | (5,321) |
| Other income | 87 | 123 | 271 | 93 |
| Total Other income (expense), net | \$ 8,394 | \$ (3,100) | \$ 12,863 | \$ 2,874 |

During the three and six months ended July 2, 2011, Cadence recorded gains of \$8.0 million on the sale of available-for-sale securities. During the six months ended July 2, 2011, Cadence recorded a gain of \$2.7 million on the sale of an equity method investment. During the six months ended July 3, 2010, Cadence recorded gains totaling \$4.8 million on the liquidation of five cost method investments.

It is Cadence's policy to review the fair value of its investment 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. Cadence determined that, as of July 2, 2011, none of its investment securities were other-than-temporarily impaired.

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During the three and six months ended July 3, 2010, Cadence determined that certain of its non-marketable securities were other-than-temporarily impaired and Cadence wrote down these investments by \$1.5 million.

NOTE 17. SEGMENT REPORTING

Segment reporting requires disclosures of certain information regarding reportable segments, products and services, geographic areas of operation and major customers. Segment reporting is based on the management approach : how management organizes the company s reportable segments for which separate financial information is (i) available and (ii) evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Cadence s chief operating decision maker is its President and Chief Executive Officer, or CEO. Cadence s CEO reviews Cadence s consolidated results as one reportable segment. In making operating decisions, the CEO primarily considers consolidated financial information, accompanied by disaggregated information about revenues by geographic region.

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

The following table presents a summary of revenue by geography for the three and six months ended July 2, 2011 and July 3, 2010:

| | Three Months Ended | | Six Months Ended | |
|--------------------------------------|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In thousands) | | | |
| Americas: | | | | |
| United States | \$ 124,191 | \$ 94,648 | \$ 236,210 | \$ 177,297 |
| Other Americas | 8,200 | 8,352 | 13,341 | 13,495 |
| Total Americas | 132,391 | 103,000 | 249,551 | 190,792 |
| Europe, Middle East and Africa: | | | | |
| Germany | 9,319 | 22,706 | 21,044 | 36,882 |
| Other Europe, Middle East and Africa | 47,139 | 30,240 | 91,690 | 65,278 |
| Total Europe, Middle East and Africa | 56,458 | 52,946 | 112,734 | 102,160 |
| Japan | 49,194 | 31,822 | 99,359 | 82,875 |
| Asia | 45,227 | 39,296 | 87,728 | 73,175 |
| Total | \$ 283,270 | \$ 227,064 | \$ 549,372 | \$ 449,002 |

No one customer accounted for 10% or more of total revenue during the three and six months ended July 2, 2011 and July 3, 2010.

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The following table presents a summary of long-lived assets by geography as of July 2, 2011 and January 1, 2011:

| | As of July 2, 2011 | As of January 1, 2011 |
|--------------------------------------|--------------------------|-----------------------------|
| | (In thousands) | |
| Americas: | | |
| United States | \$ 238,637 | \$ 254,113 |
| Other Americas | 52 | 34 |
| Total Americas | 238,689 | 254,147 |
| Europe, Middle East and Africa: | | |
| Germany | 933 | 773 |
| Other Europe, Middle East and Africa | 4,473 | 5,568 |
| Total Europe, Middle East and Africa | 5,406 | 6,341 |
| Japan | 4,330 | 4,532 |
| Asia | 19,333 | 20,095 |
| Total | \$ 267,758 | \$ 285,115 |

Table of Contents**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 January 1, 2011. Certain of these statements, including, but not limited to, 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, forecasts, intends, may, plans, projects, 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, hardware, and design intellectual property, or IP. We license software and design IP, sell or lease hardware technology, provide maintenance for our software, design IP and hardware and provide engineering and education services throughout the world to help manage and accelerate product development processes for electronics. Our customers use our products and services to design and develop complex integrated circuits, or ICs, and electronics systems.

We primarily generate revenue from licensing our EDA software and design IP, selling or leasing our hardware technology, providing maintenance for our products and providing engineering services. Substantially all of our revenue is generated from IC and electronics systems manufacturers and designers 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.

In 2010, the semiconductor industry grew significantly as global economic conditions improved and consumer demand for electronic products improved as a result. While the EDA industry benefited from this improved environment, EDA customers remained cautious about making substantial new EDA expenditures. The semiconductor industry is forecasted to grow modestly for the remainder of 2011, and we believe that spending on EDA offerings may also grow modestly as customers invest in new projects.

Electronics companies demand ever higher levels of productivity from their design teams, better predictability in their development schedules and higher quality products in order to be competitive and profitable in the price-conscious markets they serve. Electronics companies are responding to demand for increased functionality and miniaturization by combining subsystems such as radio frequency, or RF,

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wireless communication, video signal processing and microprocessors onto a single silicon chip, creating a system-on-chip, or SoC, or multiple chips into a single chip package in a format referred to as system-in-package, or SiP. These trends toward subsystem integration have required chip makers to find solutions to challenges previously addressed by system companies, such as verifying system-level functionality and hardware-software interoperability.

Our offerings address many of the challenges associated with developing unique silicon circuitry, integrating original circuitry with design IP developed by third parties to create SoCs, and combining ICs and SoCs with software to create electronic systems. Our strategy is to provide our customers with the ability to address the broad range of issues that arise at the silicon, SoC, and system levels. In 2010, we published our vision for the industry, called EDA360, which describes in detail the challenges and opportunities in EDA. The most significant issues that our customers face in creating their products include optimizing energy consumption, manufacturing microscopic circuitry, verifying device functionality, and achieving technical performance targets, all while meeting aggressive cost requirements.

These issues are becoming more complex as requirements for performance, size, cost, and features evolve across the full spectrum of electronics products, such as smart phones, tablets, televisions, communications and internet infrastructure, and computing platforms. Providers of EDA solutions must deliver products that address these technical challenges while improving the productivity, predictability, reliability and profitability of the design processes and products of their customers.

We combine our products and technologies into platforms for four major design activities:

Functional Verification and Design IP;

Digital IC Design and Implementation;

Custom IC Design and Verification; and

System Interconnect Design.

The four Cadence® design platforms are branded as Incisive® functional verification, Encounter® digital IC design, Virtuoso® custom design and Allegro® system interconnect design. 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. Our functional verification offerings include both design IP and verification IP.

The products and technologies that comprise our platforms are combined with services, ready-to-use packages of technologies assembled from our broad portfolio and other associated components that provide comprehensive solutions for low power, mixed signal, enterprise verification and advanced node designs. These solutions and their constituent elements are marketed to users who specialize in areas such as system design and verification, functional verification, logic design, digital implementation, custom IC design and printed circuit board, or PCB, and IC package and SiP design.

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 further below under the heading Results of Operations and Liquidity and Capital Resources.

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 (loss) and net income, as

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well as on the value of certain assets and liabilities on our Condensed Consolidated Balance Sheets. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. At least quarterly, we evaluate our assumptions, judgments and estimates and make changes accordingly. Historically, our assumptions, judgments and estimates relative to our critical accounting estimates have not differed materially from actual results. For further information about our 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 January 1, 2011.

On January 2, 2011, we adopted new accounting standards prospectively for multiple element arrangements, or MEAs, and for revenue arrangements that include both hardware and software elements. As such, additional assumptions, judgments and estimates are now required in the accounting for revenue recognition, which are described below.

Revenue Recognition

We begin to recognize revenue from licensing and supporting our software, IP and hardware products when all of the following criteria are met:

We have persuasive evidence of an arrangement with a customer;

Delivery of all specified products has occurred;

The fee for the arrangement is considered to be fixed or determinable, at the outset of the arrangement;
and

Collectibility of the fee is probable.

Significant judgment is involved in the determination of whether the facts and circumstances of an arrangement support that the fee for the arrangement is considered to be fixed or determinable and that collectibility of the fee is probable, and these judgments can affect the amount of revenue that we recognize in a particular reporting period. We must also make these judgments when assessing whether a contract amendment to a term arrangement (primarily in the context of a license extension or renewal) constitutes a concession. Our experience has been that we are able to determine whether a fee is fixed or determinable for term licenses and we have established a history of collecting under the original contract without providing concessions on payments, products or services.

For installment contracts that do not include a substantial up-front payment, we consider that a fee is fixed or determinable only if the arrangement has payment periods that are equal to or less than the term of the licenses and the payments are collected in equal or nearly equal installments, when evaluated over the entire term of the arrangement. While we do not expect our experience to change, if we no longer were to have a history of collecting under the original contract without providing concessions on term licenses, revenue from term licenses would be required to be recognized when payments under the installment contract become due and payable. Such a change could have a material adverse effect on our results of operations.

Our experience has been that we are generally able to estimate whether collection is probable. Significant judgment is applied as we assess the creditworthiness of our customers to make this determination. If our experience were to change, such a change could have a material adverse effect on our results of operations. If, in our judgment, collection of a fee is not probable, we defer the revenue until the uncertainty is removed, which generally means revenue is recognized upon receipt of cash payment from the customer.

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An MEA is any arrangement that includes or contemplates rights to a combination of software or hardware products, software license types, services, training or maintenance in a single arrangement. From time to time, we may include individual deliverables in separately priced and separately executed contracts with the same customer. We evaluate all relevant facts and circumstances in determining whether the separate contracts should be accounted for individually as distinct arrangements or whether the separate contracts are, in substance, an MEA. Significant judgment can be involved in determining whether a group of contracts might be so closely related that they are, in effect, part of a single arrangement.

For a single transaction or MEA that includes software and nonsoftware elements, we allocate consideration to all deliverables based on their relative standalone selling prices. In these circumstances, there is a hierarchy to determine the standalone selling price to be used for allocating consideration to deliverables as follows:

Vendor-specific objective evidence of fair value, or VSOE;

Third-party evidence of selling price, or TPE; and

Best estimate of the selling price, or ESP.

For MEAs that contain software and nonsoftware elements, we allocate the consideration to software or software-related elements as a group, and to any nonsoftware element separately based on the standalone selling price hierarchy. The consideration allocated to each element is then recognized as revenue when the basic revenue recognition criteria are met for each element. Once the consideration is allocated to the group of software and software-related elements, it then follows the recognition principles of pre-existing software accounting guidance.

We have established VSOE for certain service offerings based upon the pricing of these elements when sold separately. VSOE for maintenance is based upon the customer's stated annual renewal rate. We have not established VSOE for any of our products, for annual maintenance that is not cancellable by the customer, or for maintenance of less than 12 months.

TPE is determined based on competitor prices for similar deliverables when sold separately. Generally, our offerings contain significant differentiation such that comparable pricing of products with similar functionality cannot be obtained. Furthermore, we are unable to reliably determine the selling prices for similar competitor products on a stand-alone basis. Therefore, we typically are not able to obtain TPE and it is not used to determine any standalone selling prices.

We calculate the ESP of our hardware products based on our pricing practices, including the historical average prices charged for comparable hardware products. Our process for determining ESP for our software deliverables without VSOE or TPE takes into account multiple factors that vary depending upon the unique facts and circumstances related to each deliverable. Key external and internal factors considered in developing the ESPs include, but are not limited to, prices charged by us for similar arrangements, historical pricing practices and the nature of the product. In addition, when developing ESPs, we may consider other factors as appropriate, including the pricing of competitive alternatives if they exist, and product-specific business objectives.

We generally have a minimum of two deliverables contained in arrangements involving the sale of our hardware. The first deliverable is the hardware product and software essential to the functionality of the hardware product delivered at the time of sale, and the second deliverable is the right to receive maintenance on the hardware product and the hardware product's essential software. We allocate consideration between these deliverables based on the relative standalone selling price for each deliverable. Consideration allocated to the hardware product and the related essential software are recognized as revenue at the time of delivery

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provided all other conditions for revenue recognition have been met. Consideration allocated to the maintenance is deferred and recognized as revenue on a straight-line basis over the respective maintenance terms.

We account for MEAs that consist only of software or software-related products in accordance with industry-specific accounting guidance for software and software-related transactions. If VSOE of all undelivered elements exists, the consideration is allocated using the residual method. Under the residual method, the consideration allocated to the undelivered elements is deferred and the remaining portion of the arrangement fee is recognized up-front as the software products are delivered. If VSOE does not exist for all elements to support the allocation of the total fee among all elements of the arrangement, or if VSOE does not exist for all undelivered elements to apply the residual method, revenue is recognized ratably over the term of the undelivered elements.

For our subscription licenses, including our eDA Platinum Cards, the software license agreements typically combine the right to use specified software products, the right to maintenance, and the right to receive and use for no additional fee unspecified future software products, when and if available, during the term of the license agreement. Under these license agreements, when all four of the revenue recognition criteria outlined above are met, we recognize revenue ratably over the term of the license agreement beginning with delivery of the products. Subscription license revenue is allocated to product and maintenance revenue. The allocation to maintenance revenue is based on the average substantive renewal rates included in the sale of similar term license arrangements. In the event that the license fee for this type of arrangement is not considered to be fixed or determinable at the outset of the arrangement, we recognize revenue at the lesser of (i) the pro-rata portion of the license fee for the applicable period, or (ii) as payments from the customer become due (if all other conditions for revenue recognition have been satisfied).

For term and perpetual licenses that include a stated annual maintenance renewal rate, including our eDA Gold Cards, software license fees are recognized as up-front revenue when all four of the revenue recognition criteria outlined above are met, generally upon delivery, and the maintenance fees are recognized ratably over the term of the maintenance period. Under our current business model, a relatively small percentage of our revenue from software licenses is recognized on an up-front basis.

License agreements under which license fees are recognized up-front do not include the right to receive unspecified future products. However, when such license agreements are executed with the same customer within close proximity or in contemplation of other license agreements that require ratable revenue recognition, the licenses together may be deemed an MEA, in which event all such revenue is recognized over multiple periods.

Revenue from services contracts is recognized either on the time and materials method, as work is performed, or on the percentage-of-completion method. For contracts with fixed or not-to-exceed fees, we estimate on a monthly basis the percentage of completion based on the completion of milestones relating to the arrangement. We have a history of accurately estimating project status and the costs necessary to complete projects. A number of internal and external factors can affect our estimates, including labor rates, utilization and efficiency variances, and specification and testing requirement changes. If different conditions were to prevail such that accurate estimates could not be made, then the use of the completed contract method would be required and the recognition of all revenue and costs would be deferred until the project was completed. Such a change could have a material impact on our results of operations.

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Results of Operations

Financial results for the three and six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010, reflect the following:

An increase in revenue because of:

Higher business levels due to the timing of contract renewals with existing customers;

Increased revenue recognized from bookings in prior quarters from our continuing transition to a ratable license mix and a decrease in the average contract duration;

Increases in the sale and lease of our hardware products; and

Our acquisition of Denali in the second quarter of fiscal 2010.

An increase in employee-related costs for commissions and other employee incentive compensation primarily resulting from improving business levels during the three and six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010, partially offset by decreased costs as a result of our prior year restructuring plans;

An increase in the cost of hardware products sold due to increases in the sale and lease of our hardware products;

An increase in operating expenses, primarily research and development, related to the acquisition of Denali; and

The increase in deferred tax liabilities from the intangible assets acquired with Denali and the resulting benefit for income taxes because of the release of valuation allowance against our deferred tax assets during the three months ended July 3, 2010.

Revenue

We primarily generate revenue from licensing our EDA software and design IP, selling or leasing our hardware technology, providing maintenance for our software, design IP and hardware and providing engineering services. We principally use 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.

The timing of our product revenue is significantly affected by the mix of orders executed in any given period. For some orders, such as subscription orders, product and maintenance revenue is recognized ratably over multiple periods. In addition, depending on the individual facts and circumstances of a particular order, we have some orders for which product and maintenance revenue is recognized as payments become due and some for which revenue is only recognized when payment is received. For other orders, all product revenue is recognized up-front in the same quarter in which the order is executed.

We seek to achieve a mix of bookings with approximately 90% of the aggregate value of our bookings of a type for which the revenue is recurring, or ratable, in nature, and approximately 10% of the resulting revenue recognized up-front, upon completion of delivery. Our ability to achieve this 90% to 10% ratio of ratable to up-front may be impacted by an increase in hardware sales beyond our current expectations. For an additional description of the impact of hardware sales on the anticipated mix of bookings, see the discussion under the heading **Critical Accounting Estimates Revenue Recognition** above, and Note 3 to our Condensed Consolidated Financial Statements.

During the three and six months ended July 2, 2011, and July 3, 2010, over 90% of the aggregate value of our bookings was of a type for which the revenue is recurring, or ratable, in nature.

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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. Historically, larger customers generally have used products from two or more of our five product groups and rarely completely terminated their relationship with us upon expiration of the license. See the discussion under the heading **Critical Accounting Estimates Revenue Recognition** above for an 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;

Timing of contract renewals with existing customers;

Length of our sales cycle; and

Size, duration, terms and type of:

Contract renewals with existing customers;

Additional sales to existing customers; and

Sales to new customers.

The value and renewal of contracts, and consequently product revenue recognized, are 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 by the extent to which contracts contain flexible payment terms.

Revenue by Period

The following table shows our revenue for the three and six months ended July 2, 2011 and July 3, 2010 and the change in revenue between periods:

| | Three Months Ended | | | Six Months Ended | | |
|---------------|--------------------|-----------------|---------|------------------|-----------------|----------|
| | July 2, 2011 | July 3, 2010 | Change | July 2, 2011 | July 3, 2010 | Change |
| | (In millions) | | | | | |
| Product | \$ 157.9 | \$ 117.1 | \$ 40.8 | \$ 299.8 | \$ 219.8 | \$ 80.0 |
| Services | 29.5 | 25.3 | 4.2 | 57.3 | 51.2 | 6.1 |
| Maintenance | 95.9 | 84.7 | 11.2 | 192.3 | 178.0 | 14.3 |
| Total revenue | \$ 283.3 | \$ 227.1 | \$ 56.2 | \$ 549.4 | \$ 449.0 | \$ 100.4 |

Product revenue increased during the three and six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010, primarily because of higher business levels due to the timing of contract renewals with existing customers, increased revenue recognized from bookings in prior quarters from our continuing transition to a ratable license mix and a decrease in the average contract duration, an increase in revenue related to the sale and lease of our hardware products and an increase in revenue due to our acquisition of Denali in the second quarter of fiscal 2010.

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Services revenue increased during the three and six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010, primarily because of cash collections from customers for which revenue is recognized upon receipt of cash payment and higher utilization rates for our services personnel.

We adopted new revenue recognition accounting standards on the first day of fiscal 2011 for revenue arrangements that include both hardware and software elements. If we had accounted for arrangements entered into on or after January 2, 2011 under the pre-existing accounting standards, revenue for the three months ended July 2, 2011 would have been \$3.1 million more than reported and revenue for the six months ended July 2, 2011 would have been \$2.1 million less than reported. See Note 3 to our Condensed Consolidated Financial Statements for an additional description of our adoption of these accounting standards.

Revenue by Product Group

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

| | Three Months Ended | | | | |
|---------------------------------------|--------------------|------------------|-----------------------|-----------------------|-----------------|
| | July 2, 2011 | April 2, 2011 | January 1, 2011 | October 2, 2010 | July 3, 2010 |
| Functional Verification and Design IP | 33% | 28% | 22% | 25% | 26% |
| Digital IC Design | 21% | 24% | 26% | 23% | 21% |
| Custom IC Design | 22% | 20% | 27% | 24% | 26% |
| System Interconnect | 8% | 10% | 8% | 10% | 10% |
| Design for Manufacturing | 6% | 8% | 7% | 8% | 6% |
| Services and other | 10% | 10% | 10% | 10% | 11% |
| Total | 100% | 100% | 100% | 100% | 100% |

As described in Note 2 to our Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011, certain of our licensing arrangements allow customers the ability to remix among software products. Additionally, we have arrangements with customers that include a combination of our products 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. The actual usage of our products by these customers may differ and, if that proves to be the case, the revenue allocation in the table above would differ.

The increase in the percentage of revenue contributed by the Functional Verification product group during the three months ended July 2, 2011, as compared to the three months ended April 2, 2011, is due to an increase in revenue related to the sale and lease of our hardware products during the three months ended July 2, 2011.

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 onset of the arrangement.

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| | Three Months Ended | | | Six Months Ended | | |
|--------------------------------|--------------------|-----------------|---------|------------------|-----------------|----------|
| | July 2, 2011 | July 3, 2010 | Change | July 2, 2011 | July 3, 2010 | Change |
| | (In millions) | | | | | |
| United States | \$ 124.2 | \$ 94.7 | \$ 29.5 | \$ 236.2 | \$ 177.3 | \$ 58.9 |
| Other Americas | 8.2 | 8.4 | (0.2) | 13.3 | 13.5 | (0.2) |
| Europe, Middle East and Africa | 56.5 | 52.9 | 3.6 | 112.8 | 102.1 | 10.7 |
| Japan | 49.2 | 31.8 | 17.4 | 99.4 | 82.9 | 16.5 |
| Asia | 45.2 | 39.3 | 5.9 | 87.7 | 73.2 | 14.5 |
| Total revenue | \$ 283.3 | \$ 227.1 | \$ 56.2 | \$ 549.4 | \$ 449.0 | \$ 100.4 |

The increase in revenue in the United States and Japan is primarily due to higher business levels due to the timing of contract renewals with existing customers in the United States and Japan, increased revenue recognized from bookings in prior quarters from our continuing transition to a ratable license mix, an increase in revenue related to the sale and lease of our hardware products and an increase in revenue due to our acquisition of Denali in the second quarter of fiscal 2010. The increase in revenue in Asia is primarily due to the economic growth in the region, resulting in increased business levels and cash collections.

Revenue by Geography as a Percent of Total Revenue

| | Three Months Ended | | Six Months Ended | |
|--------------------------------|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| United States | 44% | 42% | 43% | 40% |
| Other Americas | 3% | 4% | 2% | 3% |
| Europe, Middle East and Africa | 20% | 23% | 21% | 23% |
| Japan | 17% | 14% | 18% | 18% |
| Asia | 16% | 17% | 16% | 16% |
| Total | 100% | 100% | 100% | 100% |

No one customer accounted for 10% or more of total revenue during the three and six months ended July 2, 2011 and July 3, 2010.

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 and reduced revenue in periods when the United States dollar strengthens against the Japanese yen. For an 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 – Foreign Currency Risk.**

Table of Contents**Stock-based Compensation Expense Summary**

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

| | Three Months Ended | | Six Months Ended | |
|----------------------------|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In millions) | | | |
| Cost of product | \$ ---- | \$ ---- | \$ 0.1 | \$ 0.1 |
| Cost of services | 0.5 | 0.5 | 0.9 | 1.0 |
| Cost of maintenance | 0.3 | 0.3 | 0.6 | 0.7 |
| Marketing and sales | 2.7 | 2.4 | 4.8 | 4.6 |
| Research and development | 4.1 | 4.5 | 7.9 | 8.9 |
| General and administrative | 2.7 | 2.7 | 5.4 | 5.5 |
| Total | \$ 10.3 | \$ 10.4 | \$ 19.7 | \$ 20.8 |

Cost of Revenue

| | Three Months Ended | | | Six Months Ended | | |
|-------------|--------------------|-----------------|----------|------------------|-----------------|----------|
| | July 2, 2011 | July 3, 2010 | Change | July 2, 2011 | July 3, 2010 | Change |
| | (In millions) | | | | | |
| Product | \$ 20.1 | \$ 7.1 | \$ 13.0 | \$ 34.3 | \$ 12.4 | \$ 21.9 |
| Services | \$ 20.6 | \$ 21.6 | \$ (1.0) | \$ 40.7 | \$ 43.5 | \$ (2.8) |
| Maintenance | \$ 10.7 | \$ 10.5 | \$ 0.2 | \$ 21.6 | \$ 21.9 | \$ (0.3) |

The following table shows cost of revenue as a percentage of related revenue for the three and six months ended July 2, 2011 and July 3, 2010:

| | Three Months Ended | | Six Months Ended | |
|-------------|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| Product | 13% | 6% | 11% | 6% |
| Services | 70% | 85% | 71% | 85% |
| Maintenance | 11% | 12% | 11% | 12% |

Cost of Product

Cost of product includes costs associated with the sale and lease of our hardware and licensing of our software and design IP products. Cost of product associated with our hardware products 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 and design IP products. Cost of product also 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.

A summary of Cost of product is as follows:

| | Three Months Ended | | Six Months Ended | |
|--------------------------------------|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In millions) | | | |
| Product related costs | \$ 17.6 | \$ 6.5 | \$ 29.6 | \$ 11.2 |
| Amortization of acquired intangibles | 2.5 | 0.6 | 4.7 | 1.2 |

| | | | | |
|-----------------------|---------|--------|---------|---------|
| Total Cost of product | \$ 20.1 | \$ 7.1 | \$ 34.3 | \$ 12.4 |
|-----------------------|---------|--------|---------|---------|

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Cost of product increased by \$13.0 million during the three months ended July 2, 2011, as compared to the three months ended July 3, 2010, and increased by \$21.9 million during the six months ended July 2, 2011, as compared to the six months ended July 3, 2010, due to the following:

| | Change | |
|---|----------------|----------------|
| | Three Months | Six Months |
| | (In millions) | |
| Hardware costs | \$ 10.2 | \$ 16.4 |
| Amortization of acquired intangibles | 1.9 | 3.5 |
| Salary, benefits and other employee-related costs | 0.8 | 1.7 |
| Other individually insignificant items | 0.1 | 0.3 |
| Total change in Cost of product | \$ 13.0 | \$ 21.9 |

Hardware costs increased during the three and six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010, primarily due to an increase in hardware revenue. Although we expect hardware revenue and costs to remain above historical levels for the remainder of fiscal 2011, we expect hardware revenue and costs to decline from the levels experienced during the three and six months ended July 2, 2011. Amortization of acquired intangibles included in Cost of product increased during the three and six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010, primarily due to amortization of intangible assets associated with the Denali acquisition.

Cost of product depends primarily upon the actual mix of hardware and software product sales in any given period, and 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.

Cost of Services

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. Cost of services decreased by \$1.0 million during the three months ended July 2, 2011 as compared to the three months ended July 3, 2010, and decreased by \$2.8 million during the six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010, primarily due to a decrease in employee salary, benefits and other employee-related costs.

Cost of Maintenance

Cost of maintenance includes the cost of customer services, such as telephonic and on-site support, employee salary, benefits and other employee-related costs, and documentation of maintenance updates, as well as amortization of intangible assets directly related to our maintenance contracts. There were no significant changes in Cost of maintenance during the three and six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010.

Operating Expenses

| | Three Months Ended | | | Six Months Ended | | |
|---------------------------------|--------------------|-----------------|----------------|------------------|-----------------|----------------|
| | July 2, 2011 | July 3, 2010 | Change | July 2, 2011 | July 3, 2010 | Change |
| | (In millions) | | | | | |
| Marketing and sales | \$ 77.0 | \$ 71.5 | \$ 5.5 | \$ 155.4 | \$ 146.3 | \$ 9.1 |
| Research and development | 99.3 | 91.9 | 7.4 | 200.6 | 181.3 | 19.3 |
| General and administrative | 25.4 | 17.1 | 8.3 | 44.7 | 39.9 | 4.8 |
| Total operating expenses | \$ 201.7 | \$ 180.5 | \$ 21.2 | \$ 400.7 | \$ 367.5 | \$ 33.2 |

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The increase in our operating expenses during the three and six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010, is primarily due to higher employee-related costs, including the additional costs related to our acquisition of Denali, which primarily affected our Research and development expenses. The increase is also due to recording fewer recoveries of allowances for doubtful accounts during the three and six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010.

The following table shows operating expenses as a percentage of total revenue for the three and six months ended July 2, 2011 and July 3, 2010:

| | Three Months Ended | | Six Months Ended | |
|----------------------------|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| Marketing and sales | 27% | 31% | 28% | 33% |
| Research and development | 35% | 40% | 37% | 40% |
| General and administrative | 9% | 8% | 8% | 9% |

Marketing and Sales

Marketing and sales expense increased by \$5.5 million during the three months ended July 2, 2011, as compared to the three months ended July 3, 2010, and increased by \$9.1 million during the six months ended July 2, 2011, as compared to the six months ended July 3, 2010, due to the following:

| | Change | |
|---|--------------------------|---------------------|
| | Three Months Ended | Six Months Ended |
| | (In millions) | |
| Salary, benefits and other employee-related costs | \$ 5.9 | \$ 11.2 |
| Executive and other severance costs | 1.0 | 1.0 |
| Depreciation | (0.6) | (1.5) |
| Other individually insignificant items | (0.8) | (1.6) |
| | \$ 5.5 | \$ 9.1 |

Research and Development

Research and development expense increased by \$7.4 million during the three months ended July 2, 2011, as compared to the three months ended July 3, 2010, and increased by \$19.3 million during the six months ended July 2, 2011, as compared to the six months ended July 3, 2010, primarily due to an increase in employee salary, benefits and other employee-related costs.

General and Administrative

General and administrative expense increased by \$8.3 million during the three months ended July 2, 2011, as compared to the three months ended July 3, 2010, and increased by \$4.8 million during the six months ended July 2, 2011, as compared to the six months ended July 3, 2010, due to the following:

| | Change | |
|---|--------------------------|---------------------|
| | Three Months Ended | Six Months Ended |
| | (In millions) | |
| Bad debt expense | \$ 9.5 | \$ 6.8 |
| Salary, benefits and other employee-related costs | 0.1 | 1.8 |
| Professional services | (1.3) | (2.5) |

| | | |
|--|--------|--------|
| Other individually insignificant items | ---- | (1.3) |
| | \$ 8.3 | \$ 4.8 |

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and collectively with the 2011 Notes, the Convertible Senior Notes. Interest expense for the three and six months ended July 2, 2011 and July 3, 2010 was as follows:

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In millions) | | | |
| Contractual cash interest expense: | | | | |
| Convertible Senior Notes | \$ 1.0 | \$ 1.7 | \$ 2.1 | \$ 3.5 |
| 2015 Notes | 2.3 | 0.4 | 4.6 | 0.4 |
| Amortization of debt discount: | | | | |
| Convertible Senior Notes | 3.2 | 4.7 | 6.4 | 9.8 |
| 2015 Notes | 3.4 | 0.6 | 6.7 | 0.6 |
| Amortization of deferred financing costs: | | | | |
| Convertible Senior Notes | 0.3 | 0.4 | 0.5 | 0.8 |
| 2015 Notes | 0.5 | 0.1 | 0.9 | 0.1 |
| Other interest expense | 0.1 | 0.1 | 0.6 | 0.2 |
| Total interest expense | \$ 10.8 | \$ 8.0 | \$ 21.8 | \$ 15.4 |

The increase in interest expense during the three and six months ended July 2, 2011, as compared to the three and six months ended July 3, 2010, is due to interest expense related to the 2015 Notes that were issued in June 2010. For an additional description of our 2015 Notes and Convertible Senior Notes, see Note 2 to our Condensed Consolidated Financial Statements.

Other Income (Expense), Net

Other income (expense), net, for the three and six months ended July 2, 2011 and July 3, 2010 was as follows:

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In millions) | | | |
| Interest income | \$ 0.3 | \$ 0.3 | \$ 0.7 | \$ 0.5 |
| Gains on sale of marketable securities | 8.0 | ---- | 8.0 | ---- |
| Gains on sale of non-marketable securities | 0.1 | 0.2 | 2.7 | 4.8 |
| Gains on trading securities in the non-qualified deferred compensation trust | 1.2 | 1.1 | 2.9 | 2.2 |
| Gains (losses) on foreign exchange | (1.3) | 2.0 | (1.7) | 2.2 |
| Equity losses from investments | ---- | ---- | ---- | (0.1) |
| Write-down of investments | ---- | (1.5) | ---- | (1.5) |
| Loss on early extinguishment of debt | ---- | (5.3) | ---- | (5.3) |
| Other income | 0.1 | 0.1 | 0.3 | 0.1 |
| Total other income (expense), net | \$ 8.4 | \$ (3.1) | \$ 12.9 | \$ 2.9 |

During the three and six months ended July 2, 2011, we recorded gains of \$8.0 million on the sale of available-for-sale securities. During the six months ended July 2, 2011, we recorded a gain of \$2.7 million on the sale of an equity method investment. During the six months ended July 3, 2010, we recorded gains totaling \$4.8 million on the liquidation of five cost method investments.

During the three and six months ended July 3, 2010, we determined that certain of our non-marketable securities were other-than-temporarily impaired and we wrote down these investments by \$1.5 million.

Table of Contents**Income Taxes**

The following table presents the provision for income taxes and the effective tax rate for the three and six months ended July 2, 2011 and July 3, 2010:

| | Three Months Ended | | Six Months Ended | |
|--------------------------------------|-----------------------------------|-----------------|------------------|-----------------|
| | July 2, 2011 | July 3, 2010 | July 2, 2011 | July 3, 2010 |
| | (In millions, except percentages) | | | |
| Provision (benefit) for income taxes | \$ (4.3) | \$ (54.5) | \$ 0.4 | \$ (49.5) |
| Effective tax rate | (19.2%) | 930.5% | 1.1% | 391.5% |

Our Provision (benefit) for income taxes for the three and six months ended July 2, 2011 was primarily comprised of the tax benefit of \$5.7 million from the effective settlement of the Internal Revenue Service, or IRS, examination of our federal income tax returns for the tax years 2003 through 2005, the tax benefit from the release of the valuation allowance of \$5.0 million against our deferred tax assets due to the recognition of deferred tax liabilities related to the acquisition of intangible assets held by the company acquired during the three months ended July 2, 2011, tax expense on certain of our foreign subsidiaries and interest expense on unrecognized tax benefits.

Our benefit for income taxes for the three and six months ended July 3, 2010 was primarily due to the release of approximately \$66.7 million of valuation allowance against our deferred tax assets due to the recognition of deferred tax liabilities related to the acquisition of intangibles with Denali, partially offset by tax expense related to increases in unrecognized tax benefits, taxes on certain of our foreign subsidiaries, and interest expense on our unrecognized tax benefits.

We estimate our annual effective tax rate for fiscal 2011 to be approximately 10% primarily because of tax expense related to certain of our foreign subsidiaries and interest expense on our unrecognized tax benefits, which was partially offset by the tax benefit from the effective settlement of the IRS examination of the 2003 through 2005 tax years and the release of valuation allowance related to the acquisition of intangible assets held by the company acquired during the three months ended July 2, 2011. Our estimated annual effective tax rate is based on our expectation that we will record a valuation allowance that will offset the potential tax benefit of certain United States tax losses and credit carryforwards generated during fiscal 2011. We also expect that our estimated annual effective tax rate to be particularly sensitive to any changes to our estimates of tax expense during fiscal 2011.

The IRS and other tax authorities regularly examine our income tax returns. For further discussion regarding our Income taxes, including the status of the IRS examinations, see Note 9 to our Condensed Consolidated Financial Statements.

Table of Contents**Liquidity and Capital Resources**

| | As of | | |
|---|------------------|-------------------------------------|------------|
| | July 2, 2011 | January 1, 2011 (In millions) | Change |
| Cash, cash equivalents and Short-term investments | \$ 668.6 | \$ 570.1 | \$ 98.5 |
| Net working capital | \$ (19.1) | \$ 181.9 | \$ (201.0) |
| | Six Months Ended | | |
| | July 2, 2011 | July 3, 2010 (In millions) | Change |
| Cash provided by operating activities | \$ 125.8 | \$ 95.7 | \$ 30.1 |
| Cash used for investing activities | \$ (22.4) | \$ (265.6) | \$ 243.2 |
| Cash provided by financing activities | \$ 1.1 | \$ 76.5 | \$ (75.4) |

Cash and Cash Equivalents and Short-term Investments

As of July 2, 2011, our principal sources of liquidity consisted of \$668.6 million of Cash and cash equivalents and Short-term investments, as compared to \$570.1 million as of January 1, 2011. Approximately one-third of our cash and cash equivalents is held in accounts in the United States.

Our primary sources of cash during the six months ended July 2, 2011 were:

Customer payments for software and design IP licenses and from the sale and lease of our hardware products;

Customer payments for maintenance;

Customer payments for engineering services;

Proceeds from the sale of available-for-sale securities and long-term investments; and

Cash received for common stock purchases under our employee stock purchase plan.

Our primary uses of cash during the six months ended July 2, 2011 were:

Payments relating to salaries, benefits, other employee-related costs and other operating expenses, including our restructuring plans;

Payments to former shareholders of acquired businesses, net of cash acquired;

Payments related to the anticipated settlement of our securities litigation;

Purchases of inventory related to our hardware products; and

Purchases of property, plant and equipment.

We expect that current cash and short-term investment balances and cash flows that are generated from operations will be sufficient to meet our working capital, other capital and liquidity requirements for at least the next 12 months.

Table of Contents**Net Working Capital**

Net working capital decreased by \$201.0 million as of July 2, 2011, as compared to January 1, 2011, due to the following:

| | Change (In millions) |
|--|-------------------------|
| Increase in Convertible notes | \$ (290.6) |
| Decrease in Receivables, net | (41.7) |
| Increase in Current portion of deferred revenue | (25.3) |
| Decrease in Short-term investments | (9.5) |
| Increase in Prepaid expenses and others | 1.6 |
| Increase in Inventories | 5.3 |
| Decrease in Accounts payable and accrued liabilities | 51.2 |
| Increase in Cash and cash equivalents | 108.0 |
| | \$ (201.0) |

The decrease in our Net Working Capital during the six months ended July 2, 2011 is primarily due to the classification of our 2015 Notes as a current liability on our Condensed Consolidated Balance Sheet as of July 2, 2011.

During the three months ended July 2, 2011, the closing sale price of our common stock exceeded \$9.81 for more than 20 of the last 30 consecutive trading days of that period. As a result, as of July 2, 2011, the 2015 Notes became convertible into cash at the election of holders of the 2015 Notes. Holders of the 2015 Notes can submit their 2015 Notes for conversion from July 2, 2011 through October 1, 2011. Because we would be required to settle the 2015 Notes in cash if holders elect to convert the 2015 Notes, we classified the \$287.1 million net liability of the 2015 Notes as a current liability on our Condensed Consolidated Balance Sheet as of July 2, 2011. Any gain or loss on extinguishment of the 2015 Notes would be recognized upon the cash conversion of the 2015 Notes.

Because the 2015 Notes were convertible into cash as of July 2, 2011, we classified the fair value of the 2015 Notes Embedded Conversion Derivative as a current liability on our Condensed Consolidated Balance Sheet as of July 2, 2011, which increased our Total current liabilities by \$222.1 million. We also classified the fair value of the 2015 Notes Hedges as current assets on our Condensed Consolidated Balance Sheet as of July 2, 2011, which increased Total current assets by \$222.1 million, resulting in no net change in our net working capital as of July 2, 2011.

Should the holders of our 2015 Notes elect to convert their Notes into cash, we would be required to make cash payments of up to \$350.0 million, which is the full principal amount of the 2015 Notes. In connection with the 2015 Notes, we entered into convertible note hedge transactions and sold warrants to reduce our exposure above the \$350.0 million principal balance in the event of a cash conversion of the 2015 Notes. The 2015 Notes currently trade, and have traded during the three months ended July 2, 2011, at a substantial premium to the conversion price. As a result, we do not anticipate a conversion of the 2015 Notes by the noteholders between July 2, 2011 and October 1, 2011. However, should the holders of the 2015 Notes elect to convert their notes between July 2, 2011 and October 1, 2011, we have sufficient liquidity to fund any conversions of the 2015 Notes.

Because our 2011 Notes mature on December 15, 2011, our Condensed Consolidated Balance Sheets include a current liability of \$146.7 million as of July 2, 2011 and \$143.3 million as of January 1, 2011, representing the \$150.0 million principal amount of the 2011 Notes, net of the applicable debt discount on the

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respective dates. Discount amortization will continue through December 15, 2011 when the carrying value of the 2011 Notes will equal the \$150.0 million principal amount due at maturity.

For an additional description of our 2011 Notes and 2015 Notes, and the conversion terms thereof, see Note 2 to our Condensed Consolidated Financial Statements.

Cash Flows from Operating Activities

Net cash from operating activities increased by \$30.1 million during the six months ended July 2, 2011, as compared to the six months ended July 3, 2010, due to the following:

| | Change (In millions) |
|---|-------------------------|
| Net income, net of non-cash related items | \$ 60.3 |
| Changes in operating assets and liabilities, net of effect of acquired businesses | (30.2) |
| | \$ 30.1 |

Cash flows from operating activities include Net income, 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 business levels and the payment terms set forth in our license agreements. While the semiconductor industry grew and overall economic conditions stabilized during fiscal 2010, our customers may experience adverse changes in the future that may cause them to delay purchasing our products and services or delay or default on their payment obligations.

As of July 2, 2011, no single customer accounted for more than 10% of our Receivables, net and Installment contract receivables. As of January 1, 2011, one customer accounted for 19% of our Receivables, net and Installment contract receivables. As of July 2, 2011 approximately 40% of our total Receivables, net and Installment contract receivables were attributable to the ten customers with the largest balances of Receivables, net and Installment contract receivables. As of January 1, 2011, approximately half of our total Receivables, net and Installment contract receivables were attributable to the ten customers with the largest balances of Receivables, net and Installment contract receivables. If our customers are not successful in generating sufficient cash 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 yet 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 cash flows from operations.

On February 11, 2011, all parties to our securities litigation agreed to settle the securities litigation for consideration of \$38.0 million, of which \$22.2 million was to be paid by our insurance carriers. During the three months ended July 2, 2011, we paid \$16.4 million into a securities litigation settlement fund which amount included our portion of the settlement consideration of \$15.8 million and \$0.6 million of accrued interest. As of July 2, 2011, \$6.7 million had been paid into the securities litigation settlement fund by our insurance carriers. Subsequent to July 2, 2011, our insurance carriers paid the remaining \$15.5 million into the securities litigation settlement fund. The settlement is subject to court approval.

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On February 8, 2011, all parties to our derivative litigation agreed to settle the derivative litigation, which settlement includes a \$1.8 million payment to the plaintiffs' counsel for attorney's fees and costs. If the settlement is approved by the court, the \$1.8 million will be paid by our insurance carriers.

As of July 2, 2011, \$17.3 million remained to be paid as part of the securities litigation and derivative litigation settlements, which amount is included in Accounts payable and accrued liabilities as of July 2, 2011. Our insurance carriers had agreed to pay the \$17.3 million remaining, so it is included in Prepaid expenses and other on our Condensed Consolidated Balance Sheet as of July 2, 2011. As of January 1, 2011, the \$40.0 million estimated total settlement amount was included in Accounts payable and accrued liabilities on our Condensed Consolidated Balance Sheet, and the estimated \$24.2 million to be paid by our insurance carriers was included in Prepaid expenses and other on our Condensed Consolidated Balance Sheet.

As of July 2, 2011, we have paid \$83.1 million in connection with the restructuring plans initiated in 2008, 2009 and 2010. We expect to pay an additional \$3.5 million related to the 2008, 2009 and 2010 restructuring activities, of which \$0.8 million is for termination benefits related to the 2010 restructuring activities. We expect substantially all termination benefits related to the 2010 Restructuring Plan to be paid by the end of fiscal 2011.

During the three months ended July 2, 2011, we determined that uncertain tax positions that were subject to the IRS examination of our federal corporation income tax returns for the tax years 2003 through 2005 were effectively settled. We do not expect the effective settlement to result in significant cash payments.

We expect that cash flows from operating activities will fluctuate in future periods due to a number of factors, including our operating results and the timing of our billings, collections and tax payments.

Cash Flows from Investing Activities

Net cash used in investing activities decreased \$243.2 million during the six months ended July 2, 2011, as compared to the six months ended July 3, 2010, due to the following:

| | Change (In millions) |
|---|-------------------------|
| Cash paid in business combinations and asset acquisitions, net of cash acquired | \$ 231.1 |
| Proceeds from the sale of available-for-sale securities | 9.6 |
| Purchases of property, plant and equipment | 7.5 |
| Purchases of software licenses | 2.4 |
| Proceeds from the sale of long-term investments | (7.4) |
| | \$ 243.2 |

The decrease in net cash used in investing activities is primarily due to the decrease in Cash paid in business combinations and asset acquisitions, net of cash acquired, which includes cash paid for our acquisition of Denali during the six months ended July 3, 2010. In connection with our business combinations and asset acquisitions completed before July 2, 2011, we may be obligated to make payments based on, or subject to the satisfaction of, certain performance metrics. If performance is such that these payments are fully achieved, we may be obligated to pay up to an aggregate of \$27.2 million in cash during the next 58 months, of which up to \$19.8 million would be expensed in our Condensed Consolidated Income Statements.

We expect to continue our investing activities, including purchasing property, plant and equipment, purchasing intangible assets, purchasing software licenses, or other acquisitions, and making long-term equity investments.

Table of Contents**Cash Flows from Financing Activities**

In June 2010, we issued \$350.0 million principal amount of the 2015 Notes. Concurrently with the issuance of the 2015 Notes, we entered into the 2015 Notes Hedges with various parties to reduce the potential cash outlay from the conversion of the 2015 Notes and to mitigate the negative effect such conversion may have on the price of our common stock. In separate transactions, we sold warrants, or the 2015 Warrants, to purchase our common stock at a price of \$10.78 per share to various parties. We used an aggregate of \$187.2 million of the net proceeds from the issuance of the 2015 Notes to purchase in the open market \$100.0 million principal amount of our 2011 Notes and \$100.0 million principal amount of our 2013 Notes, and we repurchased 6.5 million shares of our common stock at a cost of \$40.0 million.

Net cash from financing activities decreased by \$75.4 million during the six months ended July 2, 2011, as compared to the six months ended July 3, 2010, due to the following:

| | Change (In millions) |
|---|-------------------------|
| Proceeds from issuance of 2015 Notes, net of initial purchaser's fees | \$ (340.2) |
| Proceeds from sale of 2015 Warrants | (37.5) |
| Purchase of treasury stock | 40.0 |
| Purchase of 2015 Notes Hedges | 76.7 |
| Payment of Convertible Senior Notes | 187.2 |
| Other individually insignificant items | (1.6) |
| | \$ (75.4) |

For an additional description of our Convertible Senior Notes and 2015 Notes, and the conversion terms thereof, see Note 2 to our Condensed Consolidated Financial Statements and Net Working Capital, above.

When treasury stock is reissued at a price higher than its cost, the difference is recorded as a component of Capital in excess of par in the Condensed Consolidated Balance Sheets. When treasury stock is reissued at a price lower than its cost, the difference is 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 Accumulated deficit in the Condensed Consolidated Balance Sheets. We recorded losses on the re-issuance of treasury stock of \$9.2 million during the six months ended July 2, 2011, as compared to \$74.2 million during the six months ended July 3, 2010.

Other Factors Affecting Liquidity and Capital Resources*2.625% Cash Convertible Senior Notes Due 2015*

In June 2010, we issued \$350.0 million principal amount of our 2015 Notes to four 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 Rule 144A of the Securities Act. Concurrently with the issuance of the 2015 Notes, we entered into hedge transactions, or the 2015 Notes Hedges, with various parties to reduce the potential cash outlay from the cash conversion of the 2015 Notes and to mitigate the negative effect such cash conversion may have on the price of our common stock. In separate transactions, we sold warrants, or the 2015 Warrants, to various parties. The 2015 Notes mature on June 1, 2015, and will be paid in cash at maturity.

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During the three months ended July 2, 2011, the closing sale price of our common stock exceeded \$9.81 for more than 20 of the last 30 consecutive trading days of that period. As a result, as of July 2, 2011, the 2015 Notes became convertible into cash at the election of holders of the 2015 Notes.

For an additional description of the 2015 Notes, the conversion terms thereof and the hedge and warrants transactions, see Note 2 to our Condensed Consolidated Financial Statements and Net Working Capital above. *1.375% Convertible Senior Notes Due December 15, 2011 and 1.500% Convertible Senior Notes Due December 15, 2013*

In December 2006, we issued \$250.0 million principal amount of our 2011 Notes and \$250.0 million of our 2013 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, or the Convertible Senior Notes Hedges, with various parties to reduce the potential dilution from the conversion of the Convertible Senior Notes and to mitigate the negative effect such conversion may have on the price of our common stock. In separate transactions, we sold warrants, or the Convertible Senior Notes Warrants, to various parties. The 2011 Notes mature on December 15, 2011 and the 2013 Notes mature on December 15, 2013. The principal amounts will be paid in cash at maturity.

In connection with the issuance of the 2015 Notes, we used an aggregate of \$187.2 million of the net proceeds to purchase in the open market \$100.0 million principal amount of our 2011 Notes and \$100.0 million principal amount of our 2013 Notes, resulting in a remaining principal balance of \$150.0 million for the 2011 Notes and \$150.0 million for the 2013 Notes. During the fourth quarter of fiscal 2010 in a separate transaction, we repurchased in the open market \$5.5 million principal amount of our 2013 Notes, which resulted in a remaining principal balance for the 2013 Notes of \$144.5 million. We also sold a portion of the Convertible Senior Notes Hedges and purchased a portion of the Convertible Senior Notes Warrants at the time of these repurchases.

Because our 2011 Notes mature on December 15, 2011, our Condensed Consolidated Balance Sheets include a current liability of \$146.7 million as of July 2, 2011 and \$143.3 million as of January 1, 2011, representing the \$150.0 million principal amount of the 2011 Notes, net of the applicable debt discount on the respective dates. Amortization of the debt discount will continue through December 15, 2011 when the carrying value of the 2011 Notes will equal the \$150.0 million principal amount due at maturity.

For an additional description of the Convertible Senior Notes, including the hedge and warrants transactions, see Note 2 to our Condensed Consolidated Financial Statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Risk

Most of our revenue, expenses 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, in particular, Japan, where we invoice customers in the local currency, we are adversely affected by a stronger dollar. The primary effect of foreign currency transactions on our results of operations from a weakening United States dollar is an increase in revenue generally offset by an increase in expenses. Conversely, the primary effect of foreign currency transactions on our results of

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operations from a strengthening United States dollar is a reduction in revenue generally offset by a 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 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.

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 July 2, 2011, 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 before or during September 2011.

| | Notional Principal (In millions) | Weighted Average Contract Rate |
|----------------------|--|---|
| Forward Contracts: | | |
| Indian rupee | \$ 17.2 | 44.82 |
| Chinese renminbi | 10.6 | 6.48 |
| European Union euro | 10.2 | 0.69 |
| Japanese yen | 9.4 | 80.63 |
| Canadian dollar | 8.8 | 0.97 |
| Israeli shekel | 8.6 | 3.40 |
| Hong Kong dollar | 7.2 | 7.78 |
| New Taiwan dollar | 7.2 | 28.77 |
| Other | 9.2 | N/A |
| Total | \$ 88.4 | |
| Estimated fair value | \$ 0.5 | |

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.

Table of Contents**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 the 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 July 2, 2011. 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 July 2, 2011.

| | Carrying Value (In millions) | Average Interest Rate |
|------------------------------------|------------------------------------|--------------------------|
| Interest-Bearing Instruments: | | |
| Cash equivalents variable rate | \$ 532.3 | 0.13% |
| Cash variable rate | 88.4 | 0.18% |
| Cash fixed rate | 8.3 | 4.57% |
| Total interest-bearing instruments | \$ 629.0 | 0.20% |

Equity Price Risk**2.625% Cash Convertible Senior Notes Due 2015**

In June 2010, we issued \$350.0 million principal amount of our 2015 Notes. In a separate private placement transaction, we also sold warrants to various parties for the purchase of up to approximately 46.4 million shares of our common stock at a price of \$10.78 per share. These warrants expire on various dates from September 2015 through December 2015 and must be settled in net shares. For an additional description of our 2015 Notes, see Note 2 to our Condensed Consolidated Financial Statements.

1.375% Convertible Senior Notes Due December 15, 2011 and 1.500% Convertible Senior Notes Due December 15, 2013

In December 2006, we issued \$250.0 million principal amount of our 2011 Notes and \$250.0 million of our 2013 Notes. During fiscal 2010 we repurchased in the open market \$100.0 million principal amount of our 2011 Notes and \$105.5 million principal amount of our 2013 Notes, resulting in a remaining principal balance as of July 2, 2011 of \$150.0 million for the 2011 Notes and \$144.5 million for the 2013 Notes. For

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an additional description of our 2011 Notes and 2013 Notes, see Note 2 to our Condensed Consolidated Financial Statements.

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. See Note 8 to our Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended January 1, 2011 for an additional description of these investments. Our investment in non-marketable equity securities had a carrying value of \$11.8 million as of July 2, 2011 and \$9.3 million as of January 1, 2011.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We carried out an evaluation required by Rule 13a-15 of the Securities Exchange Act of 1934, as amended, or the Exchange Act, under the supervision and with the participation of our management, including the Chief Executive Officer, or CEO, and the Chief Financial Officer, or CFO, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13-15(e) and 15d-15(e) under the Exchange Act) as of July 2, 2011.

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 to identify any material weaknesses in our disclosure controls and procedures, to determine whether we had identified any acts of fraud involving personnel who have a significant role in our disclosure controls and procedures, and to confirm that any necessary corrective action, including process improvements, was taken. This type of evaluation is done every fiscal quarter so that our conclusions concerning the effectiveness of these controls can be reported in our periodic reports filed with the SEC. The overall goals of these evaluation activities are to monitor our disclosure controls and procedures and to make modifications as necessary. We intend to maintain these disclosure controls and procedures, modifying them as circumstances warrant.

Based on their evaluation as of July 2, 2011, our CEO and CFO have concluded that our disclosure controls and procedures were effective to provide reasonable assurance that the information required to be disclosed by us in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended July 2, 2011 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Inherent Limitations on Effectiveness of Controls

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all errors and all fraud. Internal control over financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of internal control are met. Further, the design of 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 within Cadence have been prevented or, if any have occurred, that they have been detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in various disputes and litigation that arise in the ordinary course of business. These include disputes and lawsuits related to intellectual property, indemnification obligations, mergers and acquisitions, licensing, contracts, distribution arrangements and employee relations matters. At least quarterly, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount or the range of loss can be estimated, we accrue a liability for the estimated loss. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based on our judgments using 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 our estimates.

On February 8, 2011 and February 11, 2011, we agreed to settle our pending derivative and securities litigation, respectively. See Note 14 to our Condensed Consolidated Financial Statements for an additional description of our legal proceedings and these settlements.

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 January 1, 2011 and filed with the SEC on February 24, 2011.

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 orders and 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.

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The IC and electronics systems industries experienced significant challenges in 2008 and 2009. The IC and electronic systems industries have also experienced significant downturns in connection with, or in anticipation of, maturing product cycles of both these industries and their customers' products. The economic downturn in 2008 and 2009 was characterized by diminished product demand, production overcapacity, high inventory levels and significant decreases in average selling prices. This economic downturn in the industries we serve contributed to the reduction in our revenue in 2008 and 2009, as compared to our revenue in 2007. Although the semiconductor industry experienced growth in 2010, and is expected to grow modestly in the remainder of 2011, spending on EDA products and services may grow more slowly than the semiconductor industry as a whole in 2011.

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 incurred net losses during fiscal 2008 and fiscal 2009, we recorded net income in 2010 and in the first and second quarters of fiscal 2011, but we may incur a net loss in the future. 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 certain orders for our software products.

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 that include a stated annual maintenance renewal rate is recognized upon the later of the effective date of the arrangement or delivery of the software product. Product revenue associated with term licenses that do not include a stated annual maintenance renewal rate and product revenue associated with subscription licenses are recognized over multiple periods during the term of the license. Revenue may also be deferred 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 affected by the timing of license renewals, changes in existing contractual arrangements with customers and the mix of license types (i.e., perpetual, term or subscription) for existing customers. These 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 substantial proportion of licenses require ratable revenue recognition, and we expect the license mix, combined with the modest growth in spending by our customers in the semiconductor sector, may make it difficult for us to significantly increase our revenue in future fiscal periods.

We plan operating expense levels primarily based on forecasted revenue levels. These expenses and the effect of long-term commitments are relatively fixed in the short term. In addition, revenue levels are harder to forecast in a difficult economic environment. If the macroeconomic environment weakens, and we experience a shortfall in revenue, our operating results could differ from our expectations because we may not be able to quickly reduce our expenses in response to short-term business changes.

The methods, estimates and judgments that we use in applying our accounting policies have a significant impact on our results of operations (see Critical Accounting Estimates under Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations). Such methods, estimates and judgments are, by their nature, subject to substantial risks, uncertainties and assumptions, and factors may arise over time that may lead us to change our methods, estimates and judgments. Changes in those methods, estimates and judgments could significantly affect our results of operations.

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

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 and customer requirements and frequent new product introductions and improvements. Currently, the industries we serve are experiencing the following trends:

Migration to nanometer design – the continuous shrinkage of the size of process features and other features, such as wires, transistors and contacts on ICs, due to the ongoing advances in the semiconductor manufacturing processes – 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. Shrinking transistor sizes are challenging the industry in the application of more complex physics and chemistry in order to produce 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 that may reduce their need to upgrade or enhance 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 fabrication masks. 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 or SoCs. The unavailability of a broad range of high-quality design IP (including our own) that can be reliably incorporated into a customer’s design with our software products and services could lead to reduced 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 engineering services businesses could reduce the need for some IC companies to invest in EDA products.

If we are unable to respond quickly and successfully to these trends, 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.

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Our stock price has been subject to significant fluctuations and may continue to be subject to fluctuations.

The market price of our common stock has experienced significant fluctuations and may fluctuate or decline 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, including, but not limited to:

- 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 securities analysts or investors;
- Changes in our bookings, revenue or earnings estimates;
- Announcements of a restructuring plan;
- Changes in management;
- A gain or loss of a significant customer or market segment share;
- Material litigation;
- Announcements of new products or acquisitions of new technologies by us, our competitors or our customers; and
- Market conditions in the IC, electronics systems and semiconductor industries.

In addition, equity markets in general, and the equities of technology companies in particular, have experienced extreme price and volume fluctuations. Such price and volume fluctuations may adversely affect the market price of our common stock for reasons unrelated to our business or operating results.

Litigation could adversely affect our financial condition or operations.

We are currently, and in the future may be, involved in various disputes and litigation 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. We are also currently engaged in a consolidated securities class action lawsuit and shareholder derivative lawsuits. For information regarding the litigation matters in which we are currently engaged, please refer to the discussion under Item 1, Legal Proceedings and Note 14 to our Condensed Consolidated Financial Statements. 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, operating results, financial condition or cash flows. 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 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. In some cases, maintenance is 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 operating results. Our customers, many of which are large semiconductor companies, often have significant bargaining power in negotiations with us. Mergers or acquisitions of our customers can reduce the total level of purchases of our software and

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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 failure to attract, train, motivate and retain management and key employees 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, and as a result, we may experience disruption to our business that may harm our operating results and our relationships with our employees, customers and suppliers may be adversely affected.

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 in 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 these employees, or losing trained employees to competing employers could also reduce our operating 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 equity compensation 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 receive significant revenue from our current research and development efforts for several years, if at all.

Developing EDA technology and integrating acquired technology 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 and improve our competitive position. However, we cannot ensure 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 industry and the commercial electronics engineering services industry 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 engineering services and offer better strategic concepts, technical solutions, prices and response time, or a combination of these factors, than those of our

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competitors and the internal design departments of electronics manufacturers. We may not 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 engineering services, possibly resulting in a shift of customer preferences away from our products and services and significantly decreased revenue;

Decisions by electronics manufacturers to perform engineering 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, possibly making it more difficult for us to acquire companies or technologies at an acceptable price or at all; and

The combination of two or more of our EDA competitors 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 Corporation. 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.

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.

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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 consummate any particular transaction, but may nonetheless incur significant costs, or if a transaction is consummated, 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 when 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 unanticipated liabilities assumed from the acquired business or of assets acquired, such that we cannot realize the anticipated value of the acquisition;
- 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;
- Customer dissatisfaction with existing license agreements with us, possibly dissuading 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 where 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 based on the performance of the acquired businesses or the employees who joined us with the acquired businesses. We may continue to use contingent purchase price payments in connection with acquisitions in the future. The performance goals pursuant to which these future payments may be made generally relate to achievement by the acquired business, or by the employees who joined us with the acquired business of certain specified orders, revenue, run rate, 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. While we expect to derive value from an acquisition in excess of such contingent payment obligations, our strategy may change and we may be required to make certain contingent payments without deriving the anticipated value.

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

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proprietary rights in technology and products. Despite the 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. Patents may not be issued on any of our pending applications and our issued 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. The protection of our intellectual property may require the expenditure of significant financial and managerial resources. Moreover, the steps we take to protect our intellectual property may not adequately protect our rights or prevent third parties from infringing or misappropriating our proprietary rights.

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 engineering services business holds licenses to certain software and other intellectual property owned by third parties, including that of our competitors. Our failure to obtain software or other intellectual property licenses or other intellectual property rights that is necessary or helpful for our business on favorable terms, or our 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 EDA product-related patents. New patents are being issued at a rapid rate and are owned by EDA companies as well as entities and individuals outside the EDA industry. It is not always practicable to determine in advance whether a product or any of its components infringes the patent rights of others. As a result, from time to time, we may be compelled to respond to or prosecute intellectual property infringement claims to protect our rights or defend a customer's rights.

Intellectual property infringement claims, including defense reimbursement obligations related to third party 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 operating results may suffer.

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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 complexity and expense associated with our products and services 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 have been and may in the future 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.

Our reported financial results may be adversely affected by changes in United States generally accepted accounting principles.

United States generally accepted accounting principles are subject to interpretation by the Financial Accounting Standards Board, or FASB, the American Institute of Certified Public Accountants, the SEC and various bodies formed to promulgate and interpret appropriate accounting principles. During fiscal 2010, the FASB issued exposure drafts of proposed accounting principles related to revenue recognition and leases which could change the way we account for certain of our transactions. The FASB has continued to discuss these proposed accounting principles during fiscal 2011. A change in these or other principles or interpretations could have a significant effect on our reported financial results and could affect the reporting of transactions completed before the announcement of a change. In addition, the SEC announced a multi-year plan that could ultimately lead to the use of International Financial Reporting Standards by United States issuers in their SEC filings. Any such change could have a significant effect on our reported financial results.

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

We have significant operations outside the United States. Our revenue from international operations as a percentage of total revenue was approximately 56% during the three months ended July 2, 2011 and 58% during the three months ended July 3, 2010, a substantial portion of which is denominated in United States dollars. 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 an effect on our revenue or operating results.

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

Exposure to foreign currency transaction risk can arise when transactions are conducted in a currency different from the functional currency of one of our subsidiaries. A subsidiary's functional currency is generally the currency in which it primarily conducts its operations, including product pricing, expenses and borrowings. Although we attempt to reduce the effect 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, including tariffs and other trade barriers;
- 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;
- Compliance with United States and foreign laws and regulations applicable to our worldwide operations;
- Political and economic instability;
- Unexpected changes in regulatory requirements; 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.

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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, the introduction of a virus into our computer systems or natural disasters near any of our international locations, could significantly interfere with our business operations.

We have substantial cash requirements in the United States, but a significant portion of our cash is held and generated outside of the United States, and if our cash available in the United States is insufficient to meet our operating expenses and debt repayment obligations in the United States, then we may be required to raise cash in ways that could negatively affect our financial condition, results of operations and the market price of our common stock.

We have significant operations outside the United States. As of July 2, 2011, approximately one third of our Cash and cash equivalents balance was held in accounts in the United States, with the remainder of the balance held in accounts outside of the United States. We believe that the combination of our existing United States cash balances and future United States operating cash flows are sufficient to meet our ongoing United States operating expenses and debt repayment obligations. However, if these sources of cash are insufficient to meet our future funding obligations in the United States, we could be required to seek other available funding sources which could negatively impact our results of operations, financial position and the market price of our common stock.

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:

- Changes in tax laws or the interpretation of such tax laws, including potential United States and international tax reforms;

- 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 and impairment of goodwill;

- Changes in the valuation allowance against our deferred tax assets;

- 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 or penalty 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.

The IRS and other tax authorities regularly examine 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, and the IRS is currently examining our federal income tax returns for the tax years 2006 through 2009.

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In May 2009, the IRS completed its field examination of our federal income tax returns for the tax years 2003 through 2005 and issued a Revenue Agent's Report, or RAR, in which the IRS proposed to assess an aggregate deficiency for the three-year period of approximately \$94.1 million. In August 2009, the IRS reduced the proposed aggregate tax deficiency for the three-year period to approximately \$60.7 million. In June 2011, the Appeals Office of the IRS, or the Appeals Office, provided us with copies of the executed settlement agreements that resolve the previously disputed tax positions. While we consider the tax positions to be effectively settled, the statute of limitations for the IRS to audit the tax returns remains open.

The calculation of our provision (benefit) for income taxes requires us to use significant judgment and involves dealing with uncertainties in the application of complex tax laws and regulations. In determining the adequacy of our provision (benefit) 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 from the amount that 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 based on such estimates. Forecasts of annual income or loss that are near break-even will cause our estimated annual effective tax rate to be particularly sensitive to any changes to our estimates of tax expense. 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.

We depend on a sole supplier for certain hardware components, making us vulnerable to supply shortages and price fluctuation.

We are dependent on a sole supplier for certain hardware components. Our reliance on a sole supplier could result in product delivery problems and reduced control over product pricing and quality, as well as limit our ability to identify and qualify another supplier in a timely manner. While it is our goal to have multiple sources to procure certain key components, in some cases it is not practical or feasible to do so. We may suffer a disruption in the supply of certain hardware components if we are unable to purchase sufficient components on a timely basis or at all for any reason.

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Our operating results and revenue could be adversely affected by customer payment delays, customer bankruptcies and defaults or modifications of licenses or supplier modifications.

As a result of the challenging economic environment in fiscal 2008 and 2009, our customers, who are primarily concentrated in the semiconductor sector, experienced adverse changes in their business, and certain customers delayed or defaulted on their payment obligations to us. If our customers experience difficulties in the future, they may delay or default on their payment obligations to us, file for bankruptcy 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 cash 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. Payment defaults by our customers or significant reductions in existing contractual commitments could have a material adverse effect on our financial condition and operating results. Because of the relatively high levels of volatility that continue to drive significant fluctuations in asset prices, as well as concern regarding high levels of leverage in sovereign and corporate debt, the capital and credit markets are volatile and unpredictable. If we were to seek funding from the capital or credit markets in response to any material level of customer defaults, we may not be able to secure funding on terms acceptable to us or at all, which may have a material negative effect on our business.

We may not be able to effectively implement our restructuring plans, and our restructuring plans may not result in the benefits we have anticipated, possibly having a negative effect on our future operating results.

During fiscal 2008, fiscal 2009 and fiscal 2010, we initiated restructuring plans in an effort to decrease costs by reducing our workforce and by consolidating facilities. We may not be able to successfully complete and realize the expected benefits of our restructuring plans, such as improvements in operating margins and cash flows, in the restructuring periods contemplated. The restructuring plans have involved and may continue to involve higher costs or a longer timetable than we currently anticipate or may fail to improve our operating results as we anticipate. Our inability to realize these benefits may result in an inefficient business structure that could negatively affect our results of operations. Our restructuring plans have caused us and will cause us to incur substantial costs related to severance and other employee-related costs. Our restructuring plans may also subject us to litigation risks and expenses. In addition, our restructuring plans may have other consequences, such as attrition beyond our planned reduction in workforce, a negative effect on employee morale or our ability to attract highly skilled employees. Our competitors may also seek to gain a competitive advantage over us. The restructuring plans could also cause our remaining employees to leave or result in reduced productivity by our employees, and, in turn, this may affect our revenue and other operating results in the future.

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. Any significant future difficulty in complying could harm our business, operating results or financial condition.

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

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

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

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

Companies in our industry that lose employees to 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.

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

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

Our certificate of incorporation allows our Board of Directors to issue, at any time and without stockholder approval, preferred stock with such terms as it may determine. No shares of preferred stock are currently outstanding. However, the rights of holders of any of our preferred stock that may be issued in the future may be superior to the rights of holders of our common stock.

Section 203 of the Delaware General Corporation Law generally prohibits a Delaware corporation from engaging in any business combination with a person owning 15% or more of its voting stock, or who is affiliated with the corporation and owned 15% or more of its voting stock at any time within three years prior to the proposed business combination, for a period of three years from the date the person became a 15% owner, unless specified conditions are met.

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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 allow our Board of Directors to resist, delay or prevent an acquisition of our company, even if a proposed transaction were favored by a majority of our independent stockholders.

Our business is subject to the risk of earthquakes and other natural disasters.

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, a region known to experience seismic activity. If significant seismic activity were to occur, our operations may be interrupted, which could adversely impact our business and results of operations.

Other of our offices in the United States and in other countries around the world may be adversely impacted by natural disasters. If a natural disaster occurs at or near any of our offices, our operations may be interrupted, which could adversely impact our business and results of operations. If a natural disaster impacts a significant number of our customers, our business and results of operations could be adversely impacted.

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, political unrest 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 that may only have sales offices or other less critical operations abroad. We are not insured for losses or interruptions caused by acts of war.

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 July 2, 2011, we had outstanding indebtedness with a principal balance of \$644.7 million as follows:

- \$350.0 million related to our 2015 Notes;
- \$150.0 million related to our 2011 Notes;
- \$144.5 million related to our 2013 Notes; and
- \$0.2 million related to our Zero Coupon Zero Yield Senior Convertible Notes Due 2023.

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 above;
- Make us more vulnerable in the event of a downturn in our business;
- Reduce funds available for use in our operations or for developments or acquisitions of new technologies;

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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.

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 any other indebtedness as well.

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

On the first day of fiscal 2009, we retrospectively adopted new accounting principles as required by the Debt with Conversion and Other Options subtopic of the FASB Accounting Standards Codification, and adjusted all periods for which the Convertible Senior Notes were outstanding before the date of adoption. This adoption had 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 our Convertible Senior Notes and 2015 Notes into cash prior to the scheduled maturities of the notes may adversely affect our liquidity and financial condition.

Holders of our Convertible Senior Notes and 2015 Notes may convert their notes into cash prior to the scheduled maturities of the notes upon the occurrence of certain events.

During the three months ended July 2, 2011, the closing sale price of our common stock exceeded \$9.81 for more than 20 of the last 30 consecutive trading days of that period. As a result, as of July 2, 2011, the 2015 Notes became convertible into cash at the election of holders of the 2015 Notes. Holders of the 2015 Notes can submit their 2015 Notes for conversion from July 2, 2011 through October 1, 2011. Because we would be required to settle the 2015 Notes in cash if holders elect to convert the 2015 Notes, we classified the \$287.1 million net liability of the 2015 Notes as a current liability on our Condensed Consolidated Balance Sheet as of July 2, 2011.

In order for the 2015 Notes to be convertible into cash in a particular fiscal quarter, a conversion condition must be met during the preceding fiscal quarter. We will reassess whether this conversion condition has been met at the end of our next fiscal quarter, which ends on October 1, 2011. If the closing sale price of our common stock does not exceed \$9.81 for 20 or more of the last 30 trading days during the three months ending October 1, 2011, the conversion condition would not be met and we would classify our 2015 Notes as a long-term liability on our Condensed Consolidated Balance Sheet as of that date.

If one or more of the 2015 Note holders elect to convert their notes or if one or more of the Convertible Senior Notes holders elect to convert their notes upon the occurrence of any of these events, we would be required to settle the converted principal through payment of cash, which could

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adversely affect our liquidity and financial condition. In addition, even if note holders do not elect to convert their notes upon the occurrence of any of these certain events, we would report any of our Convertible Senior Notes or 2015 Notes that are convertible at a balance sheet date as a current liability, which could have a material adverse impact on our net working capital. For an additional description of our Convertible Senior Notes and 2015 Notes, see Note 2 to our Condensed Consolidated Financial Statements.

Conversion of the Convertible Senior Notes and the exercise of warrants issued concurrently with the Convertible Senior Notes and 2015 Notes will, in certain circumstances, 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 before 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 98% of the product of (i) the closing sale price of our common stock and (ii) the conversion rate on that date.

From November 2, 2011, in the case of the 2011 Notes, and November 1, 2013, in the case of the 2013 Notes, and until the close of business on the scheduled trading day immediately preceding the maturity date of such Convertible Senior Notes, holders may convert their Convertible Senior Notes at any time, regardless of the foregoing circumstances. As of July 2, 2011, 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 \$21.15 per share, we entered into separate hedge and warrant transactions concurrent with the issuance of the Convertible Senior Notes to reduce the potential dilution from the conversion of the Convertible Senior Notes.

Additionally, although the 2015 Notes are only convertible into cash, we entered into separate hedge and warrant transactions concurrent with the issuance of the 2015 Notes to reduce the potential cash outlay from the conversion of the 2015 Notes. However, we cannot guarantee that the hedge and warrant instruments issued concurrently with the Convertible Senior Notes will fully mitigate the potential dilution from the Convertible Senior Notes or that the warrants issued concurrently with the 2015 Notes will not

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result in dilution. The warrants could have a dilutive effect to the extent that the market price per share of our common stock, as measured under the terms of the warrants, exceeds the strike price of the warrants. In addition, the existence of the Convertible Senior Notes and the 2015 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 holders of the Convertible Senior Notes and the 2015 Notes, under certain circumstances we may be required to repurchase the Convertible Senior Notes or the 2015 Notes in cash.

Under the terms of the Convertible Senior Notes and the 2015 Notes, we may be required to repurchase the Convertible Senior Notes and the 2015 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 and the 2015 Notes. The repurchase price for the Convertible Senior Notes and the 2015 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 and the 2015 Notes may affect the value of our common stock.

We entered into hedge transactions with various financial institutions, at the time of issuance of the Convertible Senior Notes and the 2015 Notes, with the objective of reducing the potential dilutive effect of issuing our common stock upon conversion of the Convertible Senior Notes and the potential cash outlay from the cash conversion of the 2015 Notes. We also entered into separate warrant transactions with the same financial institutions. In connection with our hedge and warrant transactions associated with the Convertible Senior Notes and the 2015 Notes, these financial institutions purchased our common stock in secondary market transactions and entered into various over-the-counter derivative transactions with respect to our common stock. These entities or their affiliates are likely to modify their hedge positions from time to time prior to conversion or maturity of the Convertible Senior Notes and the 2015 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 that Convertible Senior Notes holders will receive upon conversion of the Convertible Senior Notes and the amount of cash that 2015 Notes holders will receive upon conversion of the 2015 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. If the financial institutions with which we entered into these hedge transactions were to fail or default, our ability to settle on these transactions could be harmed or delayed.

We are subject to the risk that the hedge participants cannot, or do not, fulfill their obligations under the Convertible Senior Notes hedge transactions and the 2015 Notes hedge transactions.

Global economic conditions have resulted in the actual or perceived failure or financial difficulties of many financial institutions. If any of the participants in the hedge transactions is unwilling or unable to perform its obligations for any reason, we would not be able to receive the benefit of such transaction. We cannot provide any assurances as to the financial stability or viability of any of the participants in the hedge transactions.

Table of Contents**Rating agencies may provide unsolicited ratings on the Convertible Senior Notes and the 2015 Notes that could reduce the market value or liquidity of our Convertible Senior Notes, 2015 Notes or our common stock.**

We have not requested a rating of the Convertible Senior Notes or the 2015 Notes from any rating agency and we do not anticipate that the Convertible Senior Notes or the 2015 Notes will be rated. However, if one or more rating agencies independently elects to rate the Convertible Senior Notes or the 2015 Notes and assigns the Convertible Senior Notes or the 2015 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 or the 2015 Notes, as the case may be, and our common stock could be harmed. Should a decline occur in the market price of the Convertible Senior Notes or the 2015 Notes, as compared to the price of our common stock, this may trigger the right of the holders of the Convertible Senior Notes or the 2015 Notes to convert such notes into cash and shares of our common stock, as applicable.

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

During fiscal 2008, our Board of Directors authorized two programs to repurchase shares of our common stock in the open market with a value of up to \$1.0 billion in the aggregate. The following table sets forth the repurchases we made during the three months ended July 2, 2011:

| 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) |
|---------------|---|-------------------------------|--|---|
| April 3, 2011 | | | | |
| May 7, 2011 | 4,470 | \$ 9.74 | ---- | \$ 814.4 |
| May 8, 2011 | | | | |
| June 4, 2011 | 327,274 | \$ 10.67 | ---- | \$ 814.4 |
| June 5, 2011 | | | | |
| July 2, 2011 | 99,685 | \$ 10.12 | ---- | \$ 814.4 |
| Total | 431,429 | \$ 10.54 | ---- | |

* 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 programs.

Item 3. Defaults Upon Senior Securities

None.

Item 4. (Removed and Reserved)**Item 5. Other Information**

None.

Table of Contents**Item 6. Exhibits**

(a) The following exhibits are filed herewith:

| Exhibit Number | Exhibit Title | Incorporated by Reference | | | Provided Herewith |
|----------------|---|---------------------------|------------|-------------------------|-------------------|
| | | Form | File No. | Exhibit No. Filing Date | |
| 10.01 | Executive Transition and Release Agreement, effective as of April 27, 2011, between the Registrant and Thomas A. Cooley. | | | | X |
| 10.02 | The Senior Executive Bonus Plan. | 8-K | 001-10606 | 10.01 05/16/ 2011 | |
| 10.03 | The Registrant's Amended and Restated 2000 Equity Incentive Plan. | S-8 | 333-174200 | 99.1 05/13/2011 | |
| 10.04 | The Registrant's Amended and Restated 1987 Stock Incentive Plan. | S-8 | 333-174201 | 99.1 05/13/2011 | |
| 10.05 | Altos Design Automation, Inc. 2006 Stock Plan, as amended December 23, 2009. | S-8 | 333-174202 | 99.1 05/13/2011 | |
| 31.01 | Certification of the Registrant's Chief Executive Officer, Lip-Bu Tan, pursuant to Rule 13a-14 of the Securities Exchange Act of 1934. | | | | X |
| 31.02 | Certification of the Registrant's Chief Financial Officer, Geoffrey G. Ribar, pursuant to Rule 13a-14 of the Securities Exchange Act of 1934. | | | | X |
| 32.01 | Certification of the Registrant's Chief Executive Officer, Lip-Bu Tan, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | | | | X |
| 32.02 | Certification of the Registrant's Chief Financial Officer, Geoffrey G. Ribar, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | | | | X |
| 101.INS | XBRL Instance Document. | | | | X |
| 101.SCH | XBRL Taxonomy Extension Schema Document. | | | | X |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. | | | | X |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document. | | | | 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: July 29, 2011

By: /s/ Lip-Bu Tan

Lip-Bu Tan
President, Chief Executive
Officer and Director

DATE: July 29, 2011

By: /s/ Geoffrey G. Ribar

Geoffrey G. Ribar
Senior Vice President and Chief
Financial Officer

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