CADENCE DESIGN SYSTEMS INC
Form 10-Q
October 30, 2007

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 29, 2007

OR

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

For the transition period from _____to _____

Commission file number 0-15867

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

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes _X_ No __

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

Large accelerated filer [_X_] Accelerated filer [__] Non-accelerated filer [__]

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

On September 29, 2007, 268,811,877 shares of the registrant s common stock, $0.01 par value, were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

ASSETS

	September 29, 2007	December 30, 2006
Current Assets:		
Cash and cash equivalents	$ 935,587	$ 934,342
Short-term investments	15,654	24,089
Receivables, net of allowances of $2,499 and $3,804, respectively	278,200	238,438
Inventories	37,867	37,179
Prepaid expenses and other	111,554	77,957
Total current assets	1,378,862	1,312,005
Property, plant and equipment, net of accumulated depreciation of $612,206 and $615,768, respectively	332,519	354,575
Goodwill	1,311,087	1,267,579
Acquired intangibles, net	139,457	112,738
Installment contract receivables	221,520	149,584
Other assets	355,830	246,341
Total Assets	$ 3,739,275	$ 3,442,822

LIABILITIES AND STOCKHOLDERS EQUITY

	September 29, 2007	December 30, 2006
Current Liabilities:		
Convertible notes	$ 230,385	$ ----
Current portion of long-term debt	----	28,000
Accounts payable and accrued liabilities	241,737	259,790
Current portion of deferred revenue	241,318	260,275
Total current liabilities	713,440	548,065
Long-Term Liabilities:		
Long-term portion of deferred revenue	124,548	95,018
Convertible notes	500,000	730,385
Other long-term liabilities	448,439	370,063
Total long-term liabilities	1,072,987	1,195,466

Stockholders Equity:		
Common stock and capital in excess of par value	1,491,687	1,398,899
Treasury stock, at cost	(596,997)	(544,855)
Retained earnings	1,042,938	832,763
Accumulated other comprehensive income	15,220	12,484
Total stockholders equity	1,952,848	1,699,291
Total Liabilities and Stockholders Equity	$ 3,739,275	$ 3,442,822

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		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Revenue:				
Product	$ 273,799	$ 244,561	$ 775,496	$ 684,826
Services	31,225	34,262	95,963	99,798
Maintenance	95,900	87,325	285,611	268,251
Total revenue	400,924	366,148	1,157,070	1,052,875
Costs and Expenses:				
Cost of product	13,823	14,097	42,302	54,669
Cost of services	23,364	23,034	70,421	70,995
Cost of maintenance	15,217	15,604	45,635	47,514
Marketing and sales	97,163	97,499	297,924	289,064
Research and development	125,391	110,335	365,418	342,133
General and administrative	40,747	35,240	123,166	109,267
Amortization of acquired intangibles	4,739	4,606	13,661	17,982
Restructuring and other charges (credits)	(7,066)	(15)	(9,584)	(726)
Write-off of acquired in-process technology	2,678	----	2,678	900
Total costs and expenses	316,056	300,400	951,621	931,798
Income from operations	84,868	65,748	205,449	121,077
Interest expense	(2,849)	(2,959)	(9,373)	(9,880)
Other income, net	14,201	9,993	47,938	53,191
Income before provision for income taxes and cumulative effect of change in accounting principle	96,220	72,782	244,014	164,388
Provision for income taxes	23,488	30,722	67,265	70,579
Net income before cumulative effect of change in accounting principle	72,732	42,060	176,749	93,809
Cumulative effect of change in accounting principle, net of tax	----	----	----	418
Net income	$ 72,732	$ 42,060	$ 176,749	$ 94,227
Net income per share before cumulative effect of change in accounting principle:				

Basic	$	0.27	$	0.15	$	0.65	$	0.33
Diluted	$	0.24	$	0.14	$	0.60	$	0.30
Net income per share after cumulative effect of change in accounting principle:								
Basic	$	0.27	$	0.15	$	0.65	$	0.34
Diluted	$	0.24	$	0.14	$	0.60	$	0.30
Weighted average common shares outstanding basic		272,977		279,329		272,354		281,077
Weighted average common shares outstanding diluted		299,506		312,266		297,783		314,190

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

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

	Nine Months Ended	
	September 29, 2007	September 30, 2006
Cash and Cash Equivalents at Beginning of Period	$ 934,342	$ 861,315
Cash Flows from Operating Activities:		
Net income	176,749	94,227
Adjustments to reconcile net income to net cash provided by operating activities:		
Cumulative effect of change in accounting principle	----	(418)
Depreciation and amortization	96,798	113,862
Stock-based compensation	78,828	80,437
Equity in loss from investments, net	2,504	900
Gain on investments, net	(16,608)	(25,600)
Gain on sale and leaseback of land and buildings	(12,606)	----
Write-down of investment securities	2,550	1,429
Write-off of acquired in-process technology	2,678	900
Non-cash restructuring and other charges (credits)	(7,106)	----
Tax benefit of call options	7,036	3,969
Deferred income taxes	4,848	13,697
Proceeds from the sale of receivables, net	163,549	131,404
Recoveries on trade accounts receivable and sales returns	(975)	(3,727)
Other non-cash items	8,525	4,157
Changes in operating assets and liabilities, net of effect of acquired businesses:		
Receivables	9,053	77,489
Installment contract receivables	(273,301)	(195,038)
Inventories	(681)	(2,777)
Prepaid expenses and other	(23,229)	(9,368)
Other assets	(2,027)	5,108
Accounts payable and accrued liabilities	(35,516)	(107,147)
Deferred revenue	9,411	13,275
Other long-term liabilities	18,448	19,714
Net cash provided by operating activities	208,928	216,493
Cash Flows from Investing Activities:		
Proceeds from sale of available-for-sale securities	6,271	5,542
Proceeds from sale of short-term investments	197	----
Proceeds from the sale of long-term investments	6,323	21,599
Proceeds from the sale of property, plant and equipment	46,500	----
Purchases of property, plant and equipment	(57,405)	(48,270)
Purchases of software licenses	----	(6,409)

Investment in venture capital partnerships and equity investments		(3,214)		(2,000)
Cash paid in business combinations and asset acquisitions, net of cash acquired, and acquisition of intangibles		(74,117)		(65,352)
Net cash used for investing activities		(75,445)		(94,890)
Cash Flows from Financing Activities:				
Principal payments on term loan		(28,000)		(99,000)
Tax benefit from employee stock transactions		20,727		7,556
Proceeds from issuance of common stock		249,006		126,315
Purchases of treasury stock		(384,151)		(258,384)
Other		8,558		----
Net cash used for financing activities		(133,860)		(223,513)
Effect of exchange rate changes on cash and cash equivalents		1,622		(1,895)
Increase (decrease) in cash and cash equivalents		1,245		(103,805)
Cash and Cash Equivalents at End of Period	$	935,587	$	757,510

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

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

NOTE 1. BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q have been prepared by Cadence Design Systems, Inc., or Cadence, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, or the SEC. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, Cadence believes that the disclosures contained in this Quarterly Report comply with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, for a Quarterly Report on Form 10-Q and are adequate to make the information presented not misleading. These Condensed Consolidated Financial Statements are meant to be, and should be, read in conjunction with the Consolidated Financial Statements and the notes thereto included in Cadence s Annual Report on Form 10-K for the fiscal year ended December 30, 2006.

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

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

Cadence adopted the provisions of Financial Accounting Standards Interpretation, or FIN, No. 48 Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 on December 31, 2006, which was the first day of Cadence s 2007 fiscal year. FIN No. 48 prescribes a new recognition threshold and measurement attribute for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. Upon its adoption of FIN No. 48, Cadence applied the provisions of FIN No. 48 to all income tax positions. The cumulative effect of applying the provisions of FIN No. 48 have been reported as an adjustment to the opening balance of retained earnings or other appropriate components of equity or net assets in the Condensed Consolidated Balance Sheet as of the beginning of fiscal year 2007.

Cadence adopted the provisions of Emerging Issues Task Force, or EITF, Issue No. 06-03, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation) on December 31, 2006, which was the first day of Cadence s 2007 fiscal year. EITF No. 06-03 allows companies to choose either the gross basis or net basis of income statement presentation for taxes collected from customers and remitted to governmental authorities and requires companies to disclose such policy. Cadence applies the net basis presentation for taxes collected from customers and remitted to governmental authorities.

NOTE 2. STOCK-BASED COMPENSATION

Cadence has equity incentive plans that provide for the grant to employees of stock-based awards, including stock options and restricted stock. In addition, the 1995 Directors Plan provides for the automatic grant of stock options to non-employee members of Cadence s Board of Directors. Cadence also has an employee stock purchase plan, or ESPP, which enables employees to purchase shares of Cadence common stock.

Stock-based compensation expense and the related income tax benefit recognized under Statement of Financial Accounting Standards, or SFAS, No. 123R, Share-Based Payment in the Condensed Consolidated

Income Statements in connection with stock options, restricted stock and the ESPP for the three and nine months ended September 29, 2007 and September 30, 2006 were as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In thousands)			
Stock options	$ 9,069	$ 11,354	$ 29,166	$ 38,216
Restricted stock	12,022	11,027	41,531	34,611
ESPP	3,028	1,892	8,131	7,610
Total stock-based compensation expense	$ 24,119	$ 24,273	$ 78,828	$ 80,437
Income tax benefit	$ 7,312	$ 7,738	$ 26,488	$ 24,969

Stock Options

The exercise price of each stock option granted under Cadence s employee equity incentive plans is equal to or greater than the market price of Cadence s common stock on the date of grant. Generally, option grants vest over four years, expire no later than ten years from the grant date and are subject to the employee s continuing service to Cadence. The options granted under the 1995 Directors Stock Option Plan vest one year from the date of grant. Options assumed in connection with acquisitions generally have exercise prices that differ from the fair value of Cadence s common stock on the date of acquisition and such options generally continue to vest under their original vesting schedules and expire on the original dates stated in the acquired company s option agreements. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The weighted average grant date fair value of options granted and the weighted average assumptions used in the model for the three and nine months ended September 29, 2007 and September 30, 2006 were as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Dividend yield	None	None	None	None
Expected volatility	27.0%	24.1%	23.2%	24.6%
Risk-free interest rate	4.26%	4.59%	4.68%	4.83%
Expected life (in years)	4.4	5.3	4.4	5.4
Weighted average fair value of options granted	$ 6.41	$ 5.16	$ 5.14	$ 5.62

The computation of the expected volatility assumption used in the Black-Scholes pricing model for new grants is based on implied volatility. When establishing the expected life assumption, Cadence reviews annual historical employee exercise behavior with respect to option grants having similar vesting periods. The risk-free interest rate for the period within the expected term of the option is based on the yield of United States Treasury notes in effect at the time of grant. Cadence has not historically paid dividends; thus the expected dividend yield used in the calculation is zero.

Restricted Stock

The cost of restricted stock awards is determined using the fair value of Cadence s common stock on the date of the grant, and compensation expense is recognized over the vesting period. Generally, restricted stock awards vest

over four years and are subject to the employee s continuing service to Cadence. The weighted average grant date fair values for the three and nine months ended September 29, 2007 and September 30, 2006 were as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Weighted average fair value of restricted stock granted	$ 20.65	$ 16.59	$ 20.59	$ 16.75

Cadence issues some of its restricted stock with performance-based vesting. The terms of these restricted stock grants are consistent with grants of restricted stock described above, with the exception that they vest not upon the mere passage of time, but upon the attainment of certain predetermined performance goals. Each period, Cadence estimates the most likely outcome of such performance goals and recognizes the related stock-based compensation expense. The amount of stock-based compensation expense recognized in any one period can vary based on the attainment or estimated attainment of the various performance goals. If such performance goals are not met, no compensation expense is recognized and any previously recognized compensation expense is reversed. Stock-based compensation expense related to these performance-based restricted stock grants for the three and nine months ended September 29, 2007 and September 30, 2006 was as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In thousands)			
Stock-based compensation expense related to performance-based grants	$ 3,291	$ 2,969	$ 13,713	$ 9,792

Cumulative effect of change in accounting principle, net of tax

During the nine months ended September 30, 2006, a non-cash benefit of approximately $0.4 million for estimated forfeitures of restricted stock previously expensed was recorded as of the SFAS No. 123R implementation date as a one-time cumulative effect of change in accounting principle, net of tax. Pursuant to Accounting Principles Board, or APB, No. 25, Accounting for Stock Issued to Employees, stock-based compensation expense was not previously reduced for estimated future forfeitures, but instead was reversed upon actual forfeiture.

Employee Stock Purchase Plan

Under the ESPP, substantially all employees may purchase Cadence s common stock at a price equal to 85 percent of the lower of the fair market value at the beginning of the applicable offering period or at the end of each applicable purchase period, in an amount up to 12% of their annual base earnings plus bonuses, subject to a limit in any calendar year of $25,000 worth of common stock. The offering periods under the ESPP that began prior to August 1, 2006 were concurrent 24-month offering periods. Each offering period was divided into four consecutive six-month purchase periods. All offering periods that started before August 1, 2006 continued until they were completed or until they were terminated as provided in the documents governing the ESPP. Participants in the ESPP remained in the 24-month offering periods until these offering periods were completed or until such participant withdrew from the ESPP, whichever was earlier. Effective August 1, 2006, offering periods under the ESPP are six months with a

corresponding six month purchase period. New offerings begin on each February 1st and August 1st, and those offerings run consecutively rather than concurrently. Participants were converted to the six-month offering periods starting with the next offering period in which the participants enroll on or after August 1, 2006. Beginning with the August 1, 2007 offering period, all participants are participating in a six-month offering period and all 24-month offering periods have been completed. The purchase dates under the ESPP are January 31st and July 31st of each year.

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Shares of common stock issued under the ESPP for the three and nine months ended September 29, 2007 and September 30, 2006 were as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In thousands, except per share amounts)			
Cadence shares issued under the ESPP	1,279	1,812	3,200	3,640
Cash received from the exercise of purchase rights under the ESPP	$ 21,383	$ 20,831	$ 43,964	$ 41,619
Weighted average purchase price per share	$ 16.71	$ 11.49	$ 13.74	$ 11.43

Compensation expense is calculated using the fair value of the employees purchase rights under the Black-Scholes option pricing model. The weighted average grant date fair value of purchase rights granted under the ESPP and the weighted average assumptions used in the model for the three and nine months ended September 29, 2007 and September 30, 2006 were as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Dividend yield	None	None	None	None
Expected volatility	27.0%	24.1%	24.6%	24.0%
Risk-free interest rate	4.96%	5.18%	5.08%	4.89%
Expected life (in years)	0.5	0.5	0.5	1.1
Weighted average fair value of purchase rights granted	$ 5.01	$ 3.60	$ 4.74	$ 4.32

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

NOTE 3. INCOME TAXES

Cadence adopted the provisions of FIN No. 48 on December 31, 2006, which was the first day of Cadence s 2007 fiscal year. Cadence applies FIN No. 48 to each income tax position accounted for under SFAS No. 109, Accounting for Income Taxes, at each financial statement reporting date. This process involves the assessment of whether each income tax position is more likely than not of being sustained based on its technical merits. In making this assessment, Cadence must assume that the taxing authority will examine the income tax position and have full knowledge of all relevant information. For each income tax position that meets the more likely than not recognition threshold, Cadence then assesses the largest amount of tax benefit that is greater than 50 percent likely of being realized upon effective settlement with the taxing authority. Cadence reports the difference between the tax benefit recorded for financial statement purposes and the amount reflected in the tax return within income tax receivable, income tax payable,

deferred tax assets or deferred tax liabilities.

The cumulative effect of adopting FIN No. 48 was reported as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets) in the Condensed Consolidated Balance Sheet for fiscal 2007. Cadence recognized a $59.4 million decrease in the net liabilities for unrecognized tax benefits, which was accounted for as an increase to the December 31, 2006 balance of retained earnings. Cadence also recognized a $42.6 million decrease in the net liabilities for unrecognized tax benefits, which was accounted for as a $35.3 million

increase in the December 31, 2006 balance of Common stock and capital in excess of par value and a $7.3 million decrease in the December 31, 2006 balance of Goodwill.

Upon adoption of FIN No. 48, Cadence also recognized additional long-term income tax assets of $115.0 million and additional long-term income tax liabilities of $115.0 million to present the unrecognized tax benefits as gross amounts on the Condensed Consolidated Balance Sheet. Cadence also decreased current income tax liabilities by $26.2 million and increased long-term income tax liabilities by the same amount based on its anticipation of the amount of cash payments to be made within one year.

As of December 31, 2006, Cadence had $337.2 million of total gross unrecognized tax benefits. Of that total, $232.1 million of unrecognized tax benefits would, if recognized, affect the effective tax rate.

Upon adoption of FIN No. 48, Cadence adopted an accounting policy to classify interest and penalties on unrecognized tax benefits as income tax expense. For years prior to the adoption of FIN No. 48, Cadence also reported interest and penalties on unrecognized tax benefits as income tax expense. As of December 31, 2006, the total amounts of accrued interest and penalties were $65.8 million and $10.1 million, respectively.

The Internal Revenue Service, or IRS, and other tax authorities regularly examine Cadence s income tax returns. Cadence s United States federal income tax returns beginning with the 1997 tax year remain subject to examination by the IRS. Cadence s California income tax returns beginning with the 2001 tax year (plus any amended tax returns which need to be filed upon the potential settlement of the IRS examination of the tax years beginning with 1997) remain subject to examination by the California Franchise Tax Board.

In November 2003, the IRS completed its field examination of Cadence s federal income tax returns for the tax years 1997 through 1999 and issued a Revenue Agent s Report, or RAR, in which the IRS proposed to assess an aggregate tax deficiency for the three-year period of approximately $143.0 million. The most significant of the disputed adjustments for the tax years 1997 through 1999 relates to transfer pricing arrangements that Cadence had with a foreign subsidiary. Cadence has filed a protest to certain of the proposed adjustments with the Appeals Office of the IRS where the matter is currently being considered. Cadence believes that it is reasonably possible that the total amount of the unrecognized tax benefits for these transfer pricing arrangements could significantly increase or decrease within the next 12 months if a closing agreement can be reached with the Appeals Office of the IRS to resolve the proposed IRS adjustments to the transfer pricing arrangements. Cadence also believes that it is reasonably possible that the IRS could develop new policies and rules within the next 12 months that could impact the total amounts of unrecognized tax benefits for these transfer pricing arrangements. Because of the uncertain impact of any potential IRS policies and rules and because there is limited historical precedents of relevant tax settlements available, Cadence is currently unable to provide an estimate of the range of the reasonably possible change.

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

Cadence believes that the proposed IRS adjustments are inconsistent with applicable tax laws and Cadence is vigorously challenging these proposed adjustments. The RARs are not final Statutory Notices of Deficiency but the IRS imposes interest on the proposed deficiencies until the matters are resolved. Interest is compounded daily at rates published by the IRS, which rates are adjusted quarterly and have been between four and ten percent since 1997. The IRS is currently examining Cadence s federal income tax returns for the tax years 2003 through 2005.

NOTE 4. ACQUISITIONS

During the nine months ended September 29, 2007, Cadence acquired Invarium, Inc., a San Jose-based developer of advanced lithography-modeling and pattern-synthesis technology, and Clear Shape Technologies, Inc., a San Jose-based design for manufacturing technology company specializing in design-side solutions to minimize yield loss for advanced semiconductor integrated circuits. Cadence acquired these two companies for an aggregate purchase price of $75.5 million, which included the payment of cash, the fair value of assumed options and acquisition costs. The $45.7 million of goodwill recorded in connection with these acquisitions is not expected to be deductible for income tax purposes. Prior to acquiring Clear Shape Technologies, Inc., Cadence had an investment of $2.0 million in the company, representing a 12% ownership interest, which had been accounted for under the cost method of accounting. In accordance with SFAS No. 141, Business Combinations, Cadence accounted for this acquisition as a step acquisition.

In connection with these acquisitions, Cadence recorded an expense of $2.7 million in the three and nine months ended September 29, 2007 for the write-off of acquired in-process technology. The purchase price allocated to acquired in-process technology was determined through established valuation techniques. The acquired in-process technology was immediately expensed because technological feasibility had not been established, and no future alternative use existed. The write-off of acquired in-process technology is a component of operating expenses in the Consolidated Income Statements.

The acquired companies results of operations and the estimated fair values of the assets acquired and liabilities assumed have been included in Cadence s Condensed Consolidated Financial Statements from the date of acquisition. Comparative pro forma financial information for these acquisitions has not been presented because the effect on results of operations was not material to Cadence s Condensed Consolidated Financial Statements.

NOTE 5. GOODWILL AND ACQUIRED INTANGIBLES

Goodwill

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

The market approach provides an estimate of the fair value of Cadence based on the total number of shares of Cadence common stock outstanding, multiplied by the price per share. The estimated fair value is then compared to the carrying value of Cadence s net assets. If the carrying value of Cadence s net assets is greater than the aggregate market value of its outstanding shares of common stock, additional fair value analyses are performed on the individual intangible assets, including goodwill, to determine if any intangible assets are impaired, and, if so, an impairment charge is recorded.

The changes in the carrying amount of goodwill for the nine months ended September 29, 2007 were as follows:

	(In thousands)
Balance as of December 30, 2006	$ 1,267,579

Goodwill resulting from acquisitions during the period	45,700
Additions due to earnouts	4,137
Tax benefits allocable to goodwill	(475)
Adoption of FIN No. 48	(7,318)
Other	1,464
Balance as of September 29, 2007	$ 1,311,087

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Acquired Intangibles, net

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

	Gross Carrying Amount	Accumulated Amortization	Acquired Intangibles, net
		(In thousands)	
Existing technology and backlog	$ 651,427	$ (595,132)	$ 56,295
Agreements and relationships	96,585	(48,398)	48,187
Distribution rights	30,100	(12,792)	17,308
Tradenames, trademarks and patents	29,367	(11,700)	17,667
Total acquired intangibles	$ 807,479	$ (668,022)	$ 139,457

Cadence acquired intangible assets of $60.7 million during the nine months ended September 29, 2007, of which $27.9 million was acquired in connection with the acquisitions described in Note 4. Of the remainder, $30.7 million is included in Agreements and relationships and $2.1 million is included in Tradenames, trademarks, and patents in the above table. The $60.7 million of acquired intangible assets had a weighted average life of 5 years at the time of acquisition.

Acquired intangibles with finite lives as of December 30, 2006 were as follows:

	Gross Carrying Amount	Accumulated Amortization	Acquired Intangibles, net
		(In thousands)	
Existing technology and backlog	$ 625,832	$ (572,315)	$ 53,517
Agreements and relationships	63,153	(41,773)	21,380
Distribution rights	30,100	(10,535)	19,565
Tradenames, trademarks and patents	26,634	(8,358)	18,276
Total acquired intangibles	$ 745,719	$ (632,981)	$ 112,738

Amortization of acquired intangibles for the three and nine months ended September 29, 2007 and September 30, 2006 was as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
		(In thousands)		

Amortization of acquired intangibles	$	12,003	$	12,248	$	34,151	$	50,450

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

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

	(In thousands)	
2007 remaining period	$	12,488
2008		43,035
2009		33,687
2010		21,369
2011		16,066
Thereafter		12,812
Total estimated amortization expense	$	139,457

NOTE 6. CONTINGENCIES

Legal Proceedings

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

On February 8, 2007, Cadence, Magma Design Automation, Inc., or Magma, Altera Corp., or Altera, and Mentor Graphics Corp., or Mentor filed a complaint in the United States District Court for the Northern District of California against an individual, Narpat Bhandari, or Bhandari, and Vanguard Systems, Inc., or Vanguard. The complaint seeks a declaratory judgment that U.S. Patent No. 5,663,900, or the 900 Patent, which discloses an electronic simulation and emulation system and is allegedly owned by Bhandari and Vanguard, is not infringed and is invalid and unenforceable. The Complaint further seeks a declaratory judgment that LSI Logic Corporation, or LSI, has an ownership interest in the 900 Patent that precludes Vanguard and Bhandari from asserting the patent without first joining LSI. In March 2007, Cadence, Magma, Altera and Mentor amended the complaint to further plead non-infringement on the basis of obtaining a license to the 900 Patent from its co-owner, LSI. In April 2007, Vanguard and Bhandari answered the amended complaint, asserting counterclaims alleging that certain products of Cadence and the other plaintiffs infringe the 900 patent. In a case management conference held on May 21, 2007, the court granted the request of Cadence, Magma, Altera and Mentor to bifurcate the case and stay all issues except for the question of LSI s ownership interest in the 900 Patent. Cadence, Magma, Altera and Mentor filed a Motion for Summary Judgment that LSI was a joint-owner and that the license from LSI warranted dismissal of Vanguard and Bhandari s claim. After briefing, the motion was submitted to the Court on the papers on September 27, 2007. The motion is presently under submission, and no further proceedings are scheduled at this time.

On May 30, 2007, Ahmed Higazi, a former Cadence employee, filed suit against Cadence in the United States District Court for the Northern District of California alleging that Cadence improperly classified him as exempt from overtime pay. The suit alleges claims for unpaid overtime under the federal Fair Labor Standards Act and California law,

waiting time penalties under the California Labor Code, failure to provide proper earnings statements under California law, failure to provide meal and rest breaks as required by California law, unfair business practices under California Business & Professions Code section 17200, and unpaid 401(k) contributions in violation of the Employee Retirement Income Security Act, or ERISA. Plaintiff seeks to represent a class of current and former Cadence Information Technology employees, although the scope of the purported class is not yet clear. Cadence filed an Answer denying the material allegations of the complaint and raising a number of affirmative defenses. Neither side has commenced discovery, and the court has not addressed the appropriateness of class certification. Cadence intends to defend the case vigorously.

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

Other Contingencies

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

Cadence s product license and services agreements include a limited indemnification provision for claims from third parties relating to Cadence s intellectual property. Such indemnification provisions are accounted for in accordance with SFAS No. 5. The indemnification is generally limited to the amount paid by the customer. To date, claims under such indemnification provisions have not been significant.

NOTE 7. NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted average number of shares of common stock outstanding, less unvested restricted stock during the period. Diluted net income per share gives effect to convertible debt and equity instruments considered to be potential common shares, if dilutive, computed using the treasury stock method of accounting.

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

EITF No. 04-08, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share, requires Cadence to include in diluted earnings per share the shares of Cadence s common stock into which the 1.375% Convertible Senior Notes Due 2011 and the 1.500% Convertible Senior Notes Due 2013, together, the Convertible Senior Notes, may be converted. However, since the Convertible Senior Notes meet the qualification of an Instrument C under EITF No. 90-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock, and because cash will be paid for the principal amount of the obligation upon conversion, the only shares that will be considered for inclusion in diluted EPS are those relating to the excess of the conversion premium over the principal amount, using the if-converted method of accounting. In the event Cadence s common stock exceeds $21.15 per share, for the first $1.00 the price exceeds $21.15, there would be dilution of approximately 1.1 million shares. As the share price continues to increase, dilution would continue to occur but at a declining rate. The number of shares included in diluted EPS for the Convertible Senior Notes for the three and nine months ended September 29, 2007 were 0.4 million and 0.1 million, respectively.

The calculations for basic and diluted net income per share for the three and nine months ended September 29, 2007 and September 30, 2006 were as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In thousands, except per share amounts)			
Net income before cumulative effect of change in accounting principle	$ 72,732	$ 42,060	$ 176,749	$ 93,809
Effect of dilutive securities:				
Amortization of 2023 Notes transaction fees, net of tax	219	392	657	1,174
Net income before cumulative effect of change in accounting principle, as adjusted	$ 72,951	$ 42,452	$ 177,406	$ 94,983
Net income after cumulative effect of change in accounting principle	$ 72,732	$ 42,060	$ 176,749	$ 94,227
Effect of dilutive securities:				
Amortization of 2023 Notes transaction fees, net of tax	219	392	657	1,174
Net income after cumulative effect of change in accounting principle, as adjusted	$ 72,951	$ 42,452	$ 177,406	$ 95,401
Weighted average common shares:				
Weighted average common shares used to calculate basic net income per share	272,977	279,329	272,354	281,077
Convertible Senior Notes	449	----	122	----
2023 Notes	14,721	26,837	14,721	26,837
Options	8,845	4,313	8,217	4,811
Restricted stock and ESPP shares	2,514	1,787	2,369	1,465
Weighted average common and potential common shares used to calculate diluted net income per share	299,506	312,266	297,783	314,190
Basic net income per share:				
Net income per share before cumulative effect of change in accounting principle	$ 0.27	$ 0.15	$ 0.65	$ 0.33
Net income per share after cumulative effect of change in accounting principle	$ 0.27	$ 0.15	$ 0.65	$ 0.34
Diluted net income per share:				
Net income per share before cumulative effect of change in accounting principle	$ 0.24	$ 0.14	$ 0.60	$ 0.30

Net income per share after cumulative effect of change in accounting principle	$ 0.24	$ 0.14	$ 0.60	$ 0.30

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The following table presents the potential shares of Cadence common stock outstanding for the three and nine months ended September 29, 2007 and September 30, 2006 that were not included in the computation of diluted net income per share because the effect of including these shares would have been antidilutive:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In thousands)			
Options to purchase shares of common stock (various expiration dates through 2017)	10,995	26,431	11,840	24,112
Warrants to purchase shares of common stock related to the Convertible Senior Notes (various expiration dates through 2014)	23,640	----	23,640	----
Warrants to purchase shares of common stock related to the 2023 Notes (various expiration dates through 2008)	14,717	26,829	14,717	26,829
Total potential common shares excluded	49,352	53,260	50,197	50,941

NOTE 8. STOCK REPURCHASE PROGRAMS

In February 2006, the Cadence Board of Directors authorized a program to repurchase shares of Cadence s common stock in the open market with a value of up to $500.0 million in the aggregate, which program was completed during the nine months ended September 29, 2007. In November 2006, Cadence s Board of Directors authorized a new program to repurchase shares of Cadence s common stock in the open market with a value of up to an additional $500.0 million in the aggregate.

The shares repurchased under Cadence s stock repurchase programs during the three and nine months ended September 29, 2007 and September 30, 2006 were as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In thousands)			
Shares repurchased	12,000	6,000	17,900	15,000
Total cost of repurchased shares	$ 250,961	$ 97,554	$ 372,416	$ 258,384

As of September 29, 2007, the repurchase authorization remaining under Cadence s repurchase program totaled $155.4 million.

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NOTE 9. RETAINED EARNINGS

The changes in retained earnings for the three and nine months ended September 29, 2007 were as follows:

	Three Months Ended September 29, 2007 (In thousands)
Balance as of June 30, 2007	$ 971,762
Net income	72,732
Step acquisition adjustment	(1,556)
Balance as of September 29, 2007	$ 1,042,938

	Nine Months Ended September 29, 2007 (In thousands)
Balance as of December 30, 2006	$ 832,763
Net income	176,749
Re-issuance of treasury stock	(24,384)
Adoption effect of FIN No. 48	59,366
Step acquisition adjustment	(1,556)
Balance as of September 29, 2007	$ 1,042,938

NOTE 10. RESTRUCTURING AND OTHER CHARGES (CREDITS)

Cadence initiated a separate plan of restructuring in each year from 2001 through 2005 in an effort to operate more efficiently. The restructuring plans initiated each year from 2001 through 2005, or the 2001 Restructuring, 2002 Restructuring, 2003 Restructuring, 2004 Restructuring and 2005 Restructuring, respectively, were intended to decrease costs through workforce reductions and facility and resource consolidation in order to improve Cadence s cost structure. The 2001 and 2002 Restructurings primarily related to Cadence s design services business and certain other business or infrastructure groups throughout the world. The 2003 Restructuring, 2004 Restructuring and 2005 Restructuring were targeted at reducing costs throughout the company. The 2004 Restructuring has been completed and there was no remaining balance accrued for this restructuring as of September 29, 2007.

Since 2001, Cadence has recorded facilities consolidation charges, net of credits, of $87.5 million related to space reductions or facility closures of 49 sites. As of September 29, 2007, 28 of these sites had been vacated and space reductions had occurred at the remaining 21 sites. Cadence expects to pay remaining facilities-related restructuring liabilities for all of its restructuring plans prior to 2016.

The initial facility closure and space reduction costs included in these restructurings were comprised of payments required under leases, less any applicable estimated sublease income after the properties were abandoned, lease buyout costs and other contractual charges. To estimate the initial lease loss, which is the loss after Cadence s cost recovery efforts from subleasing all or part of a building, Cadence management made certain assumptions related to the time period over which the relevant building would remain vacant and sublease terms, including sublease rates and contractual common area charges.

Each reporting period, Cadence evaluates the adequacy of the lease loss accrual for each plan of restructuring. Cadence adjusts the lease loss accrual for changes in real estate markets or other factors that may affect estimated

costs or sublease income. Cadence also considers executed sublease agreements and adjusts the lease loss accrual if sublease income under the agreement differs from initial estimates.

As of September 29, 2007, total accrued restructuring costs were $19.3 million, consisting solely of estimated lease losses related to certain of the restructuring activities initiated since 2001. This amount may be adjusted in the future based upon changes in the assumptions used to estimate the lease loss. Of the $19.3 million, $11.0 million was included in Accounts payable and accrued liabilities and $8.3 million was included in Other long-term liabilities.

The activity recorded in each of the restructuring plans for the three months ended September 29, 2007, which is related to payments of remaining lease obligations, net of sublease payments received, and changes in estimates related to lease loss accruals, is presented in the following table:

	2005 Restructuring	2003 Restructuring	2002 Restructuring	2001 Restructuring	Total
			(In thousands)		
Balance, June 30, 2007	$ 1,014	$ 5,350	$ 2,940	$ 17,528	$ 26,832
Adjustments to Restructuring and other charges (credits), net	(174)	269	(33)	(7,128)	(7,066)
Non-cash charges	21	37	----	----	58
Cash payments	(89)	(346)	(272)	(71)	(778)
Effect of foreign currency translation	6	105	----	192	303
Balance, September 29, 2007	$ 778	$ 5,415	$ 2,635	$ 10,521	$ 19,349

The activity recorded in each of the restructuring plans for the nine months ended September 29, 2007, which is related to payments of remaining lease obligations, net of sublease payments received, and changes in estimates related to lease loss accruals, is presented in the following table:

	2005 Restructuring	2003 Restructuring	2002 Restructuring	2001 Restructuring	Total
			(In thousands)		
Balance, December 30, 2006	$ 1,186	$ 6,252	$ 5,147	$ 18,715	$ 31,300
Adjustments to Restructuring and other charges (credits), net	(174)	130	(1,764)	(7,776)	(9,584)
Non-cash charges	57	126	----	----	183
Cash payments	(307)	(1,324)	(748)	(1,002)	(3,381)
Effect of foreign currency translation	16	231	----	584	831
Balance, September 29, 2007	$ 778	$ 5,415	$ 2,635	$ 10,521	$ 19,349

On October 5, 2007, Cadence completed a lease termination agreement for a facility included in the 2001 Restructuring whereby Cadence paid $8.2 million and was released from all future obligations related to the facility. Cadence recorded a credit to Restructuring and other charges of $7.1 million during the three months ended September 29, 2007, representing the lease loss accrual related to this facility in excess of the amount paid. As of September 29, 2007, the remaining lease loss accrual related to this facility, consisting of the $8.2 million payment made on October 5, 2007, was included in the 2001 Restructuring in the table above.

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NOTE 11. OTHER COMPREHENSIVE INCOME

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

Cadence s comprehensive income for the three and nine months ended September 29, 2007 and September 30, 2006 was as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In thousands)			
Net income	$ 72,732	$ 42,060	$ 176,749	$ 94,227
Foreign currency translation gain (loss)	5,354	963	7,676	(3,213)
Changes in unrealized holding gains (losses) on available-for-sale securities, net of reclassification adjustment for realized gains and related tax effects	(2,330)	(4,343)	(4,024)	(6,144)
Other	16	----	(916)	----
Comprehensive income	$ 75,772	$ 38,680	$ 179,485	$ 84,870

NOTE 12. OTHER INCOME, NET

Cadence s Other income, net, for the three and nine months ended September 29, 2007 and September 30, 2006 was as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In thousands)			
Interest income	$ 12,609	$ 9,863	$ 37,472	$ 29,593
Gains (losses) on sale of non-marketable securities	83	(480)	5,642	16,366
Gains on available-for-sale securities	2,093	1,805	4,404	4,620
Gains (losses) on securities in Cadence s non-qualified deferred compensation trust	2,339	(863)	6,562	4,614
Gains (losses) on foreign exchange	(317)	165	(951)	338
Equity in loss from investments, net	(784)	(300)	(2,504)	(900)
Write-down of investment securities	(2,000)	(428)	(2,550)	(1,429)
Other income (expense)	178	231	(137)	(11)
Total other income, net	$ 14,201	$ 9,993	$ 47,938	$ 53,191

NOTE 13. SALE-LEASEBACK

In January 2007, Cadence completed the sale of certain land and buildings in San Jose, California for a sales price of $46.5 million cash. Concurrently with the sale, Cadence leased back from the purchaser approximately 262,500 square feet of office space, which represents all available space in the buildings. The lease agreement includes an initial term of two years, with two options to extend the lease for six months each. Cadence is obligated

to make lease payments related to this lease of $0.6 million for the remaining portion of 2007, $2.4 million in 2008 and $0.2 million in 2009.

A substantial portion of the gain upon sale was recognized throughout Cadence s costs and expenses during the three months ended March 31, 2007, and the remaining gain will be recognized over the initial lease term of two years. During the lease term, Cadence is constructing an additional building located on its San Jose, California campus to replace the buildings it sold in this transaction.

NOTE 14. SEGMENT AND GEOGRAPHY REPORTING

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, requires disclosures of certain information regarding operating segments, products and services, geographic areas of operation and major customers. SFAS No. 131 reporting is based upon the management approach : how management organizes the company s operating segments for which separate financial information is (i) available and (ii) evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Cadence s chief operating decision maker is its President and Chief Executive Officer, or CEO.

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

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

The following table presents a summary of revenue by geography:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In thousands)			
North America:				
United States	$ 160,895	$ 188,280	$ 523,147	$ 511,399
Other North America	5,310	7,928	21,889	24,673
Total North America	166,205	196,208	545,036	536,072
Europe, Middle East and Africa:				
Germany	14,784	26,854	46,804	71,004
Netherlands	44,373	1,702	45,105	6,959
Other Europe, Middle East and Africa	40,492	51,273	128,229	126,659
Total Europe, Middle East and Africa	99,649	79,829	220,138	204,622
Japan and Asia:				
Japan	88,863	49,246	242,442	206,418
Asia	46,207	40,865	149,454	105,763

Total Japan and Asia	135,070	90,111	391,896	312,181
Total	$ 400,924	$ 366,148	$ 1,157,070	$ 1,052,875

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

	As of	
	September 29, 2007	December 30, 2006
	(In thousands)	
North America:		
United States	$ 295,733	$ 325,076
Other North America	77	108
Total North America	295,810	325,184
Europe, Middle East and Africa:		
Germany	1,397	1,163
Other Europe, Middle East, and Africa	8,438	8,026
Total Europe, Middle East, and Africa	9,835	9,189
Japan and Asia:		
Japan	1,023	797
Asia	25,851	19,405
Total Japan and Asia	26,874	20,202
Total	$ 332,519	$ 354,575

One customer accounted for 14% of total revenue during the three months ended September 29, 2007 but no customer accounted for 10% or more of total revenue during the nine months ended September 29, 2007. No customer accounted for 10% or more of total revenue during the three and nine months ended September 30, 2006.

As of September 29, 2007, three customers accounted for 34% of Cadence s Receivables, net and Installment contract receivables. As of December 30, 2006, two customers accounted for 34% of Cadence s Receivables, net and Installment contract receivables.

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

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and notes thereto included in this Quarterly Report on Form 10-Q, or this Quarterly Report, and in conjunction with our Annual Report on Form 10-K for the fiscal year ended December 30, 2006. Certain of these statements, including, without limitation, statements regarding the extent and timing of future revenues and expenses and customer demand, statements regarding the deployment of our products, statements regarding our reliance on third parties and other statements using words such as anticipates, believes, could, estimates, expects, intends, may, plans, should, will and would, and words of similar import and the negatives thereof, constitute forward-looking statements. These statements are predictions based upon our current expectations about future events. Actual results could vary materially as a result of certain factors, including but not limited to, those expressed in these statements. We refer you to the Risk Factors, Results of Operations, Disclosures About Market Risk, and Liquidity and Capital Resources sections contained in this Quarterly Report, and the risks discussed in our other SEC filings, which identify important risks and uncertainties that could cause actual results to differ materially from those contained in the forward-looking statements.

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

Overview

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

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

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

Critical Accounting Estimates

In preparing our Condensed Consolidated Financial Statements, we make assumptions, judgments and estimates that can have a significant impact on our revenue, operating income and net income, as well as on the value of certain

assets and liabilities on our Condensed Consolidated Balance Sheets. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. At least quarterly, we evaluate our assumptions, judgments and estimates and make changes accordingly. Historically, our assumptions, judgments and estimates relative to our critical accounting estimates have not differed materially from actual results. Due to our adoption of Financial Accounting Standards Interpretation, or

FIN, No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 on December 31, 2006, our critical accounting estimate for accounting for income taxes is described below.

Accounting for income taxes

We provide for the effect of income taxes in our Condensed Consolidated Financial Statements in accordance with Statement of Financial Accounting Standards, or SFAS, No. 109, Accounting for Income Taxes and FIN No. 48. Under SFAS No. 109, income tax expense (benefit) is recognized for the amount of taxes payable or refundable for the current year, and for deferred tax assets and liabilities for the tax consequences of events that have been recognized in an entity s financial statements or tax returns. Under FIN No. 48, only income tax positions that meet the more likely than not recognition threshold may be recognized in the financial statements. An income tax position that meets the more likely than not recognition threshold shall initially and subsequently be measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon effective settlement with a taxing authority that has full knowledge of all relevant information.

We must make significant assumptions, judgments and estimates to determine our current provision for income taxes, our deferred tax assets and liabilities and any valuation allowance to be recorded against our deferred tax assets. Our judgments, assumptions and estimates relating to the current provision for income taxes take into account current tax laws, our interpretation of current tax laws and possible outcomes of current and future audits conducted by foreign and domestic tax authorities. Changes in tax laws or our interpretation of tax laws, and developments in current and future tax audits, could significantly impact the amounts provided for income taxes in our results of operations, financial position or cash flows. Our assumptions, judgments and estimates relating to the value of our net deferred tax assets take into account predictions of the amount and category of future taxable income from potential sources, including tax planning strategies that would, if necessary, be implemented to prevent a loss carryforward or tax credit carryforward from expiring unused. Actual operating results and the underlying amount and category of income in future years could render our current assumptions, judgments and estimates of recoverable net deferred taxes inaccurate, thus materially affecting our consolidated financial position or results of operations.

For further information about our other critical accounting estimates, see the discussion under the heading Critical Accounting Estimates in our Form 10-K for the year ended December 30, 2006.

Results of Operations

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

The right to access new technology;

The duration of the license; and

Payment terms.

Customer decisions regarding these aspects of license transactions determine the license type, timing of revenue recognition and potential future business activity. For example, if a customer chooses a fixed term of use, this will result in either a subscription or term license. Product revenue recognized in any period is affected by the extent to which customers purchase subscription, term or perpetual licenses, and by the extent to which contracts contain flexible payment terms. The timing of revenue recognition is also affected by the extent to which existing contracts

contain flexible payment terms and by changes in contractual arrangements with existing customers. For example, the timing and amount of product revenue that is recognized during a period could be significantly affected when:

License types utilized by an existing customer change from a subscription to a term license; or

An existing customer enters into a new contractual arrangement that includes certain terms and conditions that differ from their terminated arrangement where revenue was being recognized over multiple periods.

The amount of revenue recognized in future periods also depends on, among other things, the size, terms and timing of our:

Contract renewals with existing customers;

Additional sales to existing customers; and

Sales to new customers.

The value and duration of contracts, and consequently product revenue recognized, is also affected by the competitiveness of our products.

A business implication of a customer s decision to choose a fixed term of use is that, at the expiration of the license period, the customer must decide whether to continue using the technology and therefore renew the license agreement. Because larger customers generally use products from two or more of our five product groups, rarely will a large customer completely terminate its relationship with us at expiration of the license. See the discussion under the heading Critical Accounting Estimates in our Form 10-K for the year ended December 30, 2006 for an additional description of license types and timing of revenue recognition.

A substantial portion of our total revenue is recognized over multiple periods. As a result, we do not believe that pricing volatility has been a material component of the change in our revenue from period to period.

Revenue and Revenue Mix

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

Our product groups are:

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

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

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

System Interconnect: This product group consists of our printed circuit board, or PCB, and IC package design products, including the Allegro and OrCAD products. The Allegro system interconnect platform offering focuses on

system interconnect design platform, which enables consistent co-design of ICs, IC packages and PCBs, while the OrCAD line focuses on cost-effective, entry-level PCB solutions.

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

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Revenue by Period

The following table shows our revenue for the three and nine months ended September 29, 2007 and September 30, 2006 and the percentage change in revenue between periods:

	Three Months Ended			Nine Months Ended		
	September 29, 2007	September 30, 2006	% Change	September 29, 2007	September 30, 2006	% Change
	(In millions, except percentages)					
Product	$ 273.8	$ 244.5	12%	$ 775.5	$ 684.8	13%
Services	31.2	34.3	(9)%	96.0	99.8	(4)%
Maintenance	95.9	87.3	10%	285.6	268.3	6%
Total revenue	$ 400.9	$ 366.1	9%	$ 1,157.1	$ 1,052.9	10%

Product and maintenance revenue was higher in the three months ended September 29, 2007, as compared to the three months ended September 30, 2006, primarily because of increased revenue from licenses for Digital IC Design and Custom IC Design products, which was partially offset by decreases in revenue from licenses for Design for Manufacturing, System Interconnect and Functional Verification products. Product and maintenance revenue was higher in the nine months ended September 29, 2007, as compared to the nine months ended September 30, 2006, primarily because of increased revenue from licenses for Digital IC Design and Custom IC Design products which was partially offset by a decrease in revenue from licenses for Design for Manufacturing products.

One customer accounted for 14% of total revenue for the three months ended September 29, 2007 but no customer accounted for 10% or more of total revenue for the three months ended September 30, 2006. No customer accounted for 10% or more of total revenue for the nine months ended September 29, 2007 and for the nine months ended September 30, 2006.

Revenue by Product Group

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

	Three Months Ended				
	September 29, 2007	June 30, 2007	March 31, 2007	December 30, 2006	September 30, 2006
Functional Verification	20%	24%	24%	23%	24%
Digital IC Design	27%	29%	26%	26%	19%
Custom IC Design	32%	24%	24%	26%	30%
System Interconnect	7%	8%	10%	11%	10%
Design for Manufacturing	6%	7%	7%	6%	8%
Services and other	8%	8%	9%	8%	9%
Total	100%	100%	100%	100%	100%

As described under the heading Critical Accounting Estimates in our Form 10-K for the year ended December 30, 2006, certain of our licenses allow customers the ability to remix among software products. Additionally, we have licensed a combination of our products to customers with the actual product selection and number of licensed users to be determined at a later date. For these arrangements, we estimate the allocation of the revenue to product groups based upon the expected usage of our products by these customers. The actual usage of our products by these customers may differ and, if that proves to be the case, the revenue allocation in the above table would differ.

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

Revenue by Geography

	Three Months Ended			Nine Months Ended		
	September 29, 2007	September 30, 2006	% Change	September 29, 2007	September 30 2006	% Change
	(In millions, except percentages)					
United States	$ 160.9	$ 188.3	(15)%	$ 523.2	$ 511.4	2%
Other North America	5.3	7.9	(33)%	21.9	24.7	(11)%
Europe, Middle East and Africa	99.6	79.8	25%	220.1	204.6	8%
Japan	88.9	49.2	81%	242.4	206.4	17%
Asia	46.2	40.9	13%	149.5	105.8	41%
Total revenue	$ 400.9	$ 366.1	9%	$ 1,157.1	$ 1,052.9	10%

Revenue by Geography as a Percent of Total Revenue

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
United States	40%	51%	45%	49%
Other North America	1%	2%	2%	2%
Europe, Middle East and Africa	25%	22%	19%	19%
Japan	22%	14%	21%	20%
Asia	12%	11%	13%	10%

The rate of revenue change varies geographically primarily due to differences in the timing and size of term licenses in those regions.

Changes in foreign currency exchange rates caused our revenue to increase by $0.5 million in the three months ended September 29, 2007, as compared to the three months ended September 30, 2006, primarily due to a decrease in the valuation of the United States dollar when compared to the European Union euro, partially offset by an increase in the valuation of the United States dollar when compared to the Japanese yen.

Changes in foreign currency exchange rates caused our revenue to decrease by $1.4 million in the nine months ended September 29, 2007, as compared to the nine months ended September 30, 2006, primarily due to an increase in the valuation of the United States dollar when compared to the Japanese yen, partially offset by a decrease in the valuation of the United States dollar when compared to the European Union euro. Additional information about revenue and other financial information by geography can be found in Note 14 to our Condensed Consolidated Financial Statements.

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Stock-based Compensation Expense Summary

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

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In millions)			
Cost of product	$ ----	$ ----	$ 0.1	$ 0.1
Cost of services	1.0	0.9	2.9	3.2
Cost of maintenance	0.6	0.6	1.9	2.0
Marketing and sales	5.5	5.7	17.6	18.7
Research and development	10.9	11.5	36.5	39.3
General and administrative	6.1	5.6	19.8	17.1
Total	$ 24.1	$ 24.3	$ 78.8	$ 80.4

Cost of Revenue

	Three Months Ended			Nine Months Ended		
	September 29, 2007	September 30, 2006	% Change	September 29, 2007	September 30, 2006	% Change
	(In millions, except percentages)					
Product	$ 13.8	$ 14.1	(2)%	$ 42.3	$ 54.7	(23)%
Services	$ 23.4	$ 23.0	2%	$ 70.4	$ 71.0	(1)%
Maintenance	$ 15.2	$ 15.6	(3)%	$ 45.6	$ 47.5	(4)%

Cost of Revenue as a Percent of Related Revenue

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Product	5%	6%	5%	8%
Services	75%	67%	73%	71%
Maintenance	16%	18%	16%	18%

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

A summary of Cost of product is as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In millions)			
Product related costs	$ 7.8	$ 7.8	$ 25.5	$ 27.7
Amortization of acquired intangibles	6.0	6.3	16.8	27.0
Total Cost of product	$ 13.8	$ 14.1	$ 42.3	$ 54.7

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During the three months ended September 29, 2007, there were no material fluctuations in the components of Cost of product, as compared to the three months ended September 30, 2006. Cost of product decreased $12.4 million in the nine months ended September 29, 2007, as compared to the nine months ended September 30, 2006, primarily due to:

A decrease of $10.2 million in amortization of acquired intangible assets as certain acquired intangible assets became fully amortized during the periods; and

A decrease of $1.8 million in hardware costs attributable to sales of products with lower costs.

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

Cost of services primarily includes employee salary, benefits and other employee-related costs, costs to maintain the infrastructure necessary to manage a services organization, and provisions for contract losses, if any. During the three and nine months ended September 29, 2007, there were no material fluctuations in these components of Cost of services as compared to the three and nine months ended September 30, 2006.

Cost of maintenance includes the cost of customer services, such as hot-line and on-site support, employee salary, benefits and other employee-related costs, and documentation of maintenance updates. During the three months ended September 29, 2007, there were no material fluctuations in these components of Cost of maintenance as compared to the three months ended September 30, 2006. Cost of maintenance decreased $1.9 million in the nine months ended September 29, 2007, as compared to the nine months ended September 30, 2006, primarily due to a decrease of $1.0 million in amortization of acquired intangible assets as certain acquired intangible assets became fully amortized during the periods.

Operating Expenses

	Three Months Ended September 29, 2007	Three Months Ended September 30, 2006	% Change	Nine Months Ended September 29, 2007	Nine Months Ended September 30, 2006	% Change
	(In millions, except percentages)					
Marketing and sales	$ 97.2	$ 97.5	0%	$ 297.9	$ 289.1	3%
Research and development	125.4	110.3	14%	365.4	342.1	7%
General and administrative	40.7	35.2	16%	123.2	109.3	13%
Total operating expenses	$ 263.3	$ 243.0	8%	$ 786.5	$ 740.5	6%

Operating Expenses as a Percent of Total Revenue

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006

Marketing and sales	24%	27%	26%	27%
Research and development	31%	30%	32%	32%
General and administrative	10%	10%	11%	10%

Operating Expense Summary

Overall operating expenses increased $20.3 million during the three months ended September 29, 2007, as compared to the three months ended September 30, 2006, primarily due to:

- An increase of $17.6 million in salary, benefits and other employee-related costs, primarily due to an increased number of employees and increases in bonus and salary costs; and

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An increase of $3.8 million in professional services costs; partially offset by

A decrease of $2.1 million in losses on the sale of installment contract receivables.

Overall operating expenses increased $46.0 million during the nine months ended September 29, 2007, as compared to the nine months ended September 30, 2006, primarily due to:

An increase of $48.0 million in salary, benefits and other employee-related costs, primarily due to an increased number of employees and increases in bonus and salary costs; and

An increase of $8.2 million in professional services costs; partially offset by

A decrease of $10.2 million due to the portion of the gain on the sale of land and buildings that relates to operating expenses; and

A decrease of $4.6 million in losses on the sale of installment contract receivables.

Fluctuations in foreign currency exchange rates, primarily due to the decrease in the valuation of the United States dollar when compared to the European Union euro, the British pound and the Indian rupee, partially offset by the increase in the valuation of the United States dollar when compared to the Japanese yen, increased operating expenses by $3.0 million in the three months ended September 29, 2007, as compared to the three months ended September 30, 2006, and increased operating expenses by $7.2 million in the nine months ended September 29, 2007, as compared to the nine months ended September 30, 2006.

Marketing and Sales

During the three months ended September 29, 2007, there were no material fluctuations in the components of Marketing and sales expense as compared to the three months ended September 30, 2006.

Marketing and sales expense increased $8.8 million in the nine months ended September 29, 2007, as compared to the nine months ended September 30, 2006, primarily due to:

An increase of $13.7 million in salary, benefits and other employee-related costs; partially offset by

A decrease of $3.6 million due to the portion of the gain on the sale of land and buildings that relates to Marketing and sales expense; and

A decrease of $1.0 million in stock-based compensation.

Research and Development

Research and development expense increased $15.1 million in the three months ended September 29, 2007, as compared to the three months ended September 30, 2006, primarily due to:

An increase of $12.9 million in salary, benefits and other employee-related costs due to increased staffing to support product development; and

An increase of $1.8 million in professional services costs.

Research and development expense increased $23.3 million in the nine months ended September 29, 2007, as compared to the nine months ended September 30, 2006, primarily due to:

- An increase of $27.6 million in salary, benefits and other employee-related costs due to increased staffing to support product development; partially offset by
- A decrease of $6.0 million due to the portion of the gain on the sale of land and buildings that relates to Research and development expense; and
- A decrease of $2.8 million in stock-based compensation.

General and Administrative

General and administrative expense increased $5.5 million in the three months ended September 29, 2007, as compared to the three months ended September 30, 2006, primarily due to:

- An increase of $3.7 million in salary, benefits and other employee-related costs;
- An increase of $1.7 million in bad debt expense reflecting a lower amount of bad debt recoveries; and
- An increase of $1.6 million in professional services costs; partially offset by
- A decrease of $2.1 million in losses on the sale of installment contract receivables.

General and administrative expense increased $13.9 million in the nine months ended September 29, 2007, as compared to the nine months ended September 30, 2006, primarily due to:

- An increase of $6.6 million in salary, benefits and other employee-related costs;
- An increase of $8.2 million in professional services costs;
- An increase of $2.7 million in stock-based compensation; and
- An increase of $2.3 million in bad debt expense reflecting a lower amount of bad debt recoveries; partially offset by
- A decrease of $4.6 million in losses on the sale of installment contract receivables.

Amortization of Acquired Intangibles

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In millions)			
Amortization of acquired intangibles	$ 4.7	$ 4.6	$ 13.7	$ 18.0

During the three months ended September 29, 2007, there were no material fluctuations in the components of Amortization of acquired intangibles as compared to the three months ended September 30, 2006.

Amortization of acquired intangibles decreased $4.3 million in the nine months ended September 29, 2007 as compared to the nine months ended September 30, 2006. Amortization of intangible assets from prior year acquisitions decreased $7.8 million as certain of these intangible assets have been fully amortized. This decrease was partially offset by $3.5 million of amortization of intangibles acquired in 2006 and 2007.

Restructuring and Other Charges (Credits)

We initiated a separate plan of restructuring in each year from 2001 through 2005 in an effort to operate more efficiently. The restructuring plans initiated each year from 2001 through 2005, or the 2001 Restructuring, 2002 Restructuring, 2003 Restructuring, 2004 Restructuring and 2005 Restructuring, respectively, were intended to decrease costs through workforce reductions and facility and resource consolidation, in order to improve our cost structure. The 2001 and 2002 Restructurings primarily related to our design services business and certain other business or infrastructure groups throughout the world. The 2003 Restructuring, 2004 Restructuring and 2005 Restructuring were targeted at reducing costs throughout the company. The 2004 Restructuring has been completed and there was no remaining balance accrued for this restructuring as of September 29, 2007.

Each reporting period, we evaluate the adequacy of the lease loss accrual for each plan of restructuring. We adjust the lease loss accrual for changes in real estate markets or other factors that may affect estimated costs or sublease income. We also consider executed sublease agreements and adjust the lease loss accrual if sublease

income under the agreement differs from initial estimates. The credits recorded during the three and nine months ended September 29, 2007 and September 30, 2006 primarily relate to changes in our lease loss estimates.

Restructuring and other charges (credits) for the three and nine months ended September 29, 2007 and September 30, 2006 were as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In millions)			
2005, 2003, 2002, and 2001 Plans	$ (7.1)	$ ----	$ (9.6)	$ (0.7)

Frequently, asset impairments are based on significant estimates and assumptions, particularly regarding remaining useful life and utilization rates. We may incur other charges in the future if management determines that the useful life or utilization of certain long-lived assets has been reduced.

The initial facility closure and space reduction costs included in these restructurings were comprised of payments required under leases, less any applicable estimated sublease income after the properties were abandoned, lease buyout costs and other contractual charges. To estimate the initial lease loss, which is the loss after our cost recovery efforts from subleasing all or part of a building, management made certain assumptions related to the time period over which the relevant building would remain vacant and sublease terms, including sublease rates and contractual common area charges.

As of September 29, 2007, our accrued estimate of the lease loss related to all restructuring activities initiated since 2001 was $19.3 million. This amount may be adjusted in the future based upon changes in the assumptions used to estimate the lease loss. Since 2001, we have recorded facilities consolidation charges, net of credits, of $87.5 million under the 2001 through 2005 Restructurings related to space reductions or facility closures of 49 sites. As of September 29, 2007, 28 of these sites had been vacated and space reductions had occurred at the remaining 21 sites. We expect to pay all of the facilities-related restructuring liabilities for all of our restructuring plans prior to 2016.

Because the restructuring charges and related benefits are derived from management s estimates made during the formulation of the restructurings, based on then-currently available information, our restructuring activities may not achieve the benefits anticipated on the timetable or at the level contemplated. Demand for our products and services and, ultimately, our future financial performance, is difficult to predict with any degree of certainty. Accordingly, additional actions, including further restructuring of our operations, may be required in the future.

Our workforce reduction activities related to the 2004 Restructuring and the 2005 Restructuring were completed prior to December 31, 2005. We recorded a credit during the twelve months ended December 30, 2006 to remove the remaining severance and benefits accrual related to the 2005 Restructuring. The activity recorded in each of the restructuring plans for the three and nine months ended September 29, 2007 relates to payments of remaining lease obligations, net of sublease payments received, and changes in estimates related to lease loss accruals.

On October 5, 2007, we completed a lease termination agreement for a facility included in the 2001 Restructuring whereby we paid $8.2 million and were released from all future obligations related to the facility. We recorded a credit to Restructuring and other charges of $7.1 million during the three months ended September 29, 2007, representing the lease loss accrual related to this facility in excess of the amount paid.

Write-off of Acquired In-process Technology

In connection with the acquisitions completed during the nine months ended September 29, 2007, we immediately charged to expense $2.7 million representing acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. The value assigned to acquired in-process technology was determined by identifying research projects in areas for which technological feasibility had not been established. The value was determined by estimating costs to develop the various acquired in-process technologies into commercially viable products, estimating the resulting net cash flows from such projects and discounting the

net cash flows back to their present value. The discount rates assumed in these calculations ranged from 19% to 21% and included factors that reflect the uncertainty surrounding successful development of the acquired in-process technology. The in-process technologies are expected to become commercially viable at dates ranging from March 2008 to December 2008. As of September 29, 2007, $0.3 million was incurred to complete the in-process technology and aggregate expenditures to complete the remaining in-process technology are expected to be approximately $4.5 million.

These estimates are subject to change, given the uncertainties of the development process, and no assurance can be given that deviations from these estimates will not occur. Additionally, these projects will require further research and development after they have reached a state of technological and commercial feasibility.

Interest Expense

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In millions)			
Interest expense	$ 2.8	$ 3.0	$ 9.4	$ 9.9

During the three and nine months ended September 29, 2007, the primary component of interest expense was the Convertible Senior Notes, which were issued in December 2006. During the three and nine months ended September 30, 2006, the primary component of interest expense was our Term Loan, the repayment of which was completed in March 2007.

Other income, net

Other income, net, for the three and nine months ended September 29, 2007 and September 30, 2006 was as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In millions)			
Interest income	$ 12.6	$ 9.9	$ 37.5	$ 29.6
Gains (losses) on sale of non-marketable securities	0.1	(0.5)	5.6	16.4
Gains on available-for-sale securities	2.1	1.8	4.4	4.6
Gains (losses) on securities in Cadence s non-qualified deferred compensation trust	2.3	(0.9)	6.6	4.6
Gains (losses) on foreign exchange	(0.3)	0.2	(1.0)	0.3
Equity in loss from investments, net	(0.8)	(0.3)	(2.5)	(0.9)
Write-down of investment securities	(2.0)	(0.4)	(2.6)	(1.4)
Other income (expense)	0.2	0.2	(0.1)	----
Total other income, net	$ 14.2	$ 10.0	$ 47.9	$ 53.2

Interest income increased $2.7 million in the three months ended September 29, 2007, as compared to the three months ended September 30, 2006, and $7.9 million in the nine months ended September 29, 2007, as compared to the nine months ended September 30, 2006. The increase was due to higher average cash balances and higher interest rates earned on Cash and cash equivalents during the 2007 periods.

In January 2006, KhiMetrics, Inc., a cost method investment held by Telos Venture Partners, a limited partnership in which we and our 1996 Deferred Compensation Venture Investment Plan Trust are the sole limited

partners, was sold for consideration of $6.53 per share of common stock. In connection with this sale, we received approximately $17.5 million in cash and recorded a gain of approximately $14.4 million during the nine months ended September 30, 2006. In addition, our 1996 Deferred Compensation Venture Investment Plan Trust received $2.5 million in cash and recorded a gain of $2.1 million during the three months ended April 1, 2006. Under the purchase agreement, 10% of the consideration was held in escrow to pay the cost of resolving any claims that may be asserted against KhiMetrics on or before the first anniversary of the acquisition, at which time the escrow amount remaining after resolution of such claims was distributed to the former stockholders of KhiMetrics. Upon receipt of these additional proceeds, we recorded a gain of $2.6 million and our 1996 Deferred Compensation Venture Investment Plan Trust recorded a gain of $0.4 million in the nine months ended September 29, 2007.

Income Taxes

The following table presents the provision for income taxes and the effective tax rate for the three and nine months ended September 29, 2007 and September 30, 2006:

	Three Months Ended		Nine Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
	(In millions, except percentages)			
Provision for income taxes	$ 23.5	$ 30.7	$ 67.3	$ 70.6
Effective tax rate	24.4%	42.2%	27.6%	42.9%

Our effective tax rate for the three months ended September 29, 2007 was 24.4%, as compared to 42.2% for the three months ended September 30, 2006. Our provision for income taxes for the three months ended September 29, 2007 included period-specific tax expenses of $3.2 million for net interest expense on unrecognized tax benefits and $1.2 million for non-deductible acquired in-process technology, which were partially offset by period-specific tax benefits of $0.7 million from disqualifying dispositions of shares issued under our employee stock purchase plan and incentive stock options issued under employee equity incentive plans, and $3.5 million from the impact of new tax laws enacted in the period on the measurement of our deferred tax assets and liabilities and recognition of previously unrecognized tax benefits.

Our effective tax rate for the nine months ended September 29, 2007 was 27.6%, as compared to 42.9% for the nine months ended September 30, 2006. Our provision for income taxes for the nine months ended September 29, 2007 included period-specific tax expenses of $9.5 million for net interest expense on unrecognized tax benefits and $1.2 million for non-deductible acquired in-process technology, which were partially offset by period-specific tax benefits of $4.2 million from disqualifying dispositions of shares issued under our employee stock purchase plan and incentive stock options issued under employee equity incentive plans and $4.7 million from the impact of new tax laws enacted in the period on the measurement of our deferred tax assets and liabilities and recognition of previously unrecognized tax benefits.

Our effective tax rate decreased for the three and nine months ended September 29, 2007, compared to the three and nine months ended September 30, 2006, primarily due to a greater benefit from foreign income which is taxed at a lower rate than the United States federal statutory income tax rate. In addition, our effective tax rate decreased due to the extension of the United States federal tax credit for increasing research activities which was enacted in December 2006.

We project our annual effective tax rate for the fiscal year ending December 29, 2007 to be approximately 28.0%, which includes anticipated interest expense for the year that is classified as provision for income taxes and the other period-specific items of tax expense and benefit for the nine months ended September 29, 2007 described above. However, we expect that the effective tax rate for interim reporting periods may vary from the annual effective tax rate due the recognition of period-specific items of tax expense and benefit, including interest expense related to unrecognized tax benefits, tax deductions from disqualifying dispositions of shares issued under our employee stock purchase plan and incentive stock options issued under employee equity incentive plans, non-deductible acquired in-process technology, changes in tax laws enacted during the period and changes associated with unrecognized tax benefits. Our effective tax rate for the year ended December 30, 2006 was 41.2%. Our

projected annual effective tax rate for the year ending December 29, 2007 decreased compared to the year ended December 30, 2006 primarily due to a greater benefit from foreign income which is taxed at a lower rate than the United States federal statutory income tax rate.

The Internal Revenue Service, or IRS, and other tax authorities regularly examine our income tax returns. In November 2003, the IRS completed its field examination of our federal income tax returns for the tax years 1997 through 1999 and issued a Revenue Agent s Report, or RAR, in which the IRS proposed to assess an aggregate tax deficiency for the three-year period of approximately $143.0 million. The most significant of the disputed adjustments for the tax years 1997 through 1999 relates to transfer pricing arrangements that we had with a foreign subsidiary. We have filed a protest to certain of the proposed adjustments with the Appeals Office of the IRS where the matter is currently being considered.

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

We believe that the proposed IRS adjustments are inconsistent with applicable tax laws and we are vigorously challenging these proposed adjustments. The RARs are not final Statutory Notices of Deficiency but the IRS imposes interest on the proposed deficiencies until the matters are resolved. Interest is compounded daily at rates published by the IRS, which rates are adjusted quarterly and have been between four and ten percent since 1997. The IRS is currently examining our federal income tax returns for the tax years 2003 through 2005.

We adopted the provisions of FIN No. 48 on December 31, 2006, which was the first day of our 2007 fiscal year. FIN No. 48 prescribes a new recognition threshold and measurement attribute for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. Under FIN No. 48, only income tax positions that meet the more likely than not recognition threshold may be recognized in the financial statements. An income tax position that meets the more likely than not recognition threshold shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon effective settlement with a taxing authority that has full knowledge of all relevant information.

Significant judgment is required in applying the principles of FIN No. 48 and SFAS No. 109. The calculation of our provision for income taxes involves dealing with uncertainties in the application of complex tax laws and regulations. In determining the adequacy of our provision for income taxes, we regularly assess the potential settlement outcomes resulting from income tax examinations including the current IRS exam and the RARs for the tax years 1997 through 2002. 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 predicted with certainty. In addition, we cannot be certain that such amount will not be materially different than that which is reflected in our historical income tax provisions and accruals. Should the IRS or other tax authorities assess additional taxes as a result of a current or a future examination, we may be required to record charges to operations in future periods that could have a material impact on the results of operations, financial position or cash flows in the applicable period or periods.

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Liquidity and Capital Resources

	As of		
	September 29, 2007	December 30, 2006	% Change
	(In millions, except percentages)		
Cash, cash equivalents and short-term investments	$ 951.2	$ 958.4	(1)%
Net Working Capital	$ 665.4	$ 763.9	(13)%

	Nine Months Ended		
	September 29, 2007	September 30, 2006	Change
	(In millions)		
Cash provided by operating activities	$ 208.9	$ 216.5	$ (7.6)
Cash used for investing activities	$ (75.4)	$ (94.9)	$ (19.5)
Cash used for financing activities	$ (133.9)	$ (223.5)	$ (89.6)

Cash and cash equivalents and Short-term investments

As of September 29, 2007, our principal sources of liquidity consisted of $951.2 million of Cash and cash equivalents and Short-term investments, as compared to $958.4 million as of December 30, 2006. The primary sources of our cash in the nine months ended September 29, 2007 were:

- Customer payments under software licenses and from the sale or lease of our hardware products;
- Customer payments for design and methodology services;
- Proceeds from the sale of receivables;
- Proceeds from the sale of property, plant and equipment;
- Proceeds from the exercise of stock options; and
- Common stock purchases under our employee stock purchase plan.

Our primary uses of cash in the nine months ended September 29, 2007 were:

- Payments relating to payroll, product, services and other operating expenses;
- Payments to former shareholders of acquired businesses;
- Purchases of property, plant and equipment;
- Repayment in full of our Term Loan; and

- Purchases of treasury stock.

Net working capital

Net working capital decreased $98.5 million as of September 29, 2007, as compared to December 30, 2006, primarily due to:

- A change in classification from Long-term liabilities to Current liabilities of $230.4 million of our 2023 Notes, which can be redeemed by the Noteholders on August 15, 2008; and
- A decrease of $8.4 million in Short-term investments; partially offset by
- An increase of $39.8 million in Receivables, net;
- An increase of $33.6 million in Prepaid expenses and other current assets;

A decrease of $28.0 million in Current portion of long-term debt;

A decrease of $18.1 million in Accounts payable and accrued liabilities, which includes a decrease of $26.2 million of current income tax liabilities upon our adoption of FIN No. 48; and

A decrease of $19.0 million in Current portion of deferred revenue.

Cash flows from operating activities

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

We have entered into agreements whereby we may transfer accounts receivable to certain financing institutions on a non-recourse or limited-recourse basis. These transfers are recorded as sales and accounted for in accordance with SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. During the nine months ended September 29, 2007, we transferred accounts receivable, net of the losses on the sale of the receivables, totaling $163.5 million, which approximated fair value, to financing institutions on a non-recourse basis, as compared to $131.4 million for the nine months ended September 30, 2006.

Net cash provided by operating activities decreased by $7.6 million in the nine months ended September 29, 2007 as compared to the nine months ended September 30, 2006. The decrease was primarily due to:

A net cash outflow of $100.7 million in Receivables, net, Installment contracts receivable and Proceeds from the sale of receivables, net during the nine months ended September 29, 2007, as compared to a net cash inflow of $13.9 million in Receivables, net, Installment contracts receivable and Proceeds from the sale of receivables, net during the nine months ended September 30, 2006; partially offset by

A decrease of $71.6 million in payments of Accounts payable and accrued liabilities; and

An increase of $82.5 million in Net income.

Cash flows from investing activities

Our primary investing activities consisted of:

Purchases and proceeds from the sale of property, plant and equipment;

Proceeds from the sale of short-term and long-term investments; and

Cash paid in business combinations and asset acquisitions, net of cash acquired, and acquisition of intangibles.

Net cash used for investing activities decreased by $19.4 million in the nine months ended September 29, 2007 as compared to the nine months ended September 30, 2006. The decrease was primarily due to:

An increase of $46.5 million of Proceeds from the sale of property, plant and equipment; and

A decrease of $6.4 million of Purchases of software licenses; partially offset by

An increase of $9.1 million of Purchases of property, plant and equipment;

An increase of $8.8 million in cash paid in business combinations and asset acquisitions, net of cash acquired, and acquisition of intangibles; and

A decrease of $15.3 million of Proceeds from the sale of long-term investments.

In January 2007, we completed the sale of certain land and buildings in San Jose, California for a sales price of $46.5 million cash. Concurrently with the sale, we leased back from the purchaser all available space in the buildings. During the lease term, we are constructing an additional building located on our San Jose, California campus to replace the buildings we sold in this transaction. We expect to use approximately $21.0 million in cash during 2007 for construction of this new building.

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

Cash flows from financing activities

Net cash used for financing activities decreased by $89.7 million in the nine months ended September 29, 2007 as compared to the nine months ended September 30, 2006. The decrease was primarily due to:

An increase of $122.7 million in Proceeds from the sale of common stock due to an increased number of options exercised during the nine months ended September 29, 2007; and

A decrease of $71.0 million of payments on our Term Loan, the repayment of which was completed in March 2007; partially offset by

An increase of $125.8 million in Purchases of treasury stock.

We expect to continue our financing activities and may use cash reserves to repurchase stock under our stock repurchase program.

Other factors affecting liquidity and capital resources

Income Taxes

We provide for United States income taxes on the earnings of our foreign subsidiaries unless the earnings are considered permanently invested outside of the United States. As of September 29, 2007, we intend to indefinitely reinvest our undistributed foreign earnings outside of the United States.

We adopted the provisions of FIN No. 48 on December 31, 2006, which was the first day of our 2007 fiscal year. We recognized a $59.4 million decrease in the net liabilities for unrecognized tax benefits, which was accounted for as an increase to the December 31, 2006 balance of retained earnings. We also recognized a $42.6 million decrease in the net liabilities for unrecognized tax benefits, which was accounted for as a $35.3 million increase in the December 31, 2006 balance of Common stock and capital in excess of par value and a $7.3 million decrease in the December 31, 2006 balance of Goodwill.

Upon adoption of FIN No. 48, we also recognized additional long-term income tax assets of $115.0 million and additional long-term income tax liabilities of $115.0 million to present the unrecognized tax benefits as gross amounts on the Condensed Consolidated Balance Sheet. We also decreased current income tax liabilities by $26.2 million and increased long-term income tax liabilities by the same amount based on our anticipation of the amount of cash payments to be made within one year.

The IRS and other tax authorities regularly examine our income tax returns. In November 2003, the IRS completed its field examination of our federal income tax returns for the tax years 1997 through 1999 and issued a Revenue Agent s Report, or RAR, in which the IRS proposed to assess an aggregate tax deficiency for the three-year period of approximately $143.0 million. In July 2006, the IRS completed its field examination of our federal income tax returns for the tax years 2000 through 2002 and in November 2006, the IRS issued an amended RAR in which the IRS proposed to assess an aggregate tax deficiency for the three-year period of approximately $318.0 million. For an additional description of the IRS tax examinations, see the discussion under the heading Results of Operations Income Taxes above.

We believe that the proposed IRS adjustments are inconsistent with applicable tax laws and we are vigorously challenging these proposed adjustments. The RARs are not final Statutory Notices of Deficiency but the IRS imposes interest on the proposed deficiencies until the matters are resolved. Interest is compounded daily at rates published by the IRS, which rates are adjusted quarterly and have been between four and ten percent since 1997.

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

In December 2006, we issued $250.0 million principal amount of 1.375% Convertible Senior Notes Due 2011, or the 2011 Notes, and $250.0 million of 1.500% Convertible Senior Notes Due 2013, or the 2013 Notes, and collectively, the Convertible Senior Notes, to three initial purchasers in a private placement pursuant to Section 4(2)

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of the Securities Act for resale to qualified institutional buyers pursuant to SEC Rule 144A. We received net proceeds of approximately $487.0 million after transaction fees of approximately $13.0 million, including $12.0 million of underwriting discounts, that were recorded in Other long-term assets on the Condensed Consolidated Balance Sheet as of December 30, 2006 and are being amortized to interest expense over the term of the Convertible Senior Notes. A portion of the net proceeds totaling $228.5 million was used to purchase $189.6 million principal amount of our Zero Coupon Zero Yield Senior Convertible Notes Due 2023, or the 2023 Notes.

We may not redeem the Convertible Senior Notes prior to maturity. However, holders may convert their Convertible Senior Notes prior to maturity upon the occurrence of one of the following events:

The price of our common stock reaches $27.50 for a certain period of time specified in the Convertible Senior Notes;

Specified corporate transactions occur; or

The trading price of the Convertible Senior Notes falls below a certain threshold.

As of September 29, 2007, none of the conditions allowing the holders of the Convertible Senior Notes to convert had been met.

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

Cash up to the principal amount of the note; and

Our common stock to the extent that the conversion value exceeds the amount of cash paid upon conversion of the Convertible Senior Notes.

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

Concurrently with the issuance of the Convertible Senior Notes, we entered into hedge transactions with various parties whereby we have the option to purchase up to 23.6 million shares of our common stock at a price of $21.15 per share, subject to adjustment. These options expire on December 15, 2011, in the case of the 2011 Notes, and December 15, 2013, in the case of the 2013 Notes, and must be settled in net shares. The aggregate cost of these hedge transactions was $119.8 million and has been recorded as a reduction to stockholders equity in accordance with EITF No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock.

In separate transactions, we also sold to various parties warrants for the purchase of up to 23.6 million shares of our common stock at a price of $31.50 per share in a private placement pursuant to Section 4(2) of the Securities Act. The warrants expire on various dates from February 2012 through April 2012, in the case of the 2011 Notes, and February 2014 through April 2014, in the case of the 2013 Notes, and must be settled in net shares. We received $39.4 million in cash proceeds from the sale of these warrants, which has been recorded as a reduction to Stockholders equity in accordance with EITF No. 00-19. The warrants will be included in diluted earnings per share, or EPS, to the extent the impact is considered dilutive.

As of September 29, 2007, the estimated fair value of the hedges acquired in connection with the issuance of the Convertible Senior Notes was $187.0 million and the estimated fair value of the warrants sold in connection with the issuance of the Convertible Senior Notes was $88.6 million. Subsequent changes in the fair value of these hedge and warrant transactions will not be recognized as long as the instruments remain classified as equity.

For further information about our Convertible Senior Notes, including conversion rights and the effect of a fundamental change, see the discussion under the heading Liquidity and Capital Resources Other Factors Affecting Liquidity and Capital Resources in our Form 10-K for the year ended December 30, 2006.

Zero Coupon Zero Yield Senior Convertible Notes Due 2023

In August 2003, we issued $420.0 million principal amount of our 2023 Notes to two initial purchasers in a private placement pursuant to Section 4(2) of the Securities Act for resale to qualified institutional buyers pursuant to SEC Rule 144A. In connection with the issuance of the Convertible Senior Notes in December 2006, we repurchased $189.6 million principal amount of the 2023 Notes. The 2023 Notes were issued by us at par and bear no interest. The 2023 Notes are convertible into our common stock initially at a conversion price of $15.65 per share, which, after adjustment for our partial repurchase, would result in an aggregate of 14.7 million shares issued upon conversion, subject to adjustment upon the occurrence of specified events.

We may redeem for cash all or any part of the 2023 Notes on or after August 15, 2008 for 100.00% of the principal amount. The holders of the 2023 Notes may, if notice is provided in advance as specified in the 2023 Notes, require us to repurchase all or any portion of the 2023 Notes on August 15, 2008 for 100.25% of the principal amount, and on August 15, 2013 or August 15, 2018 for 100.00% of the principal amount by providing to the paying agent a written repurchase notice. Holders of the 2023 Notes may convert their 2023 Notes prior to maturity only if:

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

As of September 29, 2007, none of the conditions allowing the holders of the 2023 Notes to convert had been met.

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

In addition, we sold to a financial institution warrants for the purchase of up to 26.8 million shares of our common stock at a price of $23.08 per share. The warrants expire on various dates from February 2008 through May 2008 and must be settled in net shares. We received $56.4 million in cash proceeds from the sale of these warrants. In connection with the purchase of a portion of the 2023 Notes in December 2006, we also purchased 12.1 million of the warrants for our common stock that were originally issued in connection with the 2023 Notes at a cost of $10.2 million. The remaining outstanding warrants will be included in diluted EPS to the extent the impact is considered dilutive.

As of September 29, 2007, the estimated fair value of the remaining hedges acquired in connection with the issuance of the 2023 Notes was $108.6 million and the estimated fair value of the remaining warrants sold in connection with the issuance of the 2023 Notes was $20.3 million. Subsequent changes in the fair value of these hedge and warrant transactions will not be recognized as long as the instruments remain classified as equity.

For further information about our 2023 Notes, including conversion rights and the effect of a fundamental change, see the discussion under the heading Liquidity and Capital Resources Other Factors Affecting Liquidity and Capital Resources in our Form 10-K for the year ended December 30, 2006.

Contractual Obligations

In our Annual Report on Form 10-K for the year ended December 30, 2006, we reported long-term income tax liabilities of $256.1 million as payments due within 1 to 3 years in our table of Contractual Obligations as of December 30, 2006. We adopted the provisions of FIN No. 48 on December 31, 2006, which was the first day of our 2007 fiscal year. As of December 31, 2006, we had current income tax liabilities related to unrecognized tax benefits of $2.0 million, which we expect to pay in less than one year. As of December 31, 2006, we had long-term income tax liabilities related to unrecognized tax benefits of $304.2 million. Of the total long-term income tax liabilities, we estimate that $255.0 million will be paid within 1 to 3 years. We estimate that the remaining long-term income tax liabilities of $49.2 million can be offset by available net operating loss and tax credit carryforwards, and we believe that future cash payments will not be required to settle this remaining income tax liability. However, the total amounts of income tax payable and the timing of such tax payments may depend upon the resolution of current and future tax examinations which cannot be predicted with certainty.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Disclosures About Market Risk

Interest Rate Risk

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

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

All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents. Investments with maturities greater than three months are classified as available-for-sale and are considered to be short-term investments. The carrying value of our interest-bearing instruments approximated fair value as of September 29, 2007. The following table presents the carrying value and related weighted average interest rates for our interest-bearing instruments, which are all classified as Cash and cash equivalents on our Condensed Consolidated Balance Sheet as of September 29, 2007.

		Carrying Value (In millions)	Average Interest Rate
Interest-Bearing Instruments:			
Commercial Paper fixed rate	$	122.9	5.05%
Cash variable rate		55.7	2.27%
Cash equivalents variable rate		660.3	5.39%
Cash equivalents fixed rate		76.5	0.47%
Total interest-bearing instruments	$	915.4	4.74%

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 we are adversely affected by a stronger dollar, relative to major currencies worldwide. The primary effect of foreign currency transactions on our results of operations from a weakening United States dollar is an increase in revenue offset by a smaller increase in expenses. Conversely, the primary effect of foreign currency transactions on

our results of operations from a strengthening United States dollar is a reduction in revenue offset by a smaller reduction in expenses.

We enter into foreign currency forward exchange contracts with financial institutions to protect against currency exchange risks associated with existing assets and liabilities. A foreign currency forward exchange contract acts as a hedge by increasing in value when underlying assets decrease in value or underlying liabilities increase in value due to changes in foreign exchange rates. Conversely, a foreign currency forward exchange contract decreases in value when underlying assets increase in value or underlying liabilities decrease in value due to changes in foreign exchange rates. These forward contracts are not designated as accounting hedges under SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and, therefore, the unrealized

gains and losses are recognized in Other income, 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 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 September 29, 2007, 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 will mature prior to or during November 2007.

	Notional Principal (In millions)	Weighted Average Contract Rate
Forward Contracts:		
Japanese yen	$ 54.7	115.06
British pound sterling	32.9	0.49
Israel shekel	11.5	4.09
Hong Kong dollar	9.0	7.78
Indian rupee	6.1	40.53
Other	26.0	
Total	$ 140.2	
Estimated fair value	$ 0.3	

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

Equity Price Risk

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

In December 2006, we issued $250.0 million principal amount of our 2011 Notes, and $250.0 million of our 2013 Notes, collectively, the Convertible Senior Notes, to three initial purchasers in a private placement pursuant to Section 4(2) of the Securities Act for resale to qualified institutional buyers pursuant to SEC Rule 144A. Concurrently with the issuance of the Convertible Senior Notes, we entered into hedge transactions with various parties, and in separate transactions, sold warrants for the purchase of our common stock to various parties to reduce the potential

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

Zero Coupon Zero Yield Senior Convertible Notes Due 2023

In August 2003, we issued $420.0 million principal amount of our 2023 Notes to two initial purchasers in a private placement pursuant to Section 4(2) of the Securities Act for resale to qualified institutional buyers pursuant

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to SEC Rule 144A. Concurrently with the issuance of the 2023 Notes, we entered into hedge transactions with one of the initial purchasers and in a separate transaction, sold warrants for the purchase of our common stock to one of the initial purchasers to reduce the potential dilution from the conversion of the 2023 Notes and to mitigate any negative effect such conversion may have on the price of our common stock. For an additional description of the 2023 Notes, including the hedge and warrants transactions, see the discussion under the heading Liquidity and Capital Resources Other Factors Affecting Liquidity and Capital Resources above.

Investments

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

The fair value of our portfolio of available-for-sale marketable equity securities, which are included in Short-term investments on the accompanying Condensed Consolidated Balance Sheets, was $15.7 million as of September 29, 2007 and $23.7 million as of December 30, 2006. While we actively monitor these investments, we do not currently engage in any hedging activities to reduce or eliminate equity price risk with respect to these equity investments. Accordingly, we could lose all or part of our investment portfolio of marketable equity securities if there is an adverse change in the market prices of the companies we invest in.

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

Our investments in non-marketable equity securities had a carrying amount of $26.7 million as of September 29, 2007 and $31.4 million as of December 30, 2006. If we determine that an other-than-temporary decline in fair value exists for a non-marketable equity security, we write down the investment to its fair value and record the related write-down as an investment loss in our Condensed Consolidated Income Statements.

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 September 29, 2007.

The evaluation of our disclosure controls and procedures included a review of our processes and implementation and the effect on the information generated for use in this Quarterly Report. In the course of this evaluation, we sought to identify any significant deficiencies or 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.

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Based on their evaluation as of September 29, 2007, our CEO and CFO have concluded that our disclosure controls and procedures were sufficiently effective to ensure that the information required to be disclosed by us in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 29, 2007 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

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

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

On February 8, 2007, Cadence, Magma Design Automation, Inc., or Magma, Altera Corp., or Altera, and Mentor Graphics Corp., or Mentor, filed a complaint in the United States District Court for the Northern District of California against an individual, Narpat Bhandari, or Bhandari, and Vanguard Systems, Inc., or Vanguard. The complaint seeks a declaratory judgment that U.S. Patent No. 5,663,900, or the 900 Patent, which discloses an electronic simulation and emulation system and is allegedly owned by Bhandari and Vanguard, is not infringed and is invalid and unenforceable. The Complaint further seeks a declaratory judgment that LSI Logic Corporation, or LSI, has an ownership interest in the 900 Patent that precludes Vanguard and Bhandari from asserting the patent without first joining LSI. In March 2007, Cadence, Magma, Altera and Mentor amended the complaint to further plead non-infringement on the basis of obtaining a license to the 900 Patent from its co-owner, LSI. In April 2007, Vanguard and Bhandari answered the amended complaint, asserting counterclaims alleging that certain products of Cadence and the other plaintiffs infringe the 900 Patent. In a case management conference held on May 21, 2007, the court granted the request of Cadence, Magma, Altera and Mentor to bifurcate the case and stay all issues except for the question of LSI s ownership interest in the 900 Patent. Cadence, Magma, Altera and Mentor filed a Motion for Summary Judgment that LSI was a joint-owner and that the license from LSI warranted dismissal of Vanguard and Bhandari s claim. After briefing, the motion was submitted to the Court on the papers on September 27, 2007. The motion is presently under submission, and no further proceedings are scheduled at this time.

On May 30, 2007, Ahmed Higazi, a former Cadence employee, filed suit against us in the United States District Court for the Northern District of California alleging that we improperly classified him as exempt from overtime pay. The suit alleges claims for unpaid overtime under the federal Fair Labor Standards Act and California law, waiting time penalties under the California Labor Code, failure to provide proper earnings statements under California law, failure to provide meal and rest breaks as required by California law, unfair business practices under California Business & Professions Code section 17200, and unpaid 401(k) contributions in violation of the Employee Retirement Income Security Act, or ERISA. Plaintiff seeks to represent a class of current and former Cadence Information Technology employees, although the scope of the purported class is not yet clear. We filed an Answer denying the material allegations of the complaint and raising a number of affirmative defenses. Neither side has commenced discovery, and the court has not addressed the appropriateness of class certification. We intend to defend the case vigorously.

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

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.

Risks Related to Our Business

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

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

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

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

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

Migration to nanometer design: the size of features such as wires, transistors and contacts on ICs continuously shrink due to the ongoing advances in semiconductor manufacturing processes. Process feature sizes refer to the width of the transistors and the width and spacing of interconnect on the IC. Feature size is normally identified by the transistor length, which is shrinking rapidly to 65 nanometers and smaller. This is commonly referred to in the semiconductor industry as the migration to nanometer design. It represents a major challenge for participants in the semiconductor industry, from IC design and design automation to design of manufacturing equipment and the manufacturing process itself. Shrinkage of transistor length to such proportions is challenging the industry in the application of more complex physics and chemistry that is needed to realize advanced silicon devices. For EDA tools, models of each component s electrical properties and behavior become more complex as do requisite analysis, design and verification capabilities. Novel design tools and methodologies must be invented quickly to remain competitive in the design of electronics in the smallest nanometer ranges.

The challenges of nanometer design are leading some customers to work with older, less risky manufacturing processes. This may reduce their need to upgrade their EDA products and design flows.

The ability to design system-on-a-chip devices, or SoCs, increases the complexity of managing a design that, at the lowest level, is represented by billions of shapes on the fabrication mask. In addition, SoCs typically incorporate microprocessors and digital signal processors that are programmed with software, requiring simultaneous design of the IC and the related software embedded on the IC.

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

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

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

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

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

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

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

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

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

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

Our installed customer base has traditionally generated additional new license, service and maintenance revenues. In future periods, customers may not necessarily license or buy additional products or contract for additional services or maintenance. Maintenance is generally renewable annually at a customer s option, and there are no mandatory payment obligations or obligations to license additional software. If our customers decide not to renew their maintenance agreements or license additional products or contract for additional services, or if they reduce the scope

of the maintenance agreements, our revenue could decrease, which could have an adverse effect on our results of operations.

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

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

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

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

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

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

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

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

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

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

In a number of our previously completed acquisitions, we have agreed to make future payments, either in the form of employee bonuses or contingent purchase price payments, or earnouts, based on the performance of the acquired businesses or the former employees of the acquired businesses hired by us. The performance goals pursuant to which these future payments may be made generally relate to achievement by the acquired business or the former employees of the acquired business hired by us of certain specified bookings, revenue, product proliferation, product development or employee retention goals during a specified period following completion of the applicable acquisition. Future acquisitions may involve issuances of stock as full or partial payment of the

purchase price for the acquired business, grants of incentive stock or options to employees of the acquired businesses (which may be dilutive to existing stockholders), expenditure of substantial cash resources or the incurrence of material amounts of debt.

The specific performance goal levels and amounts and timing of employee bonuses or contingent purchase price payments vary with each acquisition. In connection with our acquisitions completed prior to September 29, 2007, we may be obligated to pay up to an aggregate of $45.0 million in cash during the next 50 months if certain performance goals related to one or more of the criteria mentioned above are achieved in full.

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

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

- The development by others of competitive EDA products or platforms and design and methodology services, which could result in a shift of customer preferences away from our products and services and significantly decrease revenue;

- Decisions by electronics manufacturers to perform design and methodology services internally, rather than purchase these services from outside vendors due to budget constraints or excess engineering capacity;

- The challenges of developing (or acquiring externally-developed) technology solutions that are adequate and competitive in meeting the requirements of next-generation design challenges;

- The significant number of current and potential competitors in the EDA industry and the low cost of entry;

- Intense competition to attract acquisition targets, which may make it more difficult for us to acquire companies or technologies at an acceptable price or at all; and

- The combination of or collaboration among many EDA companies to deliver more comprehensive offerings than they could individually.

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

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

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

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corresponding increase in the number of sales or with lower spending, then the reduced license revenues resulting from lower prices could have an adverse effect on our results of operations.

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

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

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

There are numerous patents in the EDA industry and new patents are being issued at a rapid rate. It is not always practicable to determine in advance whether a product or any of its components infringes the patent rights of others. As a result, from time to time, we may be compelled to respond to or prosecute intellectual property infringement claims to protect our rights or defend a customer s rights. For example, see the description of the pending patent litigation under the heading Part II. Other Information Item 1. Legal Proceedings above.

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

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

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

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

Our products and services involve the storage and transmission of customers proprietary information, and breaches of our security measures could expose us to a risk of loss or misuse of this information, litigation and

potential liability. Because techniques used to obtain unauthorized access or to sabotage information systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventive measures. If an actual or perceived breach of our security occurs, the market perception of the effectiveness of our security measures could be harmed and we could lose existing customers and our ability to obtain new customers.

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

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

As part of our restructuring activities in prior years, we have reduced the workforce in certain revenue-generating portions of our business. These reductions in staffing levels could require us to forego certain future opportunities due to resource limitations, which could negatively affect our long-term revenues.

We cannot assure you that we will not be required to implement further restructuring activities or reductions in our workforce based on changes in the markets and industries in which we compete or that any future restructuring efforts will be successful.

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

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

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

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

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

Also, because of the timing of large orders and our customers buying patterns, we may not learn of bookings shortfalls, revenue shortfalls, earnings shortfalls or other failures to meet market expectations until late in a fiscal quarter. These factors may cause our operating results to fluctuate unexpectedly.

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 60% for the three months ended September 29, 2007 and 49% for the three months ended September 30, 2006. 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. Recent economic and political uncertainty and the volatility of foreign currencies in certain regions, most notably the Japanese yen, European Union euro, British pound and Indian rupee have had, and may in the future have, a harmful effect on our revenue or operating results.

Fluctuations in the rate of exchange between the United States dollar and the currencies of other countries in which we conduct business could seriously harm our business, operating results or financial condition. For example, if there is an increase in the rate at which a foreign currency exchanges into United States dollars, it will take more of the foreign currency to equal the same amount of United States dollars than before the rate increase. If we price our products and services in the foreign currency, we will receive fewer United States dollars than we did before the rate increase went into effect. If we price our products and services in United States dollars, an increase in the exchange rate will result 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.

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

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

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

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

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

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

Earnings being lower than anticipated in countries where we are taxed at lower rates as compared to the United States federal and state statutory tax rates;

An increase in expenses not deductible for tax purposes, including certain stock-based compensation, write-offs of acquired in-process technology and impairment of goodwill;

Changes in the valuation of our deferred tax assets and liabilities;

Changes in tax laws or the interpretation of such tax laws;

Changes in judgment from the evaluation of new information that results in a recognition, derecognition, or change in measurement of a tax position taken in a prior period;

Increases to interest expenses classified in the financial statements as income taxes;

New accounting standards or interpretations of such standards;

A change in our decision to indefinitely reinvest foreign earnings outside the United States; or

Results of tax examinations by the Internal Revenue Service, or IRS, and state and foreign tax authorities.

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

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

The IRS and other tax authorities regularly examine our income tax returns. In November 2003, the IRS completed its field examination of our federal income tax returns for the tax years 1997 through 1999 and issued a Revenue Agent s Report, or RAR, in which the IRS proposed to assess an aggregate tax deficiency for the three-year period of approximately $143.0 million. The most significant of the disputed adjustments for the tax years 1997 through 1999 relates to transfer pricing arrangements that we had with a foreign subsidiary. We have filed a protest to certain of the proposed adjustments with the Appeals Office of the IRS where the matter is currently being considered.

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

We believe that the proposed IRS adjustments are inconsistent with applicable tax laws and we are vigorously challenging these proposed adjustments. The RARs are not final Statutory Notices of Deficiency but the IRS imposes interest on the proposed deficiencies until the matters are resolved. Interest is compounded daily at rates published by the IRS, which rates are adjusted quarterly and have been between four and ten percent since 1997. The IRS is currently examining our federal income tax returns for the tax years 2003 through 2005.

We adopted the provisions of FIN No. 48 on December 31, 2006, which was the first day of our 2007 fiscal year. FIN No. 48 prescribes a new recognition threshold and measurement attribute for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. Under FIN No. 48, only income tax positions that meet the more likely than not recognition threshold may be recognized in the financial statements. An income tax position that meets the more likely than not recognition threshold shall initially and subsequently be measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon effective settlement with a taxing authority that has full knowledge of all relevant information.

Significant judgment is required in applying the principles of FIN No. 48 and SFAS No. 109. The calculation of our provision for income taxes involves dealing with uncertainties in the application of complex tax laws and regulations.

In determining the adequacy of our provision for income taxes, we regularly assess the potential settlement outcomes resulting from income tax examinations including the current IRS exam and the RARs for the tax years 1997 through 2002. 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 predicted with certainty. In addition, we cannot assure you that such amount will not be materially different than that which is reflected in our historical income tax provisions and accruals. Should the IRS or other tax authorities assess additional taxes as a result of a

current or a future examination, we may be required to record charges to operations in future periods that could have a material impact on the results of operations, financial position or cash flows in the applicable period or periods.

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

Forecasts of our income tax position and resultant effective tax rate are complex and subject to uncertainty because our income tax position for each year combines the effects of a 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 costs resulting from tax audits. To forecast our global tax rate, pre-tax profits and losses by jurisdiction are estimated and tax expense by jurisdiction is calculated. If the mix of profits and losses, our ability to use tax credits, or effective tax rates by jurisdiction is different than those estimates, our actual tax rate could be materially different than forecasted, which could have a material impact on our results of operations.

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

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

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

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

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

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

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

Our business is subject to the risk of earthquakes, floods and other natural catastrophic events.

Our corporate headquarters, including certain of our research and development operations and certain of our distribution facilities, is located in the Silicon Valley area of Northern California, which is a region known to

experience seismic activity. In addition, several of our facilities, including our corporate headquarters, certain of our research and development operations, and certain of our distribution operations, are in areas of San Jose, California that have been identified by the Director of the Federal Emergency Management Agency, or FEMA, as being located in a special flood area. The areas at risk are identified as being in a one hundred year flood plain, using FEMA s Flood Hazard Boundary Map or the Flood Insurance Rate Map. If significant seismic or flooding activity were to occur, our operations may be interrupted, which would adversely impact our business and results of operations.

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

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

Risks Related to Our Securities and Indebtedness

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

We have a substantial level of debt. As of September 29, 2007, we had $730.4 million of outstanding indebtedness as follows:

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

The level of our indebtedness, among other things, could:

- Make it difficult for us to satisfy our payment obligations on our debt as described below;
- Make us more vulnerable in the event of a downturn in our business;
- Reduce funds available for use in our operations;
- Make it difficult for us to incur additional debt or obtain any necessary financing in the future for working capital, capital expenditures, debt service, acquisitions or general corporate purposes;
- Limit our flexibility in planning for or reacting to changes in our business;

Make us more vulnerable in the event of an increase in interest rates if we must incur new debt to satisfy our obligations under the Convertible Senior Notes or the 2023 Notes; or

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

If we experience a decline in revenue due to any of the factors described in this section entitled Risk Factors, or otherwise, we could have difficulty paying amounts due on our indebtedness. In the case of the 2023 Notes, although they mature in 2023, the holders of the 2023 Notes may require us to repurchase for cash all or any portion of the 2023 Notes on August 15, 2008 for 100.25% of the principal amount, August 15, 2013 for 100.00% of the principal amount and August 15, 2018 for 100.00% of the principal amount. As a result, although the 2023 Notes mature in 2023, the holders may require us to repurchase the 2023 Notes at an additional premium in 2008, which

makes it probable that we will be required to repurchase the 2023 Notes in 2008 if they have not first been repurchased by us or are not otherwise converted.

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

If we are unable to generate sufficient cash flow or otherwise obtain funds necessary to make required payments, or if we fail to comply with the various requirements of our indebtedness, we would be in default, which would permit the holders of our indebtedness to accelerate the maturity of the indebtedness and could cause defaults under our other indebtedness as well. Any default under our indebtedness could have a material adverse effect on our business, operating results and financial condition. In addition, a material default on our indebtedness could suspend our eligibility to register securities using certain registration statement forms under SEC guidelines that permit incorporation by reference of substantial information regarding us, which could potentially hinder our ability to raise capital through the issuance of our securities and will increase the costs of such registration to us.

In August 2007, the Financial Accounting Standards Board, or FASB, issued Proposed FASB Staff Position, or FSP, APB 14-a, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement), which if issued in its present form, would require us to recognize additional non-cash interest expense related to our Convertible Senior Notes in our Condensed Consolidated Statements of Operations. If issued as currently proposed, we would be required to adopt FSP APB 14-a in our first quarter of fiscal 2008 with retrospective application to the issuance of our Convertible Senior Notes. If adopted in its present form, FSP APB 14-a will have an adverse effect on our operating results and financial condition, among other ways as measured by interest expense ratios commonly referred to by lenders, and could potentially hinder our ability to raise capital through the issuance of debt or equity securities.

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

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

Prior to conversion of the 2023 Notes, if the trading price of our common stock exceeds $22.69 per share over specified periods, basic net income per share will be diluted. We may redeem for cash all or any part of the 2023 Notes on or after August 15, 2008 for 100.00% of the principal amount. The holders of the 2023 Notes may require us

to repurchase for cash all or any portion of their 2023 Notes on August 15, 2008 for 100.25% of the principal amount, on August 15, 2013 for 100.00% of the principal amount, or on August 15, 2018 for 100.00% of the principal amount, by providing to the paying agent a written repurchase notice. The repurchase notice must be delivered during the period commencing 30 business days prior to the relevant repurchase date and ending on the close of business on the business day prior to the relevant repurchase date. We may redeem for cash all or any part of the 2023 Notes on or after August 15, 2008 for 100.00% of the principal amount, except for those 2023 Notes that holders have required us to repurchase on August 15, 2008 or on other repurchase dates, as described above.

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

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

As a result, although the 2023 Notes mature in 2023, the holders may require us to repurchase their notes at an additional premium in 2008, which makes it probable that we will be required to repurchase the 2023 Notes in 2008 if they have not first been repurchased by us or are not otherwise converted. As of September 29, 2007, none of the conditions allowing holders of the 2023 Notes to convert had been met.

Each $1,000 of principal of the Convertible Senior Notes is initially convertible into 47.2813 shares of our common stock, subject to adjustment upon the occurrence of specified events. Holders of the Convertible Senior Notes may convert their notes at their option on any day prior to the close of business on the scheduled trading day immediately preceding December 15, 2011 in the case of the 2011 Notes and December 15, 2013 in the case of the 2013 Notes, in each case only if:

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

On and after November 2, 2011, in the case of the 2011 Notes, and November 1, 2013, in the case of 2013 Notes, until the close of business on the scheduled trading day immediately preceding the maturity date of such Convertible Senior Notes, holders may convert their Convertible Senior Notes at any time, regardless of the foregoing circumstances. As of September 29, 2007, none of the conditions allowing holders of the Convertible Senior Notes to convert had been met.

Although the conversion price of the 2023 Notes is currently $15.65 per share, the hedge and warrant transactions that we entered into in connection with the issuance of the 2023 Notes effectively increased the conversion price of the 2023 Notes until various dates in 2008 to approximately $23.08 per share, which would result in an aggregate issuance upon conversion prior to August 15, 2008 of approximately 10.2 million shares of our common stock. We entered into hedge and warrant transactions to reduce the potential dilution from the conversion of the 2023 Notes. However, we cannot guarantee that such hedge and warrant instruments will fully mitigate the dilution. In addition, the existence of the 2023 Notes may encourage short selling by market participants because the conversion of the 2023 Notes could depress the price of our common stock.

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

conversion of the Convertible Senior Notes could depress the price of our common stock.

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

Under the terms of the 2023 Notes and the Convertible Senior Notes, we may be required to repurchase the 2023 Notes and the Convertible Senior Notes following a fundamental change in our corporate ownership or structure, such as a change of control in which substantially all of the consideration does not consist of publicly traded securities, prior to maturity of the 2023 Notes and the Convertible Senior Notes, as the case may be.

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Following a fundamental change, in certain circumstances, we may choose to pay the repurchase price of the 2023 Notes in cash, shares of our common stock or a combination of cash and shares of our common stock. If we choose to pay all or any part of the repurchase price of the 2023 Notes in shares of our common stock, this would result in dilution to the holders of our common stock. The repurchase price for the Convertible Senior Notes in the event of a fundamental change must be paid solely in cash. These repayment obligations may have the effect of discouraging, delaying or preventing a takeover of our company that may otherwise be beneficial to investors.

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

We entered into hedge transactions with various financial institutions, at the time of issuance of the Convertible Senior Notes and the 2023 Notes, with the objective of reducing the potential dilutive effect of issuing our common stock upon conversion of the Convertible Senior Notes and the 2023 Notes. We also entered into separate warrant transactions with the same financial institutions. In connection with our hedge and warrant transactions, these financial institutions purchased our common stock in secondary market transactions and entered into various over-the-counter derivative transactions with respect to our common stock. These entities or their affiliates are likely to modify their hedge positions from time to time prior to conversion or maturity of the Convertible Senior Notes and the 2023 Notes by purchasing and selling shares of our common stock, other of our securities or other instruments they may wish to use in connection with such hedging. Any of these transactions and activities could adversely affect the value of our common stock and, as a result, the number of shares and the value of the common stock holders will receive upon conversion of the Convertible Senior Notes and the 2023 Notes. In addition, subject to movement in the price of our common stock, if the hedge transactions settle in our favor, we could be exposed to credit risk related to the other party with respect to the payment we are owed from such other party.

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

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

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

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

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

- Section 203 of the Delaware General Corporation Law generally prohibits a Delaware corporation from engaging in any business combination with a person owning 15% or more of its voting stock, or who is

affiliated with the corporation and owned 15% or more of its voting stock at any time within three years prior to the proposed business combination, for a period of three years from the date the person became a 15% owner, unless specified conditions are met.

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

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

A. Recent Sales of Unregistered Securities:

None.

B. Stock Repurchases:

In February 2006, our Board of Directors authorized a program to repurchase shares of our common stock in the open market with a value of up to $500.0 million in the aggregate, which program was completed during the nine months ended September 29, 2007. In November 2006, our Board of Directors authorized a new program to repurchase shares of our common stock in the open market with a value of up to $500.0 million in the aggregate. The following table sets forth the repurchases we made during the three months ended September 29, 2007:

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)
July 1, 2007 August 4, 2007	2,885,861	$ 21.45	2,850,000	$ 345.2
August 5, 2007 September 1, 2007	8,437,663	$ 20.63	8,321,182	$ 173.6
September 2, 2007 September 29, 2007	850,787	$ 21.93	828,818	$ 155.4
Total	12,174,311	$ 20.91	12,000,000	

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

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

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Item 6. Exhibits

(a) The following exhibits are filed herewith:

Exhibit Number	Exhibit Title
10.01	The Registrant s 1987 Stock Incentive Plan, as amended and restated.
10.02	The Registrant s 1993 Nonstatutory Stock Incentive Plan, as amended and restated.
10.03	The Registrant s 1997 Nonstatutory Stock Incentive Plan, as amended and restated.
10.04	The Registrant s 2000 Nonstatutory Equity Incentive Plan, as amended and restated.
31.01	Certification of the Registrant s Chief Executive Officer, Michael J. Fister, pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.
31.02	Certification of the Registrant s Chief Financial Officer, William Porter, pursuant to Rule 13a-14 of the Securities Exchange Act of 1934.
32.01	Certification of the Registrant s Chief Executive Officer, Michael J. Fister, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.02	Certification of the Registrant s Chief Financial Officer, William Porter, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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:	October 29, 2007	By: /s/ Michael J. Fister Michael J. Fister President, Chief Executive Officer and Director
DATE:	October 29, 2007	By: /s/ William Porter William Porter Executive Vice President and Chief Financial Officer

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