CADENCE DESIGN SYSTEMS INC
Form 10-Q
October 25, 2012
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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, 2012
OR

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

For the transition period from to
Commission file number 000-15867

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

| | |
|---|---|
| Delaware<br>(State or Other Jurisdiction of<br>Incorporation or Organization) | 77-0148231<br>(I.R.S. Employer<br>Identification No.) |
| 2655 Seely Avenue, Building 5, San Jose, California<br>(Address of Principal Executive Offices) | 95134<br>(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

| | | | |
|---|---|---|---|
| Large accelerated filer | x | Accelerated filer | o |
| Non-accelerated filer | ¨ (Do not check if a smaller reporting company) | Smaller reporting company | o |

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, 2012, 280,008,255 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)

| | September 29, 2012 | December 31, 2011 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | $649,099 | $601,602 |
| Short-term investments | 95,819 | 3,037 |
| Receivables, net of allowances of $110 and $0, respectively | 123,206 | 136,772 |
| Inventories | 34,629 | 43,243 |
| 2015 Notes Hedges | 287,079 | 215,113 |
| Prepaid expenses and other | 60,780 | 64,216 |
| Total current assets | 1,250,612 | 1,063,983 |
| Property, plant and equipment, net of accumulated depreciation of $638,552 and $658,990, respectively | 246,856 | 262,517 |
| Goodwill | 233,275 | 192,125 |
| Acquired intangibles, net of accumulated amortization of $97,746 and $91,542, respectively | 192,768 | 173,234 |
| Long-term receivables | 5,668 | 11,371 |
| Other assets | 59,335 | 58,039 |
| Total Assets | $1,988,514 | $1,761,269 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Convertible notes | $305,029 | $294,061 |
| 2015 Notes Embedded Conversion Derivative | 287,079 | 215,113 |
| Accounts payable and accrued liabilities | 160,250 | 165,791 |
| Current portion of deferred revenue | 322,260 | 340,401 |
| Total current liabilities | 1,074,618 | 1,015,366 |
| Long-Term Liabilities: | | |
| Long-term portion of deferred revenue | 58,436 | 73,959 |
| Convertible notes | 136,594 | 131,920 |
| Other long-term liabilities | 130,478 | 128,894 |
| Total long-term liabilities | 325,508 | 334,773 |
| Commitments and Contingencies (Note 12) | | |
| Stockholders' Equity: | | |
| Common stock and capital in excess of par value | 1,711,797 | 1,733,884 |
| Treasury stock, at cost | (207,018) | (290,462) |
| Accumulated deficit | (962,515) | (1,083,245) |
| Accumulated other comprehensive income | 46,124 | 50,953 |
| Total stockholders' equity | 588,388 | 411,130 |
| Total Liabilities and Stockholders' Equity | $1,988,514 | $1,761,269 |

See notes to 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, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| Revenue: | | | | |
| Product | $216,561 | $163,966 | $614,886 | $463,723 |
| Services | 28,415 | 29,102 | 86,923 | 86,384 |
| Maintenance | 93,557 | 99,389 | 279,030 | 291,722 |
| Total revenue | 338,533 | 292,457 | 980,839 | 841,829 |
| Costs and Expenses: | | | | |
| Cost of product | 23,337 | 18,185 | 60,323 | 52,453 |
| Cost of services | 16,809 | 20,410 | 53,254 | 61,101 |
| Cost of maintenance | 11,124 | 11,223 | 33,756 | 32,837 |
| Marketing and sales | 82,461 | 79,914 | 246,674 | 235,292 |
| Research and development | 115,078 | 103,154 | 335,703 | 303,721 |
| General and administrative | 26,350 | 24,041 | 84,364 | 68,720 |
| Amortization of acquired intangibles | 3,876 | 3,786 | 11,305 | 12,750 |
| Restructuring and other charges (credits) | 57 | (433) | 49 | 277 |
| Total costs and expenses | 279,092 | 260,280 | 825,428 | 767,151 |
| Income from operations | 59,441 | 32,177 | 155,411 | 74,678 |
| Interest expense | (8,737) | (10,830) | (25,840) | (32,584) |
| Other income (expense), net | (131) | 7,244 | 5,972 | 20,107 |
| Income before provision (benefit) for income taxes | 50,573 | 28,591 | 135,543 | 62,201 |
| Provision (benefit) for income taxes | (8,011) | 485 | 9,469 | 864 |
| Net income | $58,584 | $28,106 | $126,074 | $61,337 |
| Net income per share – basic | $0.22 | $0.11 | $0.47 | $0.23 |
| Net income per share – diluted | $0.21 | $0.10 | $0.45 | $0.23 |
| Weighted average common shares outstanding – basic | 271,350 | 264,723 | 269,643 | 263,149 |
| Weighted average common shares outstanding – diluted | 283,328 | 270,741 | 278,760 | 270,068 |

See notes to condensed consolidated financial statements.

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CADENCE DESIGN SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)
(Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| Net income | $58,584 | $28,106 | $126,074 | $61,337 |
| Other comprehensive income (loss), net of tax effects: | | | | |
| Foreign currency translation gain (loss) | 1,025 | 26 | (3,808) | 5,631 |
| Changes in unrealized holding gains or losses on available-for-sale securities, net of reclassification adjustment for realized gains and losses | (120) | (447) | (1,141) | (8,525) |
| Changes in defined benefit plan liabilities | 65 | 23 | 120 | 36 |
| Total other comprehensive income (loss), net of tax effects | 970 | (398) | (4,829) | (2,858) |
| Comprehensive income | $59,554 | $27,708 | $121,245 | $58,479 |

See notes to condensed consolidated financial statements.

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

| | Nine Months Ended | |
|---|---|---|
| | September 29, 2012 | October 1, 2011 |
| Cash and Cash Equivalents at Beginning of Period | $601,602 | $557,409 |
| Cash Flows from Operating Activities: | | |
| Net income | 126,074 | 61,337 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 67,171 | 68,934 |
| Amortization of debt discount and fees | 17,480 | 22,068 |
| Stock-based compensation | 34,285 | 31,589 |
| Gain on investments, net | (2,222) | (19,220) |
| Non-cash restructuring and other charges | 188 | 202 |
| Deferred income taxes | (14,107) | (4,741) |
| Provisions (recoveries) for losses (gains) on receivables, net | 120 | (6,596) |
| Other non-cash items | 3,270 | 3,689 |
| Changes in operating assets and liabilities, net of effect of acquired businesses: | | |
| Receivables | 24,276 | 63,729 |
| Inventories | 6,936 | (9,767) |
| Prepaid expenses and other | 1,547 | 19,718 |
| Other assets | (3,101) | 3,718 |
| Accounts payable and accrued liabilities | (1,714) | (71,832) |
| Deferred revenue | (38,230) | 20,245 |
| Other long-term liabilities | (1,855) | (4,868) |
| Net cash provided by operating activities | 220,118 | 178,205 |
| Cash Flows from Investing Activities: | | |
| Proceeds from the sale and maturity of available-for-sale securities | 7,436 | 9,588 |
| Purchases of available-for-sale securities | (101,248) | — |
| Proceeds from the sale of long-term investments | 44 | 4,824 |
| Purchases of property, plant and equipment | (25,932) | (17,703) |
| Investment in venture capital partnerships and equity investments | (250) | (608) |
| Cash paid in business combinations and asset acquisitions, net of cash acquired | (66,432) | (44,052) |
| Net cash used for investing activities | (186,382) | (47,951) |
| Cash Flows from Financing Activities: | | |
| Principal payments on receivable sale financing | (2,907) | (2,829) |
| Tax effect related to employee stock transactions allocated to equity | 5,790 | 2,897 |
| Payment of acquisition-related contingent consideration | (39) | — |
| Proceeds from issuance of common stock | 28,755 | 16,994 |
| Stock received for payment of employee taxes on vesting of restricted stock | (13,457) | (9,926) |
| Net cash provided by financing activities | 18,142 | 7,136 |
| Effect of exchange rate changes on cash and cash equivalents | (4,381) | 1,302 |
| Increase in cash and cash equivalents | 47,497 | 138,692 |
| Cash and Cash Equivalents at End of Period | $649,099 | $696,101 |

See notes to condensed consolidated financial statements.

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

## NOTE 1. BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q have been prepared by Cadence Design Systems, Inc., or Cadence, without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission, or the SEC. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, Cadence believes that the disclosures contained in this Quarterly Report on Form 10-Q comply with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, for a Quarterly Report on Form 10-Q and are adequate to make the information presented not misleading. These Condensed Consolidated Financial Statements are meant to be, and should be, read in conjunction with the Consolidated Financial Statements and the Notes thereto included in Cadence's Annual Report on Form 10-K for the fiscal year ended December 31, 2011. Certain prior period balances have been reclassified to conform to current period presentation.

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

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

## NOTE 2. CONVERTIBLE NOTES

### 2015 Notes

In June 2010, Cadence issued $350.0 million principal amount of 2.625% Cash Convertible Senior Notes Due 2015, or the 2015 Notes. At maturity, the holders of the 2015 Notes will be entitled to receive the principal amount of the 2015 Notes plus accrued interest. The 2015 Notes are convertible into cash prior to maturity upon the occurrence of certain conditions described in the table below. If a holder of the 2015 Notes elects to convert its notes prior to maturity, the holder of the notes will be entitled to receive cash equal to the principal amount of the notes plus any additional conversion value as described in the table below under the heading "Conversion feature."

Cadence entered into hedge transactions, or the 2015 Notes Hedges, in connection with the issuance of the 2015 Notes. The purpose of the 2015 Notes Hedges was to limit Cadence's exposure to the additional cash payments above the principal amount of the 2015 Notes that may be due to the holders. As a result of the 2015 Notes Hedges, Cadence's maximum expected cash exposure upon conversion of the 2015 Notes is the $350.0 million principal balance of the notes. In June 2010, Cadence also sold warrants in separate transactions, or the 2015 Warrants. As a result of the 2015 Warrants, Cadence will experience dilution to its diluted earnings per share if its average closing stock price exceeds $10.78 for any fiscal quarter. To the extent that Cadence's stock price exceeds $10.78 at expiration of the 2015 Warrants, Cadence will issue shares to settle the 2015 Warrants.

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A summary of key terms of the 2015 Notes is as follows:

| | 2015 Notes<br>(In thousands, except percentages) |
|---|---|
| Outstanding principal maturity value – at September 29, 2012 | $350,000 |
| Contractual interest rate | 2.625% |
| Contractual maturity date | June 1, 2015 |
| Initial conversion rate | 132.5205 shares of common stock per $1,000 principal amount of notes, which is equivalent to a conversion price of approximately $7.55 per share of Cadence common stock. |
| Conversion feature (in addition to principal amount payable in cash) | Cash to the extent Cadence’s stock price exceeds approximately $7.55 per share, calculated based on the applicable conversion rate multiplied by the volume weighted average price of Cadence common stock over a specified period. |
| Early conversion conditions (or the Early Conversion Conditions) | • Closing stock price greater than $9.81 for at least 20 of the last 30 trading days in a fiscal quarter (convertible only for subsequent quarter).<br>• Specified corporate transactions.<br>• Note trading price falls below a calculated minimum. |
| Conversion immediately preceding maturity | From March 1, 2015 until the second trading day immediately preceding the maturity date, holders may convert their 2015 Notes at any time into cash as described above under “Conversion feature.” |
| Redemption at Cadence’s option prior to maturity | None. |
| Fundamental change put right | Upon certain fundamental corporate changes prior to maturity, the 2015 Note holders could require Cadence to repurchase their notes for cash equal to the principal amount of the notes plus accrued interest. |
| Make-whole premium | Upon certain fundamental changes prior to maturity, if Cadence’s stock price were between $6.16 and $40.00 per share at that time, the holders of the notes would be entitled to an increase to the conversion rate. This is referred to as a “make-whole premium.” |

| | |
|---|---|
| Financial covenants | None. |

Impact of Early Conversion Conditions on Financial Statements

The 2015 Notes are convertible into cash from September 30, 2012 through December 29, 2012 because Cadence's closing stock price exceeded $9.81 for at least 20 days in the 30-day period prior to September 29, 2012. Accordingly, the net balance of the 2015 Notes of $305.0 million is classified as a current liability on Cadence's Condensed Consolidated Balance Sheet as of September 29, 2012. The classification of the 2015 Notes as current or long-term on the Condensed Consolidated Balance Sheet is evaluated at each balance sheet date and may change from time to time depending on whether Cadence's closing stock price has exceeded $9.81 during the periods specified in the table above under "Early conversion conditions."

If one of the 2015 Notes Early Conversion Conditions is met in any future fiscal quarter, Cadence would classify its net liability under the 2015 Notes as a current liability on the Condensed Consolidated Balance Sheet as of the end of that fiscal quarter. If none of the 2015 Notes Early Conversion Conditions have been met in a future fiscal quarter prior to the one-year period immediately preceding the maturity date, Cadence would classify its net liability under the 2015 Notes as a long-term liability on the Condensed Consolidated Balance Sheet as of the end of that fiscal quarter.

If the note holders elect to convert their 2015 Notes prior to maturity, any unamortized discount and transaction fees will be expensed at the time of conversion. If the entire outstanding principal amount had been converted on September 29, 2012 Cadence would have recorded an expense of $51.2 million associated with the conversion, comprised of $45.0 million of unamortized debt discount and $6.2 million of unamortized transaction fees.

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As of September 29, 2012, the if-converted value of the 2015 Notes to the note holders of approximately $596.7 million exceeded the principal amount of $350.0 million. The fair value of the 2015 Notes was $620.3 million as of September 29, 2012 and $527.8 million as of December 31, 2011. The 2015 Notes currently trade at a premium to the if-converted value of the notes. As of September 29, 2012, none of the note holders had elected to convert their 2015 Notes.

2015 Notes Embedded Conversion Derivative

The conversion feature of the 2015 Notes, or the 2015 Notes Embedded Conversion Derivative, requires bifurcation from the 2015 Notes and is accounted for as a derivative liability. The fair value of the 2015 Notes Embedded Conversion Derivative at the time of issuance of the 2015 Notes was $76.6 million and was recorded as original debt discount for purposes of accounting for the debt component of the 2015 Notes. This discount is amortized as interest expense using the effective interest method over the term of the 2015 Notes. The 2015 Notes Embedded Conversion Derivative is carried on the Condensed Consolidated Balance Sheet at its estimated fair value. The fair value was $287.1 million as of September 29, 2012 and $215.1 million as of December 31, 2011.

2015 Notes Hedges

The 2015 Notes Hedges expire on June 1, 2015, and must be settled in cash. The aggregate cost of the 2015 Notes Hedges was $76.6 million. The 2015 Notes Hedges are accounted for as derivative assets and are carried on the Condensed Consolidated Balance Sheet at their estimated fair value. The fair value was $287.1 million as of September 29, 2012 and $215.1 million as of December 31, 2011. The 2015 Notes Embedded Conversion Derivative liability and the 2015 Notes Hedges asset are adjusted to fair value each reporting period and unrealized gains and losses are reflected in the Condensed Consolidated Income Statements. The 2015 Notes Embedded Conversion Derivative and the 2015 Notes Hedges are designed to have similar fair values. Accordingly, the changes in the fair values of these instruments offset during the three and nine months ended September 29, 2012 and October 1, 2011 and did not have a net impact on the Condensed Consolidated Income Statements for the respective periods.

The classification of the 2015 Notes Embedded Conversion Derivative liability and the 2015 Notes Hedges asset as current or long-term on the Condensed Consolidated Balance Sheet corresponds with the classification of the 2015 Notes, is evaluated at each balance sheet date and may change from time to time depending on whether the closing stock price early conversion condition is met for a particular quarter.

2015 Warrants

In June 2010, Cadence sold the 2015 Warrants in separate transactions for the purchase of up to approximately 46.4 million shares of Cadence’s common stock at a strike price of $10.78 per share, for total proceeds of $37.5 million, which was recorded as an increase in stockholders’ equity. The 2015 Warrants expire on various dates from September 2015 through December 2015 and must be settled in net shares of Cadence’s common stock. Therefore, upon expiration of the 2015 Warrants Cadence will issue shares of common stock to the purchasers of the 2015 Warrants that represent the value by which the price of the common stock exceeds the strike price stipulated within the particular warrant agreement.

Components of 2015 Notes

The components of the 2015 Notes as of September 29, 2012 and December 31, 2011 were as follows:

| | As of September 29, 2012 | December 31, 2011 |
|---|---|---|
| | (In thousands) | |
| Principal amount | $350,000 | $350,000 |
| Unamortized debt discount | (44,971) | (55,939) |
| Liability component | $305,029 | $294,061 |

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The effective interest rate and components of interest expense of the 2015 Notes for the three and nine months ended September 29, 2012 and October 1, 2011 were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands, except percentages) | | | |
| Effective interest rate | 8.1 % | 8.1 % | 8.1 % | 8.1 % |
| Contractual interest expense | $2,289 | $2,289 | $6,867 | $6,867 |
| Amortization of debt discount | $3,737 | $3,453 | $10,968 | $10,166 |

2013 Notes and 2011 Notes

In December 2006, Cadence issued $250.0 million principal amount of 1.500% Convertible Senior Notes Due December 15, 2013, or the 2013 Notes. At the same time, Cadence issued $250.0 million principal amount of 1.375% Convertible Senior Notes Due December 15, 2011, or the 2011 Notes. During 2010, Cadence repurchased a portion of the 2011 Notes and the 2013 Notes. The 2011 Notes matured on December 15, 2011, at which time Cadence paid the remaining balance on the 2011 Notes in full. As of September 29, 2012, the remaining principal maturity value of the 2013 Notes was $144.5 million.

At maturity, the holders of the 2013 Notes will be entitled to receive the principal amount of the 2013 Notes plus accrued interest. The 2013 Notes are convertible into a combination of cash and shares of Cadence common stock upon the occurrence of certain conditions described in the table below. If a holder of the 2013 Notes elects to convert its notes prior to maturity, the holder of the notes will be entitled to receive cash for the principal amount of the notes plus shares for any additional conversion value as described in the table below under the heading “Conversion feature.” As of September 29, 2012, the 2013 Notes were not convertible.

Cadence entered into hedge transactions, or the 2013 Notes Hedges and the 2011 Notes Hedges, in connection with the issuance of the 2013 Notes and the 2011 Notes. The 2011 Notes Hedges expired unexercised on December 15, 2011. Pursuant to the 2013 Notes Hedges, Cadence has the option to receive the amount of shares that may be owed to the 2013 Notes holders. The purpose of the 2013 Notes Hedges was to limit Cadence’s exposure to the dilution that may result from the issuance of shares upon conversion of the notes. In December 2006, Cadence also sold warrants in separate transactions, or the 2013 Warrants and the 2011 Warrants. As a result of the 2013 Warrants, Cadence will experience dilution to its diluted earnings per share to the extent its average closing stock price exceeds $31.50 for any fiscal quarter. If Cadence’s stock price is above $31.50 at the expiration of the 2013 Warrants, Cadence will issue shares to settle the 2013 Warrants.

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A summary of key terms of the 2013 Notes is as follows:

| | 2013 Notes<br>(In thousands, except percentages) |
|---|---|
| Principal maturity value – at issuance | $250,000 |
| Outstanding principal maturity value – at September 29, 2012 | $144,461 |
| Contractual interest rate | 1.500% |
| Contractual maturity date | December 15, 2013 |
| Initial conversion rate | 47.2813 shares of common stock per $1,000 principal amount of notes, which is equivalent to a conversion price of approximately $21.15 per share of Cadence common stock. |
| Conversion feature (in addition to principal amount payable in cash) | Shares to the extent Cadence’s stock price exceeds $21.15 per share, calculated based on the applicable conversion rate multiplied by the volume weighted average price of Cadence common stock over a specified period. |
| Early conversion conditions (or the Early Conversion Conditions) | • Closing stock price greater than $27.50 for at least 20 of the last 30 trading days in a calendar quarter (convertible only for subsequent quarter).<br>• Specified corporate transactions.<br>• Note trading price falls below calculated minimum. |
| Conversion immediately preceding maturity | From November 1, 2013, and until the trading day immediately preceding the maturity date, holders may convert their 2013 Notes at any time into cash and Cadence shares as described above under “Conversion feature.” |
| Redemption at Cadence’s option prior to maturity | None. |
| Fundamental change put right | Upon a fundamental change prior to maturity, the 2013 Note holders could require Cadence to repurchase their notes for cash equal to the principal amount of the notes plus accrued interest. |
| Make-whole premium | Upon certain fundamental changes, prior to maturity, if Cadence’s stock price were between $18.00 and $60.00 per share at that time, the holders of the notes would be entitled to an increase to the conversion rate. This is referred to as a “make-whole premium.” |

| | |
|---|---|
| Financial covenants | None. |

Impact of Early Conversion Conditions on Financial Statements

As of September 29, 2012, none of the 2013 Notes Early Conversion Conditions had been met and the 2013 Notes are classified as a long-term liability on the Condensed Consolidated Balance Sheet. The classification of the 2013 Notes as a current or long-term liability on the Condensed Consolidated Balance Sheet is evaluated at each balance sheet date and may change from time to time, depending on whether the closing stock price early conversion condition is met for that particular quarter.

As of September 29, 2012, the if-converted value of the 2013 Notes to the note holders did not exceed the principal amount of the 2013 Notes. The total fair value of the 2013 Notes, including the equity component, was $144.4 million as of September 29, 2012 and was $142.3 million as of December 31, 2011.

2013 and 2011 Notes Hedges

The 2011 Notes Hedges expired unexercised on December 15, 2011. The 2013 Notes Hedges expire on December 15, 2013, and must be settled in net shares of Cadence common stock. Therefore, upon expiration of the 2013 Notes Hedges the counterparties will deliver shares of common stock to Cadence that represent the value, if any, by which the price of the common stock exceeds the price stipulated within the particular hedge agreement. The aggregate cost of the hedges entered into in connection with the 2011 Notes Hedges (which had similar conversion features as the 2013 Notes) and 2013 Notes Hedges was $119.8 million and

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was recorded as a reduction to stockholders' equity. In connection with the purchase of a portion of the 2013 Notes and 2011 Notes in June 2010, and the purchase of a portion of the 2013 Notes in November 2010, Cadence also sold a portion of the 2013 Notes Hedges and the 2011 Notes Hedges representing options to purchase approximately 9.7 million shares of Cadence's common stock for proceeds of $0.4 million. The estimated fair value of the remaining 2013 Notes Hedges was $1.0 million as of September 29, 2012 and $1.4 million as of December 31, 2011. Subsequent changes in the fair value of the 2013 Notes Hedges will not be recognized in the Condensed Consolidated Financial Statements as long as the instruments remain classified as equity.

2013 and 2011 Warrants

In December 2006, Cadence sold warrants in separate transactions, which consisted of the 2013 Warrants and the 2011 Warrants, for the purchase of up to 23.6 million shares of Cadence's common stock at a strike price of $31.50 per share for proceeds of $39.4 million, which was recorded as an increase in stockholders' equity. In connection with the purchase of some of the 2013 Notes and the 2011 Notes in June 2010 and November 2010, Cadence also purchased some of the 2013 Warrants and the 2011 Warrants, reducing the number of shares of Cadence common stock available for purchase by 9.7 million shares at a cost of $0.1 million. The 2011 Warrants expired on various dates from February 2012 through April 2012 and the 2013 Warrants will expire on various dates from February 2014 through April 2014. The 2013 Warrants must be settled in net shares of Cadence's common stock. Therefore, upon expiration of the 2013 Warrants Cadence will issue shares of common stock to the purchasers of the warrants that represent the value, if any, by which the price of the common stock exceeds the strike price stipulated within the particular warrant agreement. During the nine months ended September 29, 2012 the 2011 Warrants expired, reducing the number of shares of Cadence common stock available for purchase by 7.1 million shares.

Components of the 2013 Notes

The components of the 2013 Notes as of September 29, 2012 and December 31, 2011 were as follows:

| | As of September 29, 2012 | December 31, 2011 |
|---|---|---|
| | (In thousands) | |
| Equity component – included in common stock | $63,027 | $63,027 |
| Principal amount | $144,461 | $144,461 |
| Unamortized debt discount | (8,045) | (12,719) |
| Liability component | $136,416 | $131,742 |

The effective interest rate and components of interest expense of the 2013 Notes for the three and nine months ended September 29, 2012, and of the 2013 Notes and 2011 Notes for the three and nine months ended October 1, 2011, were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands, except percentages) | | | |
| Effective interest rate | 6.4% | 6.3% | 6.4% | 6.3% |
| Contractual interest expense | $540 | $1,053 | $1,619 | $3,161 |
| Amortization of debt discount | $1,588 | $3,275 | $4,674 | $9,684 |

Zero Coupon Zero Yield Senior Convertible Notes Due 2023

In August 2003, Cadence issued $420.0 million principal amount of its Zero Coupon Zero Yield Senior Convertible Notes Due 2023, or the 2023 Notes. As of September 29, 2012 and December 31, 2011, the remaining balance and the total fair value of the 2023 Notes was $0.2 million.

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NOTE 3. ACQUISITIONS AND ACQUISITION-RELATED CONTINGENT CONSIDERATION

Sigrity, Inc.

On July 2, 2012, Cadence acquired Sigrity, Inc., or Sigrity, a provider of signal and power integrity analysis tools for system, printed circuit board and integrated circuit package designs. Cadence is incorporating the Sigrity technology into its Allegro product offering. The goodwill associated with this acquisition resulted primarily from Cadence's expectation of synergies from the integration of Sigrity's product offerings with Cadence's product offerings, and is not deductible for income tax purposes. Comparative pro forma financial information for this acquisition has not been presented because the results of operations were not material to Cadence’s Condensed Consolidated Financial Statements.

Total cash consideration for Sigrity was $78.5 million (net of cash acquired of $7.5 million), of which $64.3 million was paid at closing, and $14.2 million was deferred and is conditioned upon certain Sigrity shareholders remaining employees of Cadence over designated retention periods. Cadence recorded expense of $1.8 million during the three months ended September 29, 2012 related to this deferred purchase consideration and will expense the remaining $12.4 million over the remaining retention periods.

The following table summarizes the assets acquired and liabilities assumed as part of the Sigrity acquisition:

| | (In thousands) | |
|---|---|---|
| Cash and cash equivalents | $7,490 | |
| Trade receivables | 4,254 | |
| Property, plant and equipment | 238 | |
| Other assets | 1,004 | |
| Acquired intangibles: | | |
| Existing technology (four- to ten-year useful lives) | 22,200 | |
| Agreements and relationships (three- to ten-year useful lives) | 17,100 | |
| Tradenames and trademarks (nine-year useful lives) | 1,300 | |
| Goodwill | 39,680 | |
| Total assets acquired | $93,266 | |
| Deferred revenue | (3,800 | ) |
| Other liabilities | (2,547 | ) |
| Long-term deferred tax liabilities | (15,079 | ) |
| Net assets acquired | $71,840 | |

Sigrity's assets and liabilities were recorded at their fair values on the date of acquisition. The fair values of Sigrity's intangible assets and deferred revenue were determined using significant inputs that are not observable in the market. For an additional description of these fair value calculations, see Note 7.

The deferred tax liabilities primarily related to the intangible assets acquired with Sigrity provided Cadence a future source of taxable income. Accordingly, Cadence released $14.8 million of its deferred tax asset valuation allowance, which was recognized as a benefit for income taxes during the three and nine months ended September 29, 2012.

Acquisition-related Contingent Consideration

For business combinations completed after January 3, 2009, contingent consideration is recorded at fair value on the acquisition date and adjusted to fair value at the end of each reporting period.

One of the fiscal 2011 acquisitions includes contingent consideration payments based on certain future financial measures associated with the acquired technology. This contingent consideration arrangement requires payments of up to $5.0 million if these measures are met during the three-year period subsequent to October 1, 2011. The fair value of the contingent consideration arrangement recorded on the date of the acquisition was $3.5 million. The fair value of the contingent consideration as of September 29, 2012 was $4.0 million.

Cadence may be obligated to make cash payments in connection with other business combinations and asset acquisitions, subject to the satisfaction of certain performance metrics. If performance is such that these payments are fully achieved, Cadence may be obligated to pay up to an aggregate of $18.8 million over the next 43 months. Of the $18.8 million, up to $12.5 million would be recorded as operating expenses in the Condensed Consolidated Income Statements.

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NOTE 4. GOODWILL AND ACQUIRED INTANGIBLES

Goodwill

Cadence completed its annual goodwill impairment test during the three months ended September 29, 2012 and determined that the fair value of Cadence's single reporting unit substantially exceeded the carrying amount of its net assets and that no impairment existed.

The changes in the carrying amount of goodwill during the nine months ended September 29, 2012 were as follows:

| | Gross Carrying Amount (In thousands) |
|---|---|
| Balance as of December 31, 2011 | $192,125 |
| Goodwill resulting from acquisitions | 39,680 |
| Additions due to contingent consideration* | 1,041 |
| Effect of foreign currency translation | 429 |
| Balance as of September 29, 2012 | $233,275 |

* Cadence accounts for business combinations with acquisition dates on or before January 3, 2009 under the purchase method in accordance with accounting standards that were authoritative at that time, whereby contingent consideration is added to goodwill as it is earned.

Acquired Intangibles, Net

Acquired intangibles with finite lives as of September 29, 2012 were as follows, excluding intangibles that were fully amortized as of December 31, 2011:

| | Gross Carrying Amount | Accumulated Amortization | Acquired Intangibles, Net |
|---|---|---|---|
| | (In thousands) | | |
| Existing technology | $112,947 | $(26,561) | $86,386 |
| Agreements and relationships | 134,982 | (35,705) | 99,277 |
| Distribution rights | 30,100 | (27,843) | 2,257 |
| Tradenames, trademarks and patents | 12,485 | (7,637) | 4,848 |
| Total acquired intangibles | $290,514 | $(97,746) | $192,768 |

Acquired intangibles with finite lives as of December 31, 2011 were as follows, excluding intangibles that were fully amortized as of January 1, 2011:

| | Gross Carrying Amount | Accumulated Amortization | Acquired Intangibles, Net |
|---|---|---|---|
| | (In thousands) | | |
| Existing technology | $90,433 | $(17,119) | $73,314 |
| Agreements and relationships | 118,060 | (27,123) | 90,937 |
| Distribution rights | 30,100 | (25,585) | 4,515 |
| Tradenames, trademarks and patents | 26,183 | (21,715) | 4,468 |
| Total acquired intangibles | $264,776 | $(91,542) | $173,234 |

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Amortization of acquired intangibles for the three and nine months ended September 29, 2012 and October 1, 2011 was as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands) | | | |
| Cost of product | $3,605 | $2,906 | $9,395 | $7,585 |
| Cost of maintenance | 269 | — | 269 | — |
| Amortization of acquired intangibles | 3,876 | 3,786 | 11,305 | 12,750 |
| Total amortization of acquired intangibles | $7,750 | $6,692 | $20,969 | $20,335 |

Amortization expense from existing technology intangible assets is included in cost of product and amortization expense from a maintenance agreement intangible asset is included in cost of maintenance.

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

| | (In thousands) |
|---|---|
| 2012 – remaining period | $7,764 |
| 2013 | 27,976 |
| 2014 | 25,178 |
| 2015 | 24,831 |
| 2016 | 24,309 |
| Thereafter | 82,710 |
| Total estimated amortization expense | $192,768 |

NOTE 5. RESTRUCTURING AND OTHER CHARGES

Cadence has initiated various restructuring plans in the past in an effort to operate more efficiently. These restructuring plans were primarily comprised of severance and termination costs related to headcount reductions and facility-related lease loss charges. As of September 29, 2012, all severance and termination benefits have been paid. The following table presents activity for Cadence’s restructuring plans for the three months ended September 29, 2012:

| | Excess Facilities |
|---|---|
| Balance, June 30, 2012 | $4,512 |
| Restructuring and other charges, net | 57 |
| Cash payments | (176 ) |
| Effect of foreign currency translation | 99 |
| Balance, September 29, 2012 | $4,492 |

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The following table presents activity for Cadence's restructuring plans for the nine months ended September 29, 2012:

| | Severance and Benefits | Excess Facilities | Other | Total |
|---|---|---|---|---|
| | (In thousands) | | | |
| Balance, December 31, 2011 | $46 | $4,976 | $5 | $5,027 |
| Restructuring and other charges (credits), net | (29) | 83 | (5) | 49 |
| Cash payments | (17) | (636) | — | (653) |
| Effect of foreign currency translation | — | 69 | — | 69 |
| Balance, September 29, 2012 | $— | $4,492 | $— | $4,492 |

NOTE 6. RECEIVABLES AND ALLOWANCES FOR DOUBTFUL ACCOUNTS

Cadence's current and long-term receivables balances as of September 29, 2012 and December 31, 2011 were as follows:

| | As of September 29, 2012 | December 31, 2011 |
|---|---|---|
| | (In thousands) | |
| Accounts receivable | $96,216 | $99,686 |
| Installment contract receivables, short-term | 27,100 | 37,086 |
| Long-term receivables | 5,668 | 11,371 |
| Total receivables | $128,984 | $148,143 |
| Less allowance for doubtful accounts | (110) | — |
| Total receivables, net | $128,874 | $148,143 |

Cadence's customers are primarily concentrated within the semiconductor, electronics systems and consumer electronics industries. As of September 29, 2012, one customer accounted for 10% of Cadence's total receivables and as of December 31, 2011, no single customer accounted for more than 10% of Cadence's total receivables. As of September 29, 2012, approximately 55% of Cadence's total receivables were attributable to the ten customers with the largest balances of total receivables. As of December 31, 2011, approximately 45% of Cadence's total receivables were attributable to the ten customers with the largest balances of total receivables.

The following table presents the change in Cadence's allowance for doubtful accounts for the nine months ended September 29, 2012:

| | Balance at Beginning of Period | Charged to Costs and Expenses | Uncollectible Accounts Written Off, Net | Balance at End of Period |
|---|---|---|---|---|
| Allowance for doubtful accounts | $— | $(120) | $10 | $(110) |

NOTE 7. FAIR VALUE

Inputs to valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Cadence's market assumptions. These two types of inputs have created the following fair-value hierarchy:

- Level 1 – Quoted prices for identical instruments in active markets;
- Level 2 – Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

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

This hierarchy requires Cadence to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value. Cadence recognizes transfers between levels of the hierarchy based on the fair values of the respective financial instruments at the end of the reporting period in which the transfer occurred. There were no transfers between levels of the fair value hierarchy during the three and nine months ended September 29, 2012.

The fair values of Cadence's 2013 Notes and 2015 Notes, which differ from their carrying values, are influenced by interest rates and Cadence's stock price and stock price volatility and are determined by prices for the 2013 Notes and 2015 Notes observed in market trading, which are level 2 inputs.

On a quarterly basis, Cadence measures at fair value certain financial assets and liabilities. The fair value of financial assets and liabilities was determined using the following levels of inputs as of September 29, 2012 and December 31, 2011:

| | Fair Value Measurements as of September 29, 2012: | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | |
| Assets | | | | |
| Cash equivalents: | | | | |
| Money market funds | $484,465 | $484,465 | $— | $— |
| United States Treasury securities | 3,975 | 3,975 | — | — |
| Bank certificates of deposit | 1,000 | — | 1,000 | — |
| Corporate debt securities | 501 | — | 501 | — |
| Commercial paper | 500 | — | 500 | — |
| Short-term investments: | | | | |
| Corporate debt securities | 32,613 | — | 32,613 | — |
| Bank certificates of deposit | 28,522 | — | 28,522 | — |
| United States Treasury securities | 21,460 | 21,460 | — | — |
| United States government agency securities | 8,235 | 8,235 | — | — |
| Commercial paper | 2,988 | — | 2,988 | — |
| Marketable equity securities | 2,001 | 2,001 | — | — |
| Trading securities held in Non-Qualified Deferred Compensation Plan, or NQDC | 23,561 | 23,561 | — | — |
| 2015 Notes Hedges | 287,079 | — | 287,079 | — |
| Foreign currency exchange contracts | 778 | — | 778 | — |
| Total Assets | $897,678 | $543,697 | $353,981 | $— |

| | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Liabilities | | | | |
| Acquisition-related contingent consideration | $4,108 | $— | $— | $4,108 |
| 2015 Notes Embedded Conversion Derivative | 287,079 | — | 287,079 | — |
| Total Liabilities | $291,187 | $— | $287,079 | $4,108 |

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| | Fair Value Measurements as of December 31, 2011: | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| | (In thousands) | | | |
| Assets | | | | |
| Cash equivalents – money market funds | $484,102 | $484,102 | $— | $— |
| Short-term investments: | | | | |
| Marketable equity securities | 3,037 | 3,037 | — | — |
| Trading securities held in NQDC | 24,058 | 24,058 | — | — |
| 2015 Notes Hedges | 215,113 | — | 215,113 | — |
| Foreign currency exchange contracts | 200 | — | 200 | — |
| Total Assets | $726,510 | $511,197 | $215,313 | $— |

| | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Liabilities | | | | |
| Acquisition-related contingent consideration | $3,911 | $— | $— | $3,911 |
| 2015 Notes Embedded Conversion Derivative | 215,113 | — | 215,113 | — |
| Total Liabilities | $219,024 | $— | $215,113 | $3,911 |

Level 1 Measurements

Cadence's cash equivalents held in money market funds, available-for-sale United States Treasury securities, United States government agency securities, equity securities and the trading securities held in Cadence's NQDC trust are measured at fair value using level 1 inputs.

Level 2 Measurements

The 2015 Notes Hedges and the 2015 Notes Embedded Conversion Derivative are measured at fair value using level 1 and level 2 inputs. These instruments are not actively traded and are valued using an option pricing model that uses observable market data for all inputs, such as implied volatility of Cadence's common stock, risk-free interest rate and other factors. Cadence's available-for-sale corporate debt securities, bank certificates of deposit and commercial paper are measured at fair value using level 2 inputs. Cadence obtains the fair values of its level 2 available-for-sale securities from a professional pricing service and validates the fair values by assessing the pricing methods and inputs and by comparing the fair values to another independent source.

Cadence's foreign currency exchange contracts are measured at fair value using observable foreign currency exchange rates.

Level 3 Measurements

The liabilities included in level 3 represent the fair value of contingent consideration associated with certain of Cadence's 2011 and 2010 acquisitions. Cadence makes estimates regarding the fair value of contingent consideration liabilities on the acquisition date and at the end of each reporting period until the contingency is resolved. The fair value of these arrangements is determined by calculating the net present value of the expected payments using significant inputs that are not observable in the market, including revenue projections and discount rates consistent with the level of risk of achievement. The fair value of these contingent consideration arrangements is affected most significantly by the changes in the revenue projections, but is also impacted by the discount rate used to adjust the outcomes to their present values. If the revenue projections increase or decrease, the fair value of the contingent consideration will increase or decrease accordingly, in amounts that will vary based on the timing of the projected revenues, the timing of the expected payments and the discount rate used to calculate the present value of the expected payments. Cadence used discount rates ranging from 11% to 16% to value its contingent consideration liabilities as of September 29, 2012 and December 31, 2011. Cadence believes that its estimates and assumptions are reasonable, but significant judgment is involved.

Changes in the fair value of contingent consideration liabilities subsequent to the acquisition are recorded in general and administrative expense in the Condensed Consolidated Income Statements. For an additional description of the related business combinations, see Note 3.

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The following table summarizes the level 3 activity for the nine months ended September 29, 2012:

| | (In thousands) |
|---|---|
| Balance as of December 31, 2011 | $3,911 |
| Payments | (39 ) |
| Adjustments | 236 |
| Balance as of September 29, 2012 | $4,108 |

Cadence acquired intangible assets of $40.6 million in connection with its acquisition of Sigrity during the three months ended September 29, 2012. The fair value of the intangible assets acquired was determined using the income approach and using level 3 inputs. Key assumptions include the level and timing of expected future cash flows, conditions and demands specific to electronic design automation software development, discount rates consistent with the level of risk and the economy in general. The fair value of these intangible assets is affected most significantly by the projected income associated with the intangible assets and the timing of the projected income, but is also impacted by the discount rate used to adjust the outcomes to their present values. If the income projections increase or decrease, the fair value of the intangible assets would increase or decrease accordingly, in amounts that will vary based on the timing of the projected income and the discount rate used to calculate the present value of the expected income. Cadence used discount rates ranging from 11% to 12% to value the intangible assets acquired with Sigrity.

As part of the Sigrity acquisition, Cadence also assumed an obligation related to deferred revenue of $3.8 million, which was estimated using the cost build-up approach. The cost build-up approach determines fair value using estimates of the costs required to provide the contracted deliverables plus an assumed profit of 25%. The total costs including the assumed profit were adjusted to present value using a discount rate of approximately 3%. The resulting fair value approximates the amount that Cadence would be required to pay a third party to assume the obligation. The fair value of the deferred revenue obligation is affected most significantly by the estimated costs required to support the obligation, but is also affected by the assumed profit and the discount rate.

Cadence believes that its estimates and assumptions related to the fair value of its acquired intangible assets and deferred revenue obligations are reasonable, but significant judgment is involved. For an additional description of the Sigrity acquisition, see Note 3.

NOTE 8. CASH, CASH EQUIVALENTS AND INVESTMENTS

Cadence's cash, cash equivalents and short-term investments at fair value as of September 29, 2012 and December 31, 2011 were as follows:

| | As of September 29, 2012 | December 31, 2011 |
|---|---|---|
| | (In thousands) | |
| Cash and cash equivalents | $649,099 | $601,602 |
| Short-term investments | 95,819 | 3,037 |
| Cash, cash equivalents and short-term investments | $744,918 | $604,639 |

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Cash and Cash Equivalents

Cadence considers all highly liquid investments with original maturities of three months or less on the date of purchase to be cash equivalents. The following table summarizes Cadence’s cash and cash equivalents at fair value as of September 29, 2012 and December 31, 2011:

| | As of September 29, 2012 | December 31, 2011 |
|---|---|---|
| | (In thousands) | |
| Cash and interest bearing deposits | $158,658 | $117,500 |
| Money market funds | 484,465 | 484,102 |
| United States Treasury securities | 3,975 | — |
| Bank certificates of deposit | 1,000 | — |
| Corporate debt securities | 501 | — |
| Commercial paper | 500 | — |
| Total cash and cash equivalents | $649,099 | $601,602 |

The amortized cost of Cadence's cash equivalents approximates fair value.

Short-Term Investments

Cadence’s short-term investments include marketable debt securities with original maturities greater than three months on the date of purchase and marketable equity securities. Cadence considers its entire portfolio of marketable debt and equity securities to be available for sale and available to fund current operations. Available-for-sale debt securities are carried at fair value, with the unrealized gains and losses presented net of tax as a separate component of other comprehensive income. Unrealized and realized gains and losses are determined using the specific identification method.

Cadence recognizes gains on its available-for-sale securities when they are realized. Cadence recognizes losses on its available-for-sale securities when they are realized or when Cadence has determined that an other-than-temporary decline in fair value has occurred. For an available-for-sale debt security, an other-than-temporary decline in fair value has occurred when the security’s fair value is less than its amortized cost basis and Cadence intends to sell the security, or it is more likely than not that Cadence will be required to sell the security, before recovery of its amortized cost basis. Cadence records realized gains, realized losses and other-than-temporary impairments as part of other income (expense), net in the Condensed Consolidated Income Statements.

The following tables summarize Cadence’s short-term investments as of September 29, 2012 and December 31, 2011:

| | As of September 29, 2012 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (In thousands) | | | |
| Corporate debt securities | $32,551 | $63 | $(1 ) | $32,613 |
| Bank certificates of deposit | 28,506 | 17 | (1 ) | 28,522 |
| United States Treasury securities | 21,436 | 24 | — | 21,460 |
| United States government agency securities | 8,222 | 13 | — | 8,235 |
| Commercial paper | 2,986 | 2 | — | 2,988 |
| Marketable equity securities | 1,823 | 178 | — | 2,001 |
| Total short-term investments | $95,524 | $297 | $(2 ) | $95,819 |

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| | As of December 31, 2011 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (In thousands) | | | |
| Marketable equity securities | $1,830 | $1,207 | $— | $3,037 |
| Total short-term investments | $1,830 | $1,207 | $— | $3,037 |

Cadence purchased its investments in marketable debt securities during the three months ended June 30, 2012 and the three months ended September 29, 2012. As of September 29, 2012, any security Cadence held with an unrealized loss had been held for less than six months.

The amortized cost and estimated fair value of marketable debt securities included in short-term investments as of September 29, 2012, by contractual maturity, are shown in the table below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations without call or prepayment penalties.

| | Amortized Cost | Fair Value |
|---|---|---|
| | (In thousands) | |
| Due in less than one year | $56,437 | $56,485 |
| Due in one to three years | 37,264 | 37,333 |
| Total marketable debt securities included in short-term investments | $93,701 | $93,818 |

Realized gains from the sale of marketable debt and equity securities during three and nine months ended September 29, 2012 and October 1, 2011 were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands) | | (In thousands) | |
| Gains on sale of marketable debt and equity securities | $8 | $— | $125 | $8,052 |

Amortization of premium or discount related to Cadence’s marketable debt securities for the three and nine months ended September 29, 2012 and October 1, 2011 was as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands) | | (In thousands) | |
| Amortization of premium (discount) | $251 | $— | $271 | $— |

Non-Marketable Investments

Cadence’s non-marketable investments generally consist of voting preferred stock or convertible debt of privately-held companies and are included in other assets on Cadence’s Condensed Consolidated Balance Sheets. If Cadence determines that it has the ability to exercise significant influence over the issuer, which may include considering whether the investments are in-substance common stock, the investment is accounted for using the equity method.

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Cadence's non-marketable investments as of September 29, 2012 and December 31, 2011 were as follows:

| | As of September 29, 2012 | December 31, 2011 |
|---|---|---|
| | (In thousands) | |
| Cost method | $5,054 | $6,157 |
| Equity method | 4,283 | 4,303 |
| Total non-marketable investments | $9,337 | $10,460 |

Net realized gains on the sale of non-marketable investments during the three and nine months ended September 29, 2012 and October 1, 2011 were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands) | | (In thousands) | |
| Gains on sale of non-marketable investments | $— | $5,379 | $— | $8,108 |

NOTE 9. NET INCOME PER SHARE

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

The calculations for basic and diluted net income per share for the three and nine months ended September 29, 2012, and October 1, 2011, are as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands, except per share amounts) | | | |
| Net income | $58,584 | $28,106 | $126,074 | $61,337 |
| Weighted average common shares used to calculate basic net income per share | 271,350 | 264,723 | 269,643 | 263,149 |
| 2023 Notes | 11 | 11 | 11 | 11 |
| 2015 Warrants | 6,286 | — | 3,148 | — |
| Stock-based compensation | 5,681 | 6,007 | 5,958 | 6,908 |
| Weighted average common shares used to calculate diluted net income per share | 283,328 | 270,741 | 278,760 | 270,068 |
| Net income per share - basic | $0.22 | $0.11 | $0.47 | $0.23 |
| Net income per share - diluted | $0.21 | $0.10 | $0.45 | $0.23 |

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The following table presents shares of Cadence's common stock outstanding for the three and nine months ended September 29, 2012, and October 1, 2011, that were excluded from the computation of diluted net income per share because the effect of including these shares in the computation of diluted net income per share would have been anti-dilutive:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands) | | | |
| 2015 Warrants (various expiration dates through 2015) | — | 46,382 | — | 46,382 |
| 2011 Warrants and 2013 Warrants (various expiration dates through 2014) | 6,830 | 17,916 | 6,830 | 18,194 |
| Options to purchase shares of common stock (various expiration dates through 2022) | 10,003 | 14,184 | 12,767 | 14,184 |
| Non-vested shares of restricted stock | 10 | 2,805 | 82 | 21 |
| Total potential common shares excluded | 16,843 | 81,287 | 19,679 | 78,781 |

NOTE 10. ACCUMULATED DEFICIT

The changes in accumulated deficit for the three and nine months ended September 29, 2012 were as follows:

| | Three Months Ended |
|---|---|
| | (In thousands) |
| Balance as of June 30, 2012 | $(1,018,190) |
| Net income | 58,584 |
| Reissuance of treasury stock | (2,909) |
| Balance as of September 29, 2012 | $(962,515) |

| | Nine Months Ended |
|---|---|
| | (In thousands) |
| Balance as of December 31, 2011 | $(1,083,245) |
| Net income | 126,074 |
| Reissuance of treasury stock | (5,344) |
| Balance as of September 29, 2012 | $(962,515) |

NOTE 11. OTHER COMPREHENSIVE INCOME

Cadence's other comprehensive income is comprised of foreign currency translation gains and losses, changes in unrealized holding gains and losses on available-for-sale securities net of reclassifications for realized gains and losses and changes in defined benefit plan liabilities as presented in Cadence's Condensed Consolidated Statements of Comprehensive Income.

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Changes in unrealized holding gains or losses on available-for-sale securities include the following for the three and nine months ended September 29, 2012, and October 1, 2011:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands) | | | |
| Unrealized holding gains or losses | $(112) | $(447) | $(1,018) | $(481) |
| Reclassification of unrealized holding gains or losses to other income (expense), net | (8) | — | (123) | (8,044) |
| Changes in unrealized holding gains or losses | $(120) | $(447) | $(1,141) | $(8,525) |

Accumulated other comprehensive income was comprised of the following as of September 29, 2012, and December 31, 2011:

| | September 29, 2012 | December 31, 2011 |
|---|---|---|
| | (In thousands) | |
| Foreign currency translation gain | $50,182 | $53,990 |
| Changes in defined benefit plan liabilities | (4,348) | (4,468) |
| Unrealized holding gains on available-for-sale securities | 290 | 1,431 |
| Total accumulated other comprehensive income | $46,124 | $50,953 |

NOTE 12. CONTINGENCIES

Legal Proceedings

From time to time, Cadence is involved in various disputes and litigation that arise in the ordinary course of business. These include disputes and lawsuits related to intellectual property, indemnification obligations, mergers and acquisitions, licensing, contracts, distribution arrangements and employee relations matters. At least quarterly, Cadence reviews the status of each significant matter and assesses its potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount or the range of loss can be estimated, Cadence accrues a liability for the estimated loss. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based on Cadence’s judgments using the best information available at the time. As additional information becomes available, Cadence reassesses the potential liability related to pending claims and litigation matters and may revise estimates.

Other Contingencies

Cadence provides its customers with a warranty on sales of hardware products, generally for a 90-day period. Cadence did not incur any significant costs related to warranty obligations during the three and nine months ended September 29, 2012, or October 1, 2011.

Cadence’s product license and services agreements typically include a limited indemnification provision for claims from third parties relating to Cadence’s intellectual property. If the potential loss from any indemnification claim is considered probable and the amount or the range of loss can be estimated, Cadence accrues a liability for the estimated loss. The indemnification is generally limited to the amount paid by the customer. Cadence did not incur any significant losses from indemnification claims during the three and nine months ended September 29, 2012, or October 1, 2011.

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NOTE 13. STATEMENT OF CASH FLOWS

The supplemental cash flow information for the nine months ended September 29, 2012, and October 1, 2011, is as follows:

| | Nine Months Ended | |
|---|---|---|
| | September 29, 2012 | October 1, 2011 |
| | (In thousands) | |
| Cash Paid During the Period for: | | |
| Interest | $5,677 | $6,708 |
| Income taxes, including foreign withholding tax | $12,481 | $13,304 |
| Non-cash Investing and Financing Activities: | | |
| Stock options assumed for acquisition | $— | $1,600 |
| Available-for-sale securities received from customer | $20 | $312 |
| Receivables related to sales of cost-method investments | $— | $4,858 |

NOTE 14. OTHER INCOME (EXPENSE), NET

Cadence’s other income (expense), net, for the three and nine months ended September 29, 2012, and October 1, 2011, was as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands) | | | |
| Interest income | $650 | $318 | $1,295 | $1,015 |
| Amortization of premium or discount on marketable debt securities | (251) | — | (271) | — |
| Gains on sale of marketable debt and equity securities, net | 8 | — | 123 | 8,044 |
| Gains on sale of non-marketable equity investments | — | 5,379 | — | 8,108 |
| Gains (losses) on securities in Cadence’s NQDC | (839) | 204 | 3,237 | 3,116 |
| Gains (losses) on foreign exchange | 1,376 | 1,259 | 2,546 | (466) |
| Equity losses from non-marketable investments | (34) | (39) | (34) | (104) |
| Write-down of non-marketable investments | (1,081) | — | (1,103) | — |
| Other income, net | 40 | 123 | 179 | 394 |
| Total other income (expense), net | $(131) | $7,244 | $5,972 | $20,107 |

NOTE 15. SEGMENT REPORTING

Segment reporting is based on the “management approach,” following the method that management organizes the company’s reportable segments for which separate financial information is made available to, and evaluated regularly by, the chief operating decision maker in allocating resources and in assessing performance. Cadence’s chief operating decision maker is its President and Chief Executive Officer, or CEO, who reviews Cadence’s consolidated results as one reportable segment. In making operating decisions, the CEO primarily considers consolidated financial information, accompanied by disaggregated information about revenues by geographic region.

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

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The following table presents a summary of revenue by geography for the three and nine months ended September 29, 2012 and October 1, 2011:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In thousands) | | | |
| Americas: | | | | |
| United States | $141,509 | $123,808 | $414,888 | $360,018 |
| Other Americas | 4,733 | 6,116 | 18,659 | 19,457 |
| Total Americas | 146,242 | 129,924 | 433,547 | 379,475 |
| Europe, Middle East and Africa | 66,392 | 61,643 | 191,097 | 174,377 |
| Japan | 58,757 | 50,989 | 168,856 | 150,348 |
| Asia | 67,142 | 49,901 | 187,339 | 137,629 |
| Total | $338,533 | $292,457 | $980,839 | $841,829 |

The following table presents a summary of long-lived assets by geography as of September 29, 2012 and December 31, 2011:

| | As of | |
|---|---|---|
| | September 29, 2012 | December 31, 2011 |
| | (In thousands) | |
| Americas: | | |
| United States | $215,656 | $230,884 |
| Other Americas | 84 | 35 |
| Total Americas | 215,740 | 230,919 |
| Europe, Middle East and Africa | 5,081 | 4,813 |
| Japan | 2,247 | 3,960 |
| Asia | 23,788 | 22,825 |
| Total | $246,856 | $262,517 |

## 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 31, 2011. Certain of these statements, including, but not limited to, statements regarding the extent and timing of future revenues and expenses and customer demand, statements regarding the deployment of our products, statements regarding our reliance on third parties and other statements using words such as “anticipates,” “believes,” “could,” “estimates,” “expects,” “forecasts,” “intends,” “may,” “plans “should,” “will” and “would,” and words of similar import and the negatives thereof, constitute forward-looking statements. These statements are predictions based upon our current expectations about future events. Actual results could vary materially as a result of certain factors, including, but not limited to, those expressed in these statements. We refer you to the “Risk Factors,” “Results of Operations,” “Disclosures About Market Risk,” and “Liquidity and Capital Resources” sections contained in this Quarterly Report, and the risks discussed in our other Securities Exchange Commission, or SEC, filings, which identify important risks and uncertainties that could cause actual results to differ materially from those contained in the forward-looking statements.

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

Overview

We develop software, hardware and intellectual property which are used by semiconductor and electronic system customers to develop and design integrated circuits and electronic devices. We license our software, and two categories of intellectual property, or IP, commonly referred to as verification IP, or VIP, and Design IP. In addition, we sell and lease hardware technology. We provide maintenance for our product offerings and provide engineering services related to methodology, education, and hosted design solutions which help customers manage and accelerate their electronics product development processes.

Substantially all of our revenue is generated from integrated circuit, or IC, and electronics systems manufacturers and designers and is dependent upon their commencement of new design projects. As a result, our revenue is significantly influenced by our customers' business outlook and investment in the introduction of new products and the improvement of existing products.

In order to be competitive and profitable in the price-sensitive markets they serve, our customers demand high levels of productivity from their design teams, better predictability in their development schedules and high quality products. Semiconductor and electronics systems companies are responding to demand for increased functionality and miniaturization by combining subsystems – such as radio frequency, or RF, wireless communication, video signal processing and microprocessors – either onto a single silicon chip, creating a system-on-chip, or SoC, or by combining multiple chips into a single chip package in a format referred to as system-in-package, or SiP. The trend toward subsystem integration has required these chip makers to find solutions to challenges previously addressed by system companies, such as verifying system-level functionality and hardware-software interoperability.

Our offerings address many of the challenges associated with developing unique silicon circuitry, integrating that circuitry with Design IP developed by us or third parties to create SoCs, and combining ICs and SoCs with software to create electronic systems. We provide our customers with the ability to address the broad range of issues that arise at the silicon, SoC and system levels.

The most significant issues that our customers face in creating their products include optimizing energy consumption, manufacturing microscopic circuitry, verifying device functionality and achieving technical performance targets, all while meeting aggressive cost requirements. Our semiconductor and systems customers deliver a wide range of products in segments such as smart phones, tablets, televisions, communications and internet infrastructure, and computing platforms. Providers of EDA solutions must deliver products that address the technical challenges while improving the productivity, predictability, reliability and profitability of the design processes and products of their customers.

Our products are engineered to improve our customers' design productivity and design quality by providing a comprehensive set of EDA solutions and a differentiated portfolio of Design IP and VIP. Product revenues include all fees earned from granting licenses to use our software and IP, and from sales and leases of our hardware products.

We combine our products and technologies into categories related to major design activities:

- Digital IC Design;
- Functional Verification and Design IP;
- Custom IC Design;
- Design for Manufacturing, or DFM; and
- System Interconnect Design.

The major Cadence® design platforms are branded as Incisive® functional verification, Encounter® digital IC design, Virtuoso® custom design and Allegro® system interconnect design. Our functional verification offerings include VIP products and are supplemented by our Design IP offerings. In addition, we augment these platform product offerings with a set of DFM products that service both the digital and custom IC design flows. On July 2, 2012, we acquired Sigrity, Inc., or Sigrity, a provider of signal and power integrity analysis tools for system, printed circuit board and IC package design. We are incorporating the Sigrity technology into our Allegro product offering. We also offer the Sigrity technology on a stand-alone basis.

The products and technologies included in these categories are combined with services, ready-to-use packages of technologies assembled from our broad portfolio and other associated components that provide comprehensive solutions for low power, mixed signal and advanced-node designs, as well as popular designs based on intellectual property owned and licensed by ARM Holdings, Plc. These solutions and their constituent elements are marketed to users who specialize in areas such as system design and verification, functional verification, logic design, digital implementation, custom IC design and printed circuit board, or PCB, and IC package and SiP design. We have identified certain items that management uses as performance indicators to manage our business, including revenue, certain elements of operating expenses and cash flow from operations, and we describe these items further below under the heading "Results of Operations" and "Liquidity and Capital Resources."

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## Critical Accounting Estimates

In preparing our Condensed Consolidated Financial Statements, we make assumptions, judgments and estimates that can have a significant impact on our revenue, operating income and net income, as well as on the value of certain assets and liabilities on our Condensed Consolidated Balance Sheets. We base our assumptions, judgments and estimates on historical experience and various other factors that we believe to be reasonable under the circumstances. Actual results could differ materially from these estimates under different assumptions or conditions. At least quarterly, we evaluate our assumptions, judgments and estimates and make changes accordingly. Historically, our assumptions, judgments and estimates relative to our critical accounting estimates have not differed materially from actual results. For further information about our critical accounting estimates, see the discussion in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations, under the heading "Critical Accounting Estimates" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

## Results of Operations

Financial results for the three and nine months ended September 29, 2012, as compared to the three and nine months ended October 1, 2011, reflect the following:

- An increase in the combined value of our product and maintenance revenue, primarily because of a general increase in the annualized values of software contracts with our customers and an increase in the sale and lease of our hardware products;
- An increase in employee-related costs, primarily consisting of costs related to hiring additional employees during the period and incremental costs related to our acquisition of Sigrity;
- An increase in variable compensation during the nine months ended September 29, 2012 as compared to the same period in 2011; and
- An income tax benefit in the three months ended September 29, 2012, primarily resulting from a release of valuation allowance against our deferred tax assets due to the acquisition of intangible assets held by Sigrity.

### Revenue

We primarily generate revenue from licensing our EDA software and IP, selling or leasing our hardware technology, providing maintenance for our software, IP and hardware and providing engineering services. We principally use three software and IP license types: subscription, term and perpetual.

The timing of our product revenue is significantly affected by the mix of license types in the bookings executed in any given period and whether the revenue for such bookings is recognized over multiple periods or up-front, upon completion of delivery.

We seek to achieve a consistent mix of bookings with approximately 90% of the aggregate value of our bookings of a type for which the revenue is recurring, or ratable, in nature, and the remainder of the resulting revenue recognized up-front, upon completion of delivery. Our ability to achieve this bookings mix in any single fiscal quarter may be impacted by an increase in hardware sales beyond our current expectations, because revenue for hardware sales is generally recognized up-front in the quarter in which delivery is completed.

Approximately 90% of the aggregate value of our bookings during the three and nine months ended September 29, 2012 and October 1, 2011 was of a type for which the revenue is recurring, or ratable, in nature.

For an additional description of the impact of hardware sales on the anticipated mix of bookings, our other license types and the timing of revenue recognition for license transactions, see the discussion under the heading "Critical Accounting Estimates – Revenue Recognition" in "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Form 10-K for the fiscal year ended December 31, 2011.

Although we believe that pricing volatility has not generally been a material component of the change in our revenue from period to period, we believe that the amount of revenue recognized in future periods will depend on, among other things, the:

- Competitiveness of our new technology; and
- Size, duration, timing, terms and type of:
- Contract renewals with existing customers;

- Additional sales to existing customers; and
- Sales to new customers.

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Revenue by Period

The following table shows our revenue for the three months ended September 29, 2012 and October 1, 2011 and the change in revenue between periods:

| | Three Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| Product | $216.6 | $164.0 | $52.6 | 32 % |
| Services | 28.4 | 29.1 | (0.7) | (2)% |
| Maintenance | 93.5 | 99.4 | (5.9) | (6)% |
| Total revenue | $338.5 | $292.5 | $46.0 | 16 % |

The following table shows our revenue for the nine months ended September 29, 2012 and October 1, 2011 and the change in revenue between periods:

| | Nine Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| Product | $614.9 | $463.7 | $151.2 | 33 % |
| Services | 86.9 | 86.4 | 0.5 | 1 % |
| Maintenance | 279.0 | 291.7 | (12.7) | (4)% |
| Total revenue | $980.8 | $841.8 | $139.0 | 17 % |

For software arrangements, we generally recognize revenue ratably over the duration of the arrangement and such revenue is allocated between product and maintenance revenue. As the duration decreases, the allocation to maintenance revenue decreases and the allocation to product revenue increases. Combined, product and maintenance revenue increased during the three and nine months ended September 29, 2012, as compared to the three and nine months ended October 1, 2011, primarily because of increased business levels, an increase in revenue related to the sale and lease of our hardware products and increased revenue recognized from bookings in prior periods. Maintenance revenue decreased on a standalone basis during the three and nine months ended September 29, 2012, as compared to the three and nine months ended October 1, 2011, primarily because of the increased allocation to product revenue due to the gradual decline in the average duration of our time-based software license arrangements.

Revenue by Product Group

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

| | Three Months Ended | | | | |
|---|---|---|---|---|---|
| | September 29, 2012 | June 30, 2012 | March 31, 2012 | December 31, 2011 | October 1, 2011 |
| Functional Verification and Design IP | 30 % | 33 % | 30 % | 32 % | 30 % |
| Digital IC Design | 23 % | 22 % | 23 % | 21 % | 22 % |
| Custom IC Design | 24 % | 22 % | 23 % | 23 % | 23 % |
| System Interconnect | 9 % | 8 % | 8 % | 8 % | 9 % |
| Design for Manufacturing | 6 % | 6 % | 7 % | 6 % | 6 % |
| Services and other | 8 % | 9 % | 9 % | 10 % | 10 % |
| Total | 100 % | 100 % | 100 % | 100 % | 100 % |

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As described in Note 2 in the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011, certain of our licensing arrangements allow customers the ability to remix among software products. Additionally, we have arrangements with customers that include a combination of our products, with the actual product selection and number of licensed users to be determined at a later date. For these arrangements, we estimate the allocation of the revenue to product groups based upon the expected usage of our products. The actual usage of our products by these customers may differ and, if that proves to be the case, the revenue allocation in the table above would differ.

The changes in the percentage of revenue contributed by the Functional Verification and Design IP product group for the quarters presented are generally related to changes in revenue related to our hardware products, which are included in the Functional Verification and Design IP product group.

Revenue by Geography

| | Three Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| United States | $141.5 | $123.8 | $17.7 | 14 % |
| Other Americas | 4.7 | 6.1 | (1.4) | (23)% |
| Europe, Middle East and Africa | 66.4 | 61.6 | 4.8 | 8 % |
| Japan | 58.8 | 51.0 | 7.8 | 15 % |
| Asia | 67.1 | 50.0 | 17.1 | 34 % |
| Total revenue | $338.5 | $292.5 | $46.0 | 16 % |
| | Nine Months Ended | | Change | |
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| United States | $414.9 | $360.0 | $54.9 | 15 % |
| Other Americas | 18.7 | 19.5 | (0.8) | (4)% |
| Europe, Middle East and Africa | 191.1 | 174.4 | 16.7 | 10 % |
| Japan | 168.8 | 150.3 | 18.5 | 12 % |
| Asia | 187.3 | 137.6 | 49.7 | 36 % |
| Total revenue | $980.8 | $841.8 | $139.0 | 17 % |

For the primary factors contributing to our increase in revenue across our geographies, see the general description under "Revenue by Period" above.

Revenue by Geography as a Percent of Total Revenue

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| United States | 42 % | 42 % | 42 % | 43 % |
| Other Americas | 1 % | 2 % | 2 % | 2 % |
| Europe, Middle East and Africa | 20 % | 21 % | 20 % | 21 % |
| Japan | 17 % | 18 % | 17 % | 18 % |
| Asia | 20 % | 17 % | 19 % | 16 % |
| Total | 100 % | 100 % | 100 % | 100 % |

No one customer accounted for 10% or more of total revenue during the three and nine months ended September 29, 2012 and October 1, 2011.

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

Cost of Revenue

| | Three Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| Product | $23.3 | $18.2 | $5.1 | 28 % |
| Services | $16.8 | $20.4 | (3.6) | (18)% |
| Maintenance | $11.1 | $11.2 | (0.1) | (1)% |

| | Nine Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| Product | $60.3 | $52.4 | $7.9 | 15 % |
| Services | $53.3 | $61.1 | (7.8) | (13)% |
| Maintenance | $33.8 | $32.8 | 1.0 | 3 % |

The following table shows cost of revenue as a percentage of related revenue for the three and nine months ended September 29, 2012 and October 1, 2011:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| Product | 11 % | 11 % | 10 % | 11 % |
| Services | 59 % | 70 % | 61 % | 71 % |
| Maintenance | 12 % | 11 % | 12 % | 11 % |

Cost of Product

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

A summary of cost of product is as follows:

| | Three Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| Product-related costs | $19.7 | $15.3 | $4.4 | 29 % |
| Amortization of acquired intangibles | 3.6 | 2.9 | 0.7 | 24 % |
| Total cost of product | $23.3 | $18.2 | $5.1 | 28 % |

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| | Nine Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| Product-related costs | $50.9 | $44.8 | $6.1 | 14 % |
| Amortization of acquired intangibles | 9.4 | 7.6 | 1.8 | 24 % |
| Total cost of product | $60.3 | $52.4 | $7.9 | 15 % |

The changes in cost of product during the three and nine months ended September 29, 2012, as compared to the three and nine months ended October 1, 2011, were primarily due to increases in hardware costs and amortization of acquired intangibles. Hardware costs increased primarily due to an increase in hardware sales. Amortization of acquired intangibles included in cost of product increased primarily due to amortization of intangible assets acquired with our acquisition of Sigrity on July 2, 2012 and our fiscal 2011 acquisitions.

Cost of product depends primarily upon the mix of hardware and software product sales in any given period, and also depends upon the timing and extent to which we acquire intangible assets, acquire or license third-parties' intellectual property or technology and sell our products that include such acquired or licensed intellectual property or technology.

Cost of Services

Cost of services primarily includes employee salary, benefits and other employee-related costs, costs to maintain the infrastructure necessary to manage a services organization, and provisions for contract losses, if any. Cost of services decreased by $3.6 million during the three months ended September 29, 2012, as compared to the three months ended October 1, 2011, and decreased by $7.8 million during the nine months ended September 29, 2012, as compared to the nine months ended October 1, 2011, primarily due to a decrease in employee salary, benefits and other employee-related costs. Certain of our design services engineers have been redeployed to internal research and development projects or to assist with pre-sales activities, resulting in lower cost of services expense. We expect to continue to utilize our services engineers on internal projects and pre-sales activities and we expect our cost of services to continue to decrease during the remainder of fiscal 2012, as compared to fiscal 2011.

Cost of Maintenance

Cost of maintenance includes the cost of our customer support services, such as telephone, online and on-site support, employee salary, benefits and other employee-related costs, amortization of acquired intangible assets and documentation of maintenance updates. There were no significant changes in cost of maintenance during the three and nine months ended September 29, 2012, as compared to the three and nine months ended October 1, 2011.

Operating Expenses

Our operating expenses include marketing and sales, research and development and general and administrative expenses. Factors that may cause our operating expenses to fluctuate include changes in the number of employees due to hiring, acquisitions or restructuring activities, foreign exchange rates, cost reduction strategies and the impact of our variable compensation programs, which are driven by overall operating results. Our employee salary and other compensation-related costs increased during the three months ended September 29, 2012, as compared to the three months ended October 1, 2011, primarily due to hiring additional employees for our research and development activities and the addition of employees through the acquisition of Sigrity employees. Our employee salary and other compensation-related costs increased during the nine months ended September 29, 2012, as compared to the nine months ended October 1, 2011, primarily due to hiring additional employees for our research and development activities, the addition of employees through the acquisition of Sigrity and improved business levels resulting in higher variable compensation.

Our operating expenses are denominated in various foreign currencies. We recognize lower expenses in periods when the United States dollar strengthens in value against other currencies and we recognize higher expenses when the United States dollar weakens against other currencies. For an additional description of how changes in foreign exchange rates affect our Condensed Consolidated Financial Statements, see the discussion under the heading "Item 3. Quantitative and Qualitative Disclosures About Market Risk – Foreign Currency Risk."

We expect our operating expenses to increase during the remainder of fiscal 2012, as compared to the same period in fiscal 2011, due to anticipated hiring during the remainder of fiscal 2012 and due to our acquisition of Sigrity.

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Our operating expenses for the three and nine months ended September 29, 2012 and October 1, 2011 were as follows:

| | Three Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| Marketing and sales | $82.5 | $79.9 | $2.6 | 3 % |
| Research and development | 115.1 | 103.2 | 11.9 | 12 % |
| General and administrative | 26.4 | 24.0 | 2.4 | 10 % |
| Operating expenses | $224.0 | $207.1 | $16.9 | 8 % |

| | Nine Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| Marketing and sales | $246.7 | $235.3 | $11.4 | 5 % |
| Research and development | 335.7 | 303.7 | 32.0 | 11 % |
| General and administrative | 84.4 | 68.7 | 15.7 | 23 % |
| Operating expenses | $666.8 | $607.7 | $59.1 | 10 % |

Our operating expenses, as a percentage of total revenue, for the three and nine months ended September 29, 2012 and October 1, 2011 were as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| Marketing and sales | 24 % | 27 % | 25 % | 28 % |
| Research and development | 34 % | 35 % | 34 % | 36 % |
| General and administrative | 8 % | 8 % | 9 % | 8 % |
| Operating expenses | 66 % | 71 % | 68 % | 72 % |

Marketing and Sales

The changes in marketing and sales expense for the three and nine months ended September 29, 2012, as compared to the three and nine months ended October 1, 2011, were due to the following:

| | Change | |
|---|---|---|
| | Three Months Ended | Nine Months Ended |
| | (In millions) | |
| Salary, benefits and other employee-related costs | $1.7 | $9.4 |
| Other individually insignificant items | 0.9 | 2.0 |
| | $2.6 | $11.4 |

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Research and Development

The changes in research and development expense for the three and nine months ended September 29, 2012, as compared to the three and nine months ended October 1, 2011, were due to the following:

| | Change Three Months Ended | Nine Months Ended |
|---|---|---|
| | (In millions) | |
| Salary, benefits and other employee-related costs | $9.5 | $25.8 |
| Professional services | 2.1 | 2.5 |
| Stock-based compensation | 0.7 | 2.2 |
| Other individually insignificant items | (0.4) | 1.5 |
| | $11.9 | $32.0 |

The increase in salary, benefits and other employee-related costs during the three months ended September 29, 2012, as compared to the three months ended October 1, 2011, is primarily due to hiring additional employees for our research and development activities and the addition of employees through the acquisition of Sigrity.

The increase in salary, benefits and other employee-related costs during the nine months ended September 29, 2012, as compared to the nine months ended October 1, 2011, is primarily due to hiring additional employees for our research and development activities, the addition of employees through the acquisition of Sigrity and higher variable compensation resulting from improved business levels.

We expect research and development expense to increase for the remainder of fiscal 2012, as compared to the same period in fiscal 2011, due to the higher salary, benefits and other employee related costs, as noted above, and higher professional services costs.

General and Administrative

The changes in general and administrative expense for the three and nine months ended September 29, 2012, as compared to the three and nine months ended October 1, 2011, were due to the following:

| | Change Three Months Ended | Nine Months Ended |
|---|---|---|
| | (In millions) | |
| Salary, benefits and other employee-related costs | $1.9 | $4.2 |
| Net recoveries of allowance for doubtful accounts | 0.8 | 6.7 |
| Professional services | (1.3) | 2.4 |
| Other individually insignificant items | 1.0 | 2.4 |
| | $2.4 | $15.7 |

We recorded net recoveries of our allowance for doubtful accounts of $0.7 million during the three months ended October 1, 2011 and $6.6 million during the nine months ended October 1, 2011 because we collected certain receivables that previously had been included in our allowance for doubtful accounts. These recoveries resulted in reductions in our general and administrative expense during the three and nine months ended October 1, 2011 and, as a result, our general and administrative expense increased for the three and nine months ended September 29, 2012. We had previously recorded reserves for certain customers based on changes in our assessment of collectibility for those customers. The principal factor for the assessment at that time was a general deterioration of economic conditions having a significant impact on certain customers. These customers' business prospects eventually improved, and we were able to collect the majority of those receivables that had previously been reserved, resulting in recoveries of previously reserved bad debts.

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Amortization of Acquired Intangibles

| | Three Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| Amortization of acquired intangibles | $3.9 | $3.8 | $0.1 | 3 % |

The increase in amortization of acquired intangibles during the three months ended September 29, 2012, as compared to the three months ended October 1, 2011, resulted from increased amortization of intangible assets related to our acquisition of Sigrity, which was partially offset by certain acquired intangibles becoming fully amortized.

| | Nine Months Ended | | Change | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | Amount | Percentage |
| | (In millions, except percentages) | | | |
| Amortization of acquired intangibles | $11.3 | $12.8 | $(1.5) | (12)% |

The decrease in amortization of acquired intangibles during the nine months ended September 29, 2012, as compared to the nine months ended October 1, 2011, resulted from certain acquired intangibles becoming fully amortized, which was partially offset by increased amortization of intangible assets related to our acquisition of Sigrity.

We expect amortization of acquired intangibles to increase during the remainder of fiscal 2012, as compared to the same period in fiscal 2011, due to the amortization of intangible assets acquired with Sigrity during the three months ended September 29, 2012.

Interest Expense

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2012 | October 1, 2011 | September 29, 2012 | October 1, 2011 |
| | (In millions) | | | |
| Contractual cash interest expense: | | | | |