

SYNOPSYS INC  
Form 10-Q  
August 26, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED JULY 31, 2014

OR

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

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_  
COMMISSION FILE NUMBER: 0-19807

SYNOPSYS, INC.  
(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of incorporation or organization)  
700 EAST MIDDLEFIELD ROAD  
MOUNTAIN VIEW, CA 94043  
(Address of principal executive offices, including zip code)  
(650) 584-5000  
(Registrant's telephone number, including area code)

56-1546236  
(I.R.S. Employer Identification Number)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated Filer

Non-accelerated filer  (Do not check if smaller reporting company) Smaller reporting company

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

As of August 22, 2014, there were 155,825,554 shares of the registrant's common stock outstanding.



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 FOR THE FISCAL QUARTER ENDED JULY 31, 2014  
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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## SYNOPSYS, INC.

## UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par value amounts)

	July 31, 2014	October 31, 2013*
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$903,046	\$1,022,441
Accounts receivable, net	238,863	256,026
Deferred income taxes	99,217	92,058
Income taxes receivable and prepaid taxes	18,544	18,277
Prepaid and other current assets	55,113	59,175
Total current assets	1,314,783	1,447,977
Property and equipment, net	216,010	197,600
Goodwill	2,260,897	1,975,971
Intangible assets, net	367,416	335,425
Long-term prepaid taxes	9,952	7,935
Long-term deferred income taxes	204,502	243,066
Other long-term assets	171,369	150,961
Total assets	\$4,544,929	\$4,358,935
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$319,036	\$358,197
Accrued income taxes	20,716	7,168
Deferred revenue	857,532	827,554
Short-term debt	30,000	30,000
Total current liabilities	1,227,284	1,222,919
Long-term accrued income taxes	37,030	53,064
Long-term deferred revenue	67,311	54,736
Long-term debt	52,500	75,000
Other long-term liabilities	164,751	164,939
Total liabilities	1,548,876	1,570,658
Stockholders' equity:		
Preferred Stock, \$0.01 par value: 2,000 shares authorized; none outstanding	—	—
Common Stock, \$0.01 par value: 400,000 shares authorized; 155,638 and 154,169 shares outstanding, respectively	1,556	1,542
Capital in excess of par value	1,594,965	1,597,244
Retained earnings	1,501,238	1,324,854
Treasury stock, at cost: 1,626 and 3,095 shares, respectively	(60,194)	(106,668)
Accumulated other comprehensive income (loss)	(41,512)	(28,695)
Total stockholders' equity	2,996,053	2,788,277
Total liabilities and stockholders' equity	\$4,544,929	\$4,358,935

\* Derived from audited financial statements.

See accompanying notes to unaudited condensed consolidated financial statements.



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SYNOPSIS, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	July 31,		July 31,	
	2014	2013	2014	2013
Revenue:				
Time-based license	\$431,184	\$387,088	\$1,255,515	\$1,186,538
Upfront license	31,594	39,957	101,863	95,525
Maintenance and service	59,034	55,900	161,082	175,276
Total revenue	521,812	482,945	1,518,460	1,457,339
Cost of revenue:				
License	68,573	69,857	198,700	195,918
Maintenance and service	20,685	19,253	62,065	59,074
Amortization of intangible assets	26,272	26,537	74,699	79,451
Total cost of revenue	115,530	115,647	335,464	334,443
Gross margin	406,282	367,298	1,182,996	1,122,896
Operating expenses:				
Research and development	182,809	166,668	528,395	494,140
Sales and marketing	112,271	105,381	332,847	311,069
General and administrative	37,438	34,510	112,246	104,702
Amortization of intangible assets	6,537	5,744	18,291	17,506
Total operating expenses	339,055	312,303	991,779	927,417
Operating income	67,227	54,995	191,217	195,479
Other income (expense), net	3,544	3,177	18,797	21,130
Income before provision for income taxes	70,771	58,172	210,014	216,609
Provision (benefit) for income taxes	5,115	5,875	13,345	25,699
Net income	\$65,656	\$52,297	\$196,669	\$190,910
Net income per share:				
Basic	\$0.42	\$0.34	\$1.27	\$1.25
Diluted	\$0.42	\$0.33	\$1.25	\$1.22
Shares used in computing per share amounts:				
Basic	155,194	153,915	154,611	152,969
Diluted	157,622	157,056	157,253	156,215

See accompanying notes to unaudited condensed consolidated financial statements.

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SYNOPSIS, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)

	Three Months Ended July 31, 2014		2013		Nine Months Ended July 31, 2014		2013	
	(in thousands)							
Net income	\$65,656	\$52,297	\$196,669	\$190,910				
Other comprehensive income (loss):								
Change in foreign currency translation adjustment	1,713	(6,234	) (9,502	) (20,746	)	)	)	)
Cash flow hedges:								
Deferred gains (losses), net of tax of \$311 and \$502, for the three and nine months ended July 31, 2014, respectively, and of \$804 and \$3,336 for each of the same periods in fiscal 2013, respectively	(831	) (2,189	) 1,658	1,507				
Reclassification adjustment on deferred (gains) losses included in net income, net of tax of \$(205) and \$(1,784), for the three and nine months ended July 31, 2014, respectively, and of \$601 and \$401 for each of the same periods in fiscal 2013, respectively	(2,540	) (3,741	) (4,973	) (5,471	)	)	)	)
Other comprehensive income (loss), net of tax effects	(1,658	) (12,164	) (12,817	) (24,710	)	)	)	)
Comprehensive income	\$63,998	\$40,133	\$183,852	\$166,200				

See accompanying notes to unaudited condensed consolidated financial statements.

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SYNOPSYS, INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended	
	July 31,	
	2014	2013
Cash flow from operating activities:		
Net income	\$ 196,669	\$ 190,910
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization and depreciation	140,750	141,756
Stock compensation	58,341	49,719
Allowance for doubtful accounts	(750	) 901
Deferred income taxes	7,459	7,272
Loss (gain) on sale of investments	(6,538	) (101
Net changes in operating assets and liabilities, net of acquired assets and liabilities:		
Accounts receivable	24,834	8,207
Prepaid and other current assets	982	(14,617
Other long-term assets	(18,847	) (20,292
Accounts payable and other liabilities	(28,270	) (48,188
Income taxes	(18,950	) (475
Deferred revenue	22,361	(9,722
Net cash provided by operating activities	378,041	305,370
Cash flows from investing activities:		
Proceeds from sales of long-term investments	7,313	222
Proceeds from sale of property and equipment	—	2,000
Purchases of property and equipment	(58,085	) (47,624
Cash paid for acquisitions and intangible assets, net of cash acquired	(373,513	) —
Capitalization of software development costs	(2,812	) (2,681
Other	(3,000	) —
Net cash used in investing activities	(430,097	) (48,083
Cash flows from financing activities:		
Proceeds from credit facility	200,000	—
Repayment of debt	(223,239	) (22,975
Acquisition of non-controlling interests	—	(44,004
Issuances of common stock	45,336	90,529
Purchases of treasury stock	(79,747	) (69,999
Other	(5,008	) (5,781
Net cash used in financing activities	(62,658	) (52,230
Effect of exchange rate changes on cash and cash equivalents	(4,681	) (13,069
Net change in cash and cash equivalents	(119,395	) 191,988
Cash and cash equivalents, beginning of year	1,022,441	700,382
Cash and cash equivalents, end of period	\$ 903,046	\$ 892,370
See accompanying notes to unaudited condensed consolidated financial statements.		



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SYNOPSYS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Description of Business

Synopsys, Inc. (Synopsys or the Company) is a world leader in supplying the electronic design automation (EDA) software that engineers use to design, create prototypes for and test integrated circuits, also known as chips. The Company also offers intellectual property (IP) products, which are pre-designed circuits that engineers use as components of larger chip designs rather than designing those circuits themselves. The Company provides software and hardware used to develop the systems that incorporate chips and the software that runs on them. To complement these product offerings, the Company provides technical services to support these solutions and helps its customers develop chips and electronic systems. The Company is also a leading provider of software tools that developers use to improve the quality and time-to-market of software code in a wide variety of industries, including electronics, financial services, energy, and industrials.

Note 2. Summary of Significant Accounting Policies

The Company has prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP). In management's opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its unaudited condensed consolidated balance sheets, results of operations, comprehensive income and cash flows. The Company's interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in Synopsys' Annual Report on Form 10-K for the fiscal year ended October 31, 2013 as filed with the SEC on December 20, 2013.

**Use of Estimates.** To prepare financial statements in conformity with GAAP, management must make estimates and assumptions that affect the amounts reported in the unaudited condensed consolidated financial statements and accompanying notes. Actual results could differ from these estimates and may result in material effects on the Company's operating results and financial position.

**Principles of Consolidation.** The unaudited condensed consolidated financial statements include the accounts of the Company and all of its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

**Fiscal Year End.** The Company's fiscal year generally ends on the Saturday nearest to October 31 and consists of 52 weeks, with the exception that approximately every five years, the Company has a 53-week year. When a 53-week year occurs, the Company includes the additional week in the first quarter to realign fiscal quarters with calendar quarters. Fiscal 2014 and 2013 are both 52-week years. The third fiscal quarters, and first nine months, of fiscal 2014 and 2013 ended on August 2, 2014 and August 3, 2013, respectively. For presentation purposes, the unaudited condensed consolidated financial statements and accompanying notes refer to the closest calendar month end.

**Subsequent Events.** The Company has evaluated subsequent events through the date that these unaudited condensed consolidated financial statements were issued.

Note 3. Business Combinations

During fiscal 2014, the Company made several acquisitions that were accounted for as business combinations. The Company does not consider these acquisitions to be material, individually or in the aggregate, to the Company's balance sheet and results of operations. The consolidated financial statements include the operating results of each acquired business from the respective date of acquisition.

**Acquisition of Coverity, Inc. (Coverity)**

On March 24, 2014, the Company acquired Coverity, the leading provider of software quality, testing and security tools, for \$375.5 million in cash, payable to holders of Coverity capital stock and vested stock options. Additionally, the Company assumed outstanding unvested Coverity stock options. The Company believes this



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acquisition has enabled it to enter into a new, growing market dedicated to helping companies deliver better software faster, by finding software code defects as the code is being developed rather than at the end of the process. Coverity's customer base includes Synopsys' semiconductor and systems customers, albeit different users and budgets, and extends well beyond to software developers such as independent software vendors and companies engaged in e-commerce.

The total purchase consideration and the preliminary purchase price allocation were as follows:

	(in thousands)
Total cash consideration	\$375,500
Goodwill	\$266,423
Identifiable intangibles assets acquired	101,900
Other tangible assets acquired, net	28,447
Deferred revenue	(21,270 )
Total purchase price allocation	\$375,500

As of the end of the third quarter of fiscal 2014, the Company's purchase price allocation is preliminary and has not been finalized. The acquired gross deferred revenue amount of \$68.5 million was recorded at fair value of \$21.3 million as required by accounting rules. Goodwill of \$266.4 million, which is not deductible for tax purposes, primarily resulted from the Company's assembled workforce and expectation of sales growth due to its entrance into a new market and its new technology offerings. Acquired identifiable intangible assets of \$101.9 million, consisting of technology, customer relationships, in-process R&D, backlog and trademarks, were valued using the income method, and are being amortized over two to eight years. The fair value of stock options assumed was approximately \$15.0 million using the Black-Scholes option-pricing model and are expensed over their remaining service periods on a straight-line basis.

#### Other Fiscal 2014 Acquisitions

During the nine months ended July 31, 2014, the Company acquired three other companies for cash and preliminarily allocated the total purchase consideration of \$40.3 million to the assets acquired and liabilities assumed based on their respective fair values at the acquisition dates, resulting in total goodwill of \$24.1 million, which is not deductible for tax purposes. Acquired identifiable intangible assets totaling \$22.3 million were valued using the income or cost methods and are being amortized over their respective useful lives ranging from two to eight years.

The preliminary fair value estimates for the assets acquired and liabilities assumed for these acquisitions are not yet finalized and may change as additional information becomes available during the respective measurement periods.

The primary areas of those preliminary estimates relate to certain tangible assets and liabilities, identifiable intangible assets, and taxes. Additional information, which existed as of the acquisition date but is yet unknown to the Company, may become known to the Company during the remainder of the measurement period, a period not to exceed 12 months from the acquisition date. Changes to amounts recorded as assets or liabilities will be recorded as retrospective adjustments to the provisional amounts recognized as of the acquisition date and may result in a corresponding adjustment to goodwill.

#### Note 4. Goodwill and Intangible Assets

Goodwill as of July 31, 2014 consisted of the following:

	(in thousands)
As of October 31, 2013	\$1,975,971
Additions	290,476
Effect of foreign currency translation	(5,550 )
As of July 31, 2014	\$2,260,897

Intangible assets as of July 31, 2014 consisted of the following:



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	Gross Assets (in thousands)	Accumulated Amortization	Net Assets
Core/developed technology	\$459,147	\$279,995	\$179,152
Customer relationships	210,292	86,370	123,922
Contract rights intangible	146,842	101,481	45,361
Covenants not to compete	2,530	2,530	—
Trademarks and trade names	18,779	7,056	11,723
In-process research and development (IPR&D)(1)	3,087	—	3,087
Capitalized software development costs	21,003	16,832	4,171
Total	\$861,680	\$494,264	\$367,416

(1) IPR&D is reclassified to core/developed technology upon completion or is written off upon abandonment. Intangible assets as of October 31, 2013 consisted of the following:

	Gross Assets (in thousands)	Accumulated Amortization	Net Assets
Core/developed technology	\$380,724	\$228,065	\$152,659
Customer relationships	177,151	69,745	107,406
Contract rights intangible	140,517	78,950	61,567
Covenants not to compete	2,530	2,480	50
Trademarks and trade names	10,891	5,459	5,432
In-process research and development (IPR&D)(1)	4,298	—	4,298
Capitalized software development costs	18,190	14,177	4,013
Total	\$734,301	\$398,876	\$335,425

(1) IPR&D is reclassified to core/developed technology upon completion or is written off upon abandonment. Amortization expense related to intangible assets consisted of the following:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2014	2013	2014	2013
	(in thousands)			
Core/developed technology	\$18,354	\$17,456	\$51,966	\$51,812
Customer relationships	5,816	5,352	16,655	16,088
Contract rights intangible	7,913	9,076	22,719	27,624
Covenants not to compete	17	33	50	99
Trademarks and trade names	709	363	1,600	1,333
Capitalized software development costs(1)	906	812	2,655	2,398
Total	\$33,715	\$33,092	\$95,645	\$99,354

(1) Amortization of capitalized software development costs is included in cost of license revenue in the unaudited condensed consolidated statements of operations.

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The following table presents the estimated future amortization of intangible assets:

Fiscal Year	(in thousands)
Remainder of fiscal 2014	\$32,855
2015	120,485
2016	83,359
2017	47,607
2018	33,687
2019 and thereafter	46,336
IPR&D(1)	3,087
Total	\$367,416

(1) IPR&D projects are estimated to be completed within one year as of July 31, 2014. Assets are amortized over their useful life upon completion of the project or are written off upon abandonment.

#### Note 5. Financial Assets and Liabilities

**Non-marketable equity securities.** The Company's strategic investment portfolio consists of non-marketable equity securities in privately-held companies. The securities accounted for under cost method investments are reported at cost net of impairment losses. Securities accounted for under equity method investments are recorded at cost plus the proportional share of the issuers' income or loss, which is recorded in the Company's other income (expense), net. The cost basis of securities sold is based on the specific identification method. Refer to Note 6. Fair Value Measures.

**Derivatives.** In accordance with ASC 815, Derivatives and Hedging, the Company recognizes derivative instruments as either assets or liabilities in the unaudited condensed consolidated financial statements at fair value and provides qualitative and quantitative disclosures about such derivatives. The Company operates internationally and is exposed to potentially adverse movements in foreign currency exchange rates. The Company enters into hedges in the form of foreign currency forward contracts to reduce its exposure to foreign currency rate changes on non-functional currency denominated forecasted transactions and balance sheet positions including: (1) certain assets and liabilities, (2) shipments forecasted to occur within approximately one month, (3) future billings and revenue on previously shipped orders, and (4) certain future intercompany invoices denominated in foreign currencies.

The duration of forward contracts ranges from approximately one month to 21 months, the majority of which are short-term. The Company does not use foreign currency forward contracts for speculative or trading purposes. The Company enters into foreign exchange forward contracts with high credit quality financial institutions that are rated 'A' or above and to date has not experienced nonperformance by counterparties. Further, the Company anticipates continued performance by all counterparties to such agreements.

The assets or liabilities associated with the forward contracts are recorded at fair value in other current assets or accrued liabilities in the unaudited condensed consolidated balance sheets. The accounting for gains and losses resulting from changes in fair value depends on the use of the foreign currency forward contract and whether it is designated and qualifies for hedge accounting.

#### Cash Flow Hedging Activities

Certain foreign exchange forward contracts are designated and qualify as cash flow hedges. These contracts have durations of approximately 21 months or less. Certain forward contracts are rolled over periodically to capture the full length of exposure to the Company's foreign currency risk, which can be up to three years. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on the hedged transactions. The effective portion of gains or losses resulting from changes in fair value of these hedges is initially reported, net of tax, as a component of other comprehensive income (OCI), in stockholders' equity and reclassified into revenue or operating expenses, as appropriate, at the time the hedged transactions affect earnings. We expect a majority of the hedge balance in OCI to be reclassified to the statements of operations within the next twelve months.



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Hedging effectiveness is evaluated monthly using spot rates, with any gain or loss caused by hedging ineffectiveness recorded in other income (expense), net. The premium/discount component of the forward contracts is recorded to other income (expense), net, and is not included in evaluating hedging effectiveness.

Non-designated Hedging Activities

The Company's foreign exchange forward contracts that are used to hedge non-functional currency denominated balance sheet assets and liabilities are not designated as hedging instruments. Accordingly, any gains or losses from changes in the fair value of the forward contracts are recorded in other income (expense), net. The gains and losses on these forward contracts generally offset the gains and losses associated with the underlying assets and liabilities, which are also recorded in other income (expense), net. The duration of the forward contracts for hedging the Company's balance sheet exposure is approximately one month.

The Company also has certain foreign exchange forward contracts for hedging certain international revenues and expenses that are not designated as hedging instruments. Accordingly, any gains or losses from changes in the fair value of the forward contracts are recorded in other income (expense), net. The gains and losses on these forward contracts generally offset the gains and losses associated with the foreign currency in operating income. The duration of these forward contracts is usually less than one year. The overall goal of the Company's hedging program is to minimize the impact of currency fluctuations on its net income over its fiscal year.

The effects of the changes in the fair values of non-designated forward contracts are summarized as follows:

	Three Months Ended		Nine Months Ended	
	July 31,		July 31,	
	2014	2013	2014	2013
	(in thousands)			
Gain (loss) recorded in other income (expense), net	\$(53	) \$(586	) \$(667	) \$3,344

The notional amounts in the table below for derivative instruments provide one measure of the transaction volume outstanding:

	As of July 31, 2014		As of October 31, 2013	
	(in thousands)			
Total gross notional amount	\$701,725		\$746,801	
Net fair value	\$3,009		\$7,199	

The notional amounts for derivative instruments do not represent the amount of the Company's exposure to market gain or loss. The Company's exposure to market gain or loss will vary over time as a function of currency exchange rates. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

The following represents the unaudited condensed consolidated balance sheet location and amount of derivative instrument fair values segregated between designated and non-designated hedge instruments:

	Fair Values of derivative instruments designated as hedging instruments (in thousands)	Fair Values of derivative instruments not designated as hedging instruments
As of July 31, 2014		
Other current assets	\$6,193	\$159
Accrued liabilities	\$3,247	\$96
As of October 31, 2013		
Other current assets	\$12,417	\$20
Accrued liabilities	\$5,103	\$135





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The following table represents the unaudited condensed consolidated statement of operations location and amount of gains and losses on derivative instrument fair values for designated hedge instruments, net of tax:

	Location of gain (loss) recognized in OCI on derivatives	Amount of gain (loss) recognized in OCI on derivatives (effective portion)	Location of gain (loss) reclassified from OCI	Amount of gain (loss) reclassified from OCI (effective portion)
(in thousands)				
Three months ended July 31, 2014				
Foreign exchange contracts	Revenue	\$ (40	) Revenue	\$ 1,563
Foreign exchange contracts	Operating expenses	(815	) Operating expenses	977
Total		\$ (855	)	\$ 2,540
Three months ended July 31, 2013				
Foreign exchange contracts	Revenue	\$ (158	) Revenue	\$ 3,771
Foreign exchange contracts	Operating expenses	(2,106	) Operating expenses	(30
Total		\$ (2,264	)	\$ 3,741
Nine months ended July 31, 2014				
Foreign exchange contracts	Revenue	\$ 3,324	Revenue	\$ 3,237
Foreign exchange contracts	Operating expenses	(1,707	) Operating expenses	1,736
Total		\$ 1,617		\$ 4,973
Nine months ended July 31, 2013				
Foreign exchange contracts	Revenue	\$ 2,701	Revenue	\$ 6,325
Foreign exchange contracts	Operating expenses	(1,165	) Operating expenses	(854
Total		\$ 1,536		\$ 5,471

The following table represents the ineffective portions and portions excluded from effectiveness testing of the hedge gains (losses) for derivative instruments designated as hedging instruments, which are recorded in other income (expense), net:

	Amount of gain (loss) recognized in income statement on derivatives (ineffective portion)(1)	Amount of gain (loss) recognized in income statement on derivatives (excluded from effectiveness testing)(2)
Foreign exchange contracts		
	(in thousands)	
For the three months ended July 31, 2014	\$24	\$ 548
For the three months ended July 31, 2013	\$90	\$ 260
For the nine months ended July 31, 2014	\$57	\$ 2,950
For the nine months ended July 31, 2013	\$256	\$ 1,522

(1) The ineffective portion includes forecast inaccuracies.

(2) The portion excluded from effectiveness testing includes the discount earned or premium paid for the contracts.

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Note 6. Fair Value Measures

ASC 820-10, Fair Value Measurements and Disclosures, defines fair value, establishes guidelines and enhances disclosure requirements for fair value measurements. The accounting guidance requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The accounting guidance also establishes a fair value hierarchy based on the independence of the source and objective evidence of the inputs used. There are three fair value hierarchies based upon the level of inputs that are significant to fair value measurement:

Level 1—Observable inputs that reflect quoted prices (unadjusted) for identical instruments in active markets;

Level 2—Observable inputs other than quoted prices included in Level 1 for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-driven valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3—Unobservable inputs to the valuation derived from fair valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

On a recurring basis, the Company measures the fair value of certain of its assets and liabilities, which include cash equivalents, non-qualified deferred compensation plan assets, foreign currency derivative contracts and contingent consideration associated with business combinations.

The Company's cash equivalents are classified within Level 1 or Level 2 because they are valued using quoted market prices in an active market or alternative independent pricing sources and models utilizing market observable inputs.

The Company's non-qualified deferred compensation plan assets consist of money market and mutual funds invested in domestic and international marketable securities that are directly observable in active markets and are therefore classified within Level 1.

The Company's foreign currency derivative contracts are classified within Level 2 because these contracts are not actively traded and the valuation inputs are based on quoted prices and market observable data of similar instruments.

The Company's borrowings under its credit and term loan facilities are classified within Level 2 because these borrowings are not actively traded and have a variable interest rate structure based upon market rates currently available to the Company for debt with similar terms and maturities. Refer to Note 8. Credit Facility.

The Company's liabilities for contingent consideration are classified within Level 3 because these valuations are based on management assumptions including discount rates and estimated probabilities of achievement of certain milestones which are unobservable in the market. As of July 31, 2014, the Company did not have any outstanding contingent consideration liability and as of October 31, 2013, the fair value of contingent consideration liability was estimated at \$0.5 million.

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## Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below as of July 31, 2014:

Description	Total	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
(in thousands)				
Assets				
Cash equivalents:				
Money market funds	\$439,248	\$439,248	\$—	\$—
Prepaid and other current assets:				
Foreign currency derivative contracts	6,352	—	6,352	—
Other long-term assets:				
Deferred compensation plan assets	141,933	141,933	—	—
Total assets	\$587,533	\$581,181	\$6,352	\$—
Liabilities				
Accounts payable and accrued liabilities:				
Foreign currency derivative contracts	\$3,343	\$—	\$3,343	\$—
Total liabilities	\$3,343	\$—	\$3,343	\$—

Assets and liabilities measured at fair value on a recurring basis are summarized below as of October 31, 2013:

Description	Total	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
(in thousands)				
Assets				
Cash equivalents:				
Money market funds	\$552,470	\$552,470	\$—	\$—
Prepaid and other current assets:				
Foreign currency derivative contracts	12,437	—	12,437	—
Other long-term assets:				
Deferred compensation plan assets	126,621	126,621	—	—
Total assets	\$691,528	\$679,091	\$12,437	\$—
Liabilities				
Accounts payable and accrued liabilities:				
Foreign currency derivative contracts	\$5,238	\$—	\$5,238	\$—
Contingent consideration	493	—	—	493
Total liabilities	\$5,731	\$—	\$5,238	\$493

## Assets/Liabilities Measured at Fair Value on a Non-Recurring Basis

## Non-Marketable Equity Securities

Equity investments in privately-held companies, also called non-marketable equity securities are accounted for using either the cost or equity method of accounting.

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These equity investments are classified within Level 3 as they are valued using significant unobservable inputs or data in an inactive market, and the valuation requires management judgment due to the absence of market price and inherent lack of liquidity. The non-marketable equity securities are measured and recorded at fair value when an event or circumstance which impacts the fair value of these securities indicates an other-than-temporary decline in value has occurred. The Company monitors these investments and generally uses the income approach to assess impairments based primarily on the financial conditions of these companies.

The Company did not recognize any impairment during the three and nine months ended July 31, 2014 and 2013, respectively.

As of July 31, 2014, the fair value of the Company's non-marketable securities was \$11.1 million, of which \$6.7 million and \$4.4 million were accounted for under the cost method and equity method, respectively. As of October 31, 2013, the fair value of non-marketable securities was \$11.5 million, of which \$6.9 million and \$4.6 million were accounted for under the cost method and equity method, respectively. During the nine months ended July 31, 2014, the Company received a cash distribution of \$6.6 million from the liquidation of one of its investments with a cost basis of \$0.2 million resulting in a \$6.4 million gain, which was recorded to other income (expense), net.

## Note 7. Liabilities

Accounts payable and accrued liabilities consist of:

	July 31, 2014	October 31, 2013
	(in thousands)	
Payroll and related benefits	\$258,835	\$302,374
Other accrued liabilities	45,577	47,248
Accounts payable	14,624	8,575
Total	\$319,036	\$358,197

Other long-term liabilities consist of:

	July 31, 2014	October 31, 2013
	(in thousands)	
Deferred compensation liability	\$141,933	\$126,621
Other long-term liabilities	22,818	38,318
Total	\$164,751	\$164,939

## Note 8. Credit Facility

On February 17, 2012, the Company entered into an agreement with several lenders (the Credit Agreement) providing for (i) a \$350.0 million senior unsecured revolving credit facility (the Revolver) and (ii) a \$150.0 million senior unsecured term loan facility (the Term Loan). Principal payments on a portion of the Term Loan are due in equal quarterly installments of \$7.5 million, with the remainder due when the Credit Agreement expires in October 2016. The Company can elect to make prepayments on the Term Loan, in whole or in part, without premium or penalty. Subject to obtaining additional commitments from lenders, the principal amount of the loans provided under the Credit Agreement may be increased by the Company by up to an additional \$150.0 million through October 13, 2015. The Credit Agreement contains financial covenants requiring the Company to operate within a maximum leverage ratio and maintain specified levels of cash, as well as other non-financial covenants.

During the second quarter of fiscal 2014, the Company drew down \$200.0 million under the Revolver to finance a portion of the purchase price for the acquisition of Coverity on March 24, 2014. During the three month period ended July 31, 2014, the Company made principal payments of \$200.0 million and \$7.5 million under the Revolver and Term Loan, respectively. As of July 31, 2014, the Company had an \$82.5 million outstanding balance under the Term Loan, of which \$52.5 million is classified as long-term, and no outstanding balance under the Revolver. As of October 31, 2013, the Company had a \$105.0 million outstanding balance under the Term Loan, of which \$75.0 million was classified as long-term, and no outstanding balance under the Revolver. Borrowings bear interest at a floating rate based on a margin over the Company's choice of market observable base rates as defined in the Credit Agreement. At July 31, 2014, borrowings under the Term Loan bore interest at LIBOR +1.125% and the applicable

interest rate for the Revolver was LIBOR +0.975%. In addition, commitment fees are payable on the

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Revolver at rates between 0.150% and 0.300% per year based on the Company's leverage ratio on the daily amount of the revolving commitment.

These borrowings under the Credit Agreement have a variable interest rate structure and are classified within Level 2 of the fair value hierarchy. The carrying amount of the short-term and long-term debt approximates the estimated fair value.

As a result of the Coverity acquisition, the Company assumed Coverity's credit facility with a U.S. bank that had an original expiration date of December 31, 2014. The facility provided a maximum borrowing limit of \$7.0 million. During the third quarter of fiscal 2014, the Company chose to terminate the Coverity credit facility prior to the original expiration date.

#### Note 9. Accumulated Other Comprehensive Income (Loss)

Components of accumulated other comprehensive income (loss), on an after-tax basis where applicable, were as follows:

	July 31, 2014	October 31, 2013	
	(in thousands)		
Cumulative currency translation adjustments	\$(36,350	)	\$(26,848 )
Unrealized gain (loss) on derivative instruments, net of taxes	(5,162	)	(1,847 )
Total accumulated other comprehensive income (loss)	\$(41,512	)	\$(28,695 )

The effect of amounts reclassified out of each component of accumulated other comprehensive income (loss) into net income was as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,		
	2014	2013	2014	2013	
	(in thousands)				
Reclassifications from accumulated other comprehensive income (loss) into unaudited condensed consolidated statement of operations:					
Gain (loss) on cash flow hedges, net of taxes					
Revenues	\$1,563	\$3,771	\$3,237	\$6,325	
Operating expenses	977	(30	) 1,736	(854	)
Total reclassifications into net income	\$2,540	\$3,741	\$4,973	\$5,471	

#### Note 10. Stock Repurchase Program

The Company's Board of Directors (Board) previously approved a stock repurchase program pursuant to which the Company was authorized to purchase up to \$500.0 million of its common stock, and has periodically replenished the stock repurchase program to such amount. The Board replenished the stock repurchase program up to \$500.0 million on December 3, 2013, as announced on December 4, 2013. The program does not obligate Synopsys to acquire any particular amount of common stock, and the program may be suspended or terminated at any time by Synopsys' Chief Financial Officer or the Board. The Company repurchases shares to offset dilution caused by ongoing stock issuances from existing equity plans for equity compensation awards and issuances related to acquisitions, and when management believes it is a good use of cash. Repurchases are transacted in accordance with Rule 10b-18 of the Securities Exchange Act of 1934 (Exchange Act) and may be made through any means including, but not limited to, open market purchases, plans executed under Rule 10b5-1(c) of the Exchange Act and structured transactions. As of July 31, 2014, \$420.3 million remained available for further repurchases under the program.

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Stock repurchase activities are as follow:

	Three Months Ended		Nine Months Ended	
	July 31, 2014	2013	July 31, 2014	2013
	(in thousands, except per share price)			
Shares repurchased	—	970	2,050	1,973
Average purchase price per share	\$—	\$36.10	\$38.90	\$35.49
Aggregate purchase price	\$—	\$35,000	\$79,747	\$69,999
Reissuance of treasury stock	931	1,712	3,519	5,422

Note 11. Stock Compensation

The compensation cost recognized in the unaudited condensed consolidated statements of operations for the Company's stock compensation arrangements was as follows:

	Three Months Ended		Nine Months Ended	
	July 31, 2014	2013	July 31, 2014	2013
	(in thousands)			
Cost of license	\$2,176	\$1,566	\$5,952	\$4,872
Cost of maintenance and service	684	366	1,646	1,210
Research and development expense	10,126	8,114	28,037	23,655
Sales and marketing expense	4,696	3,454	12,394	10,339
General and administrative expense	3,717	2,990	10,312	9,643
Stock compensation expense before taxes	21,399	16,490	58,341	49,719
Income tax benefit	(4,905)	(4,035)	(13,372)	(12,166)
Stock compensation expense after taxes	\$16,494	\$12,455	\$44,969	\$37,553

As of July 31, 2014, there was \$155.6 million of unamortized share-based compensation expense, which is expected to be amortized over a weighted-average period of approximately 2.7 years.

The intrinsic values of equity awards exercised during the periods are as follows:

	Three Months Ended		Nine Months Ended	
	July 31, 2014	2013	July 31, 2014	2013
	(in thousands)			
Intrinsic value of awards exercised	\$3,709	\$12,899	\$23,556	\$34,764

Note 12. Net Income per Share

The Company computes basic net income per share by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net income per share reflects the dilution from potential common shares outstanding, such as stock options and unvested restricted stock units and awards, during the period using the treasury stock method.



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The table below reconciles the weighted-average common shares used to calculate basic net income per share with the weighted-average common shares used to calculate diluted net income per share:

	Three Months Ended		Nine Months Ended	
	July 31, 2014	2013	July 31, 2014	2013
	(in thousands)			
Numerator:				
Net income	\$65,656	\$52,297	\$196,669	\$190,910
Denominator:				
Weighted-average common shares for basic net income per share	155,194	153,915	154,611	152,969
Dilutive effect of potential common shares from equity-based compensation	2,428	3,141	2,642	3,246
Weighted-average common shares for diluted net income per share	157,622	157,056	157,253	156,215
Net income per share:				
Basic	\$0.42	\$0.34	\$1.27	\$1.25
Diluted	\$0.42	\$0.33	\$1.25	\$1.22
Anti-dilutive employee stock-based awards excluded(1)	2,875	1,648	2,057	2,179

These stock options and unvested restricted stock units and restricted stock awards were anti-dilutive for the (1) respective periods and are excluded in calculating diluted net income per share. While such awards were antidilutive for the respective periods, they could be dilutive in the future.

## Note 13. Segment Disclosure

ASC 280, Segment Reporting, requires disclosures of certain information regarding operating segments, products and services, geographic areas of operation and major customers. Segment reporting is based upon the “management approach,” i.e., how management organizes the Company’s operating segments for which separate financial information is (1) available and (2) evaluated regularly by the Chief Operating Decision Makers (CODMs) in deciding how to allocate resources and in assessing performance. Synopsys’ CODMs are the Company’s two Co-Chief Executive Officers.

The Company operates in a single segment to provide software products and consulting services in the EDA software industry. In making operating decisions, the CODMs primarily consider consolidated financial information, accompanied by disaggregated information about revenues by geographic region. Specifically, the CODMs consider where individual “seats” or licenses to the Company’s products are located in allocating revenue to particular geographic areas. Revenue is defined as revenues from external customers. Goodwill is not allocated since the Company operates in one reportable operating segment. Revenues related to operations in the United States and other geographic areas were:

	Three Months Ended		Nine Months Ended	
	July 31, 2014	2013	July 31, 2014	2013
	(in thousands)			
Revenue:				
United States	\$268,228	\$234,770	\$745,458	\$706,083
Europe	65,881	68,591	203,645	197,712
Japan	61,517	64,874	184,219	200,510
Asia-Pacific and Other	126,186	114,710	385,138	353,034
Consolidated	\$521,812	\$482,945	\$1,518,460	\$1,457,339

Geographic revenue data for multi-region, multi-product transactions reflect internal allocations and are therefore subject to certain assumptions and the Company's methodology.

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One customer accounted for 10.5% and 11.5% of the Company's unaudited condensed consolidated revenue in the three months ended July 31, 2014 and 2013, respectively, and accounted for 10.7% and 11.4% of the Company's unaudited condensed consolidated revenue in the nine months ended July 31, 2014 and 2013, respectively.

## Note 14. Other Income (Expense), net

The following table presents the components of other income (expense), net:

	Three Months Ended		Nine Months Ended	
	July 31,		July 31,	
	2014	2013	2014	2013
	(in thousands)			
Interest income	\$294	\$301	\$975	\$1,563
Interest expense	(715	) (404	) (1,654	) (1,325
Gain (loss) on assets related to executive deferred compensation plan	3,069	2,841	7,529	12,511
Foreign currency exchange gain (loss)	80	217	865	6,127
Other, net(1)	816	222	11,082	2,254
Total	\$3,544	\$3,177	\$18,797	\$21,130

(1) Refer to Note 6. Fair Value Measures.

## Note 15. Taxes

## Effective Tax Rate

The Company estimates its annual effective tax rate at the end of each fiscal quarter. The Company's estimate takes into account estimations of annual pre-tax income, the geographic mix of pre-tax income and the Company's interpretations of tax laws and possible outcomes of audits.

The following table presents the provision for income taxes and the effective tax rates:

	Three Months Ended		Nine Months Ended	
	July 31,		July 31,	
	2014	2013	2014	2013
	(in thousands)			
Income before income taxes	\$70,771	\$58,172	\$210,014	\$216,609
Provision (benefit) for income tax	\$5,115	\$5,875	\$13,345	\$25,699
Effective tax rate	7.2	% 10.1	% 6.4	% 11.9

The Company's effective tax rate for the three and nine months ended July 31, 2014 is lower than the statutory federal income tax rate of 35% primarily due to the lower tax rates applicable to its non-U.S. operations, U.S. federal and California research tax credits, settlements with U.S. and Taiwan tax authorities, and statutes of limitations lapses, partially offset by state taxes and non-deductible stock compensation.

The effective tax rate decreased in the three months ended July 31, 2014, as compared to the same period in fiscal 2013, primarily due to statutes of limitations lapses that resulted in the recognition of an unrecognized tax benefit. The effective tax rate decreased in the nine months ended July 31, 2014, as compared to the same period in fiscal 2013, primarily due to the benefit of audit settlements with the Internal Revenue Service (IRS) and Taiwan in the first and second quarter of fiscal 2014, respectively, statutes of limitations lapses in the third quarter of fiscal 2014, and changes in geographical earnings mix, partially offset by the reinstatement of the research tax credit and the reversal of deferred taxes resulting from the merger of a foreign affiliate in the first quarter of fiscal 2013.

The Company's total gross unrecognized tax benefits at July 31, 2014 are \$102.9 million exclusive of interest and penalties. If the total gross unrecognized tax benefits at July 31, 2014 were recognized in the future, approximately \$99.3 million would decrease the effective tax rate.

The timing of the resolution of income tax examinations is highly uncertain as well as the amounts and timing of various tax payments that are part of the settlement process. This could cause large fluctuations in the balance



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sheet classification of current and non-current assets and liabilities. The Company believes that in the coming 12 months, it is reasonably possible that either certain audits will conclude or the statute of limitations on certain state and foreign income and withholding taxes will expire, or both. Given the uncertainty as to ultimate settlement terms, the timing of payment and the impact of such settlements on other uncertain tax positions, the range of the estimated potential decrease in underlying unrecognized tax benefits is between \$0 and \$23 million.

IRS Examinations

On November 6, 2013, the Company reached final settlement with the IRS on the remaining fiscal 2012 issues and recognized approximately \$10 million in unrecognized tax benefits in the first quarter of fiscal 2014.

Non-U.S. Examinations

On February 11, 2014 and April 1, 2014 the Company reached settlements with the Taiwan tax authorities for fiscal 2010 and 2009, respectively, with regard to certain transfer pricing issues. As a result of the settlements and the application of the settlement to other open fiscal years, the Company's unrecognized tax benefits decreased by \$5.1 million. The net tax benefit resulting from the settlements and the application to other open fiscal years was \$3.9 million.

Note 16. Effect of New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)," which supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)." This ASU requires an entity to recognize revenue when goods are transferred or services are provided to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. This ASU also requires disclosures enabling users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The new guidance will be effective for fiscal 2018, including interim periods within that reporting period, using one of two prescribed retrospective methods, and no early adoption is permitted. The Company is currently in the process of evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

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

This Quarterly Report on Form 10-Q, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), which are subject to the "safe harbor" created by those sections. Any statements herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as "may," "will," "could," "would," "should," "anticipate," "expect," "intend," "believe," "estimate," "project" or "continue," and such terms are intended to identify forward-looking statements. Without limiting the foregoing, forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements concerning expected growth in the semiconductor industry, our business outlook, the ability of our prior acquisitions (including our acquisition of Coverity, Inc.) to drive revenue growth, the sufficiency of our cash and cash equivalents and cash generated from operations, and our future liquidity requirements, and other statements that involve certain known and unknown risks, uncertainties and other factors that could cause our actual results, time frames or achievements to differ materially from those expressed or implied in our forward-looking statements. Such risks and uncertainties include, among others, those identified below in Part II, Item 1A. Risk Factors of this Form 10-Q. The information included herein represents our estimates and assumptions as of the date of this filing. Unless required by law, we undertake no obligation to update publicly any forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future. All subsequent written or oral forward-looking statements attributable to Synopsys or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Readers are urged to carefully review and consider the various disclosures made in this report and in other documents we file from time to time with the Securities and Exchange Commission (SEC) that attempt to advise interested parties of the risks and factors that may affect our business.

The following summary of our financial condition and results of operations should be read together with our unaudited condensed consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this report and with our audited consolidated financial statements and the related notes thereto contained in our Annual Report on Form 10-K for the fiscal year ended October 31, 2013, as filed with the SEC on December 20, 2013.

Overview

Business Summary

Synopsys is a global leader in providing software, intellectual property and services used to design integrated circuits and electronic systems. We supply the electronic design automation (EDA) software that engineers use to design, create prototypes for and test integrated circuits, also known as chips. We also offer intellectual property (IP) products, which are pre-designed circuits that engineers use as components of larger chip designs rather than designing those circuits themselves. We provide software and hardware used to develop the systems that incorporate chips and the software that runs on them. To complement these product offerings, we provide technical services to support our solutions and we help our customers develop chips and electronic systems. We are also a leading provider of software tools that developers use to improve the quality and time-to-market of software code in a wide variety of industries, including electronics, financial services, energy, and industrials.

Our EDA and IP customers are generally semiconductor and electronics systems companies. Our solutions help them overcome the challenge of developing increasingly advanced electronics products while reducing their design and manufacturing costs. While our products are an important part of our customers' development process, our customers' research and development budget and spending decisions may be affected by their business outlook and their willingness to invest in new and increasingly complex chip designs.

Despite global economic uncertainty, we have maintained profitability and positive cash flow on an annual basis in recent years. We achieved these results not only because of our solid execution, leading technology and strong customer relationships, but also because of our time-based revenue business model. Under this model, a substantial majority of our customers pay for their licenses over time and we typically recognize this revenue over the life of the contract, which averages approximately three years. Time-based revenue, which consists of time-based license, maintenance and service revenue, generally represents approximately 90% of our total revenue. The revenue we

recognize in a particular period generally results from selling efforts in prior periods rather than the current period. Due to our business model, decreases as well as increases in customer spending do not immediately affect our revenues in a significant way.

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As we continue to expand our product portfolio and our total addressable market, for instance in IP products, we may experience increased variability in our revenue, though we expect time-based revenue to continue to generally represent approximately 90% of our total revenue. Overall, our business outlook remains solid based on our leading technology, customer relationships, business model, diligent expense management, and acquisition strategy. We believe that these factors will help us continue to successfully execute our strategies.

### Acquisition of Coverity

On March 24, 2014, we acquired Coverity, Inc. (Coverity) the leading provider of software quality, testing and security tools. We believe this acquisition has enabled us to enter into a new, growing market dedicated to helping companies deliver better software faster, by finding software code defects as the code is being developed rather than at the end of the process. Coverity's customer base includes Synopsys' semiconductor and systems customers, albeit different users and budgets, and extends well beyond to software developers such as independent software vendors and companies engaged in e-commerce. We believe the Coverity acquisition has expanded our total addressable market. However, due to the fair value adjustment of acquired deferred revenue and amortization of intangible assets, the acquisition will have a negative effect on net income in the short term. We report revenue from our Coverity software quality, testing and security tools in our IP and Software Solutions group, which we previously referred to as IP and System-Level Solutions.

### Financial Performance Summary for the Three Months Ended July 31, 2014 (Compared to the Three Months Ended July 31, 2013)

Net income of \$65.7 million for the quarter was 26% higher compared to the same period in fiscal 2013 due to our overall growth and acquisitions, which increased our revenue by 8%, while our expenses increased by 6%.

• We repaid our senior unsecured revolving credit facility balance of \$200.0 million.

• Our cash flow from operations increased by 24% primarily due to higher cash collections.

• We continued to derive more than 90% of our revenue from time-based revenue.

### New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)," which supersedes nearly all existing revenue recognition guidance under U.S. generally accepted accounting principles (GAAP). The new guidance will be effective for fiscal 2018, including interim periods within that reporting period, using one of two prescribed retrospective methods. No early adoption is permitted. We are currently in the process of evaluating the impact of the adoption of ASU 2014-09 on our consolidated financial statements and related disclosures.

### Critical Accounting Policies and Estimates

Our discussion and analysis of our financial results under the heading "Results of Operations" below are based on our unaudited condensed consolidated financial statements, which we have prepared in accordance with GAAP. In preparing these financial statements, we make assumptions, judgments and estimates that can affect the reported amounts of assets, liabilities, revenues and expenses and net income. On an on-going basis, we evaluate our estimates based on historical experience and various other assumptions we believe are reasonable under the circumstances. Our actual results may differ from these estimates.

The accounting policies that most frequently require us to make assumptions, judgments and estimates, and therefore are critical to understanding our results of operations, are:

• Revenue recognition;

• Valuation of stock compensation;

• Valuation of intangible assets; and

• Income taxes.

Our critical accounting policies and estimates are discussed in Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of our Annual Report on Form 10-K for the fiscal year ended October 31, 2013, filed with the SEC on December 20, 2013.





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Results of Operations

Revenue Background

We generate our revenue from the sale of software licenses, maintenance and professional services and, to a small extent, hardware products. With respect to software licenses, we utilize three license types:

Technology Subscription Licenses (TSLs). TSLs are time-based licenses for a finite term, and generally provide the customer limited rights to receive, or to exchange certain quantities of licensed software for, unspecified future technology. We bundle and do not charge separately for post-contract customer support (maintenance) for the term of the license.

Term licenses. Term licenses are also for a finite term, but do not provide the customer any rights to receive, or to exchange licensed software for, unspecified future technology. Customers purchase maintenance separately for the first year and may renew annually for the balance of the term. The annual maintenance fee is typically calculated as a percentage of the net license fee.

Perpetual licenses. Perpetual licenses continue as long as the customer renews maintenance plus an additional 20 years. Perpetual licenses do not provide the customer any rights to receive, or to exchange licensed software for, unspecified future technology. Customers purchase maintenance separately for the first year and may renew annually. For the three software license types, we recognize revenue as follows:

TSLs. We typically recognize revenue from TSL fees (which include bundled maintenance) ratably over the term of the license period, or as customer installments become due and payable, whichever is later. Revenue attributable to TSLs is reported as “time-based license revenue” in the unaudited condensed consolidated statements of operations.

Term licenses. We recognize revenue from term licenses in full upon shipment of the software if payment terms require the customer to pay at least 75% of the license fee and 100% of the maintenance fee within one year from shipment and all other revenue recognition criteria are met. Revenue attributable to these term licenses is reported as “upfront license revenue” in the unaudited condensed consolidated statements of operations. For term licenses in which less than 75% of the license fee and 100% of the maintenance fee is payable within one year from shipment, we recognize revenue as customer payments become due and payable. Such revenue is reported as “time-based license revenue” in the unaudited condensed consolidated statements of operations.

Perpetual licenses. We recognize revenue from perpetual licenses in full upon shipment of the software if payment terms require the customer to pay at least 75% of the license fee and 100% of the maintenance fee within one year from shipment and all other revenue recognition criteria are met. Revenue attributable to these perpetual licenses is reported as “upfront license revenue” in the unaudited condensed consolidated statements of operations. For perpetual licenses in which less than 75% of the license fee and 100% of the maintenance fee is payable within one year from shipment, we recognize revenue as customer installments become due and payable. Such revenue is reported as “time-based license revenue” in the unaudited condensed consolidated statements of operations.

We recognize revenue from orders we receive for software licenses, services and hardware products at varying times. In most instances, we recognize revenue on a TSL software license order over the license term and on a term or perpetual software license order in the quarter in which the license is delivered. The weighted average license term of the TSLs and term licenses we entered into for the three months ended July 31, 2014 and 2013 was 3.1 and 2.9 years, respectively. Revenue on contracts requiring significant modification or development is accounted for using the percentage of completion method over the period of the development. Revenue on hardware product orders is generally recognized in full at the time the product is shipped. Contingent revenue is recognized if and when the applicable event occurs.

Revenue on maintenance orders is recognized ratably over the maintenance period (normally one year). Revenue on professional services orders is generally recognized after services are performed and accepted by the customer. Our revenue in any period is equal to the sum of our time-based license, upfront license, maintenance and professional services for the period. We derive time-based license revenue largely from TSL orders received and delivered in prior quarters and to a smaller extent due to contracts in which revenue is recognized as customer installments become due and payable and from contingent revenue arrangements. We derive upfront license revenue directly from term and perpetual license and hardware product orders mostly booked and shipped during



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the period. We derive maintenance revenue largely from maintenance orders received in prior periods since our maintenance orders generally yield revenue ratably over a term of one year. We also derive professional services revenue primarily from orders received in prior quarters, since we recognize revenue from professional services as those services are delivered and accepted or on percentage of completion for arrangements requiring significant modification of our software, and not when they are booked. Our license revenue is sensitive to the mix of TSLs and perpetual or term licenses delivered during a reporting period. A TSL order typically yields lower current quarter revenue but contributes to revenue in future periods. For example, a \$120,000 order for a three-year TSL delivered on the last day of a quarter typically generates no revenue in that quarter, but \$10,000 in each of the twelve succeeding quarters. Conversely, a \$120,000 order for perpetual and term licenses with greater than 75% of the license fee due within one year from shipment typically generates \$120,000 in revenue in the quarter the product is delivered, but no future revenue. Additionally, revenue in a particular quarter may also be impacted by perpetual and term licenses in which less than 75% of the license fees and 100% of the maintenance fees are payable within one year from shipment as the related revenue will be recognized as revenue in the period when customer payments become due and payable. Our customer arrangements are complex, involving hundreds of products and various license rights, and our customers bargain with us over many aspects of these arrangements. For example, they often demand a broader portfolio of solutions, support and services and seek more favorable terms such as expanded license usage, future purchase rights and other unique rights at an overall lower total cost. No single factor typically drives our customers' buying decisions, and we compete on all fronts to serve customers in a highly competitive EDA market. Customers generally negotiate the total value of the arrangement rather than just unit pricing or volumes.

## Total Revenue

	July 31,				
	2014	2013	\$ Change	% Change	
	(dollars in millions)				
Three months ended	\$521.8	\$482.9	\$38.9	8	%
Nine months ended	\$1,518.5	\$1,457.3	\$61.2	4	%

Our revenues are subject to fluctuations, primarily due to customer requirements, including payment terms and the timing and value of contract renewals. For example, we experience variability in our quarterly revenue due to factors such as the timing of renewals of maintenance contracts, timing of IP consulting projects and royalties, and certain contracts where revenue is recognized when customer installment payments are due, as well as volatility in hardware sales.

The increase in total revenue for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was due to our overall growth and increases in time-based license revenue, including contributions of revenue from acquired companies, and professional services and other revenue, which were partially offset by a decrease in our upfront license revenue.

The increase in total revenue for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was due to our overall growth and increases in time-based license revenue, including contributions of revenue from acquired companies, and upfront license revenue, which were partially offset by a decrease in our professional services and other revenue.

## Time-Based License Revenue

	July 31,				
	2014	2013	\$ Change	% Change	
	(dollars in millions)				
Three months ended	\$431.2	\$387.1	\$44.1	11	%
Percentage of total revenue	83	% 80	%		
Nine months ended	\$1,255.5	\$1,186.5	\$69.0	6	%
Percentage of total revenue	83	% 81	%		

The increase in time-based license revenue for the three and nine months ended July 31, 2014 compared to the same periods in fiscal 2013 was primarily attributable to an increase in TSL license revenue due to our overall growth, including contributions of revenue from acquired companies.



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## Upfront License Revenue

	July 31,			
	2014	2013	\$ Change	% Change
	(dollars in millions)			
Three months ended	\$31.6	\$40.0	\$(8.4)	(21)%
Percentage of total revenue	6	% 8	%	
Nine months ended	\$101.9	\$95.5	\$6.4	7%
Percentage of total revenue	7	% 7	%	

Changes in upfront license revenue are generally attributable to normal fluctuations in customer requirements, which can drive the amount of upfront orders and revenue in any particular period.

The decrease in upfront license revenue for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily attributable to a decrease in the sale of hardware products, which was partially offset by an increase in the sale of perpetual licenses to IP and Software Solutions products.

The increase in upfront license revenue for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily attributable to an increase in the sale of perpetual licenses to IP and Software Solutions products, which was partially offset by a decrease in the sale of hardware products.

## Maintenance and Service Revenue

	July 31,			
	2014	2013	\$ Change	% Change
	(dollars in millions)			
Three months ended				
Maintenance revenue	\$18.0	\$19.1	\$(1.1)	(6)%
Professional services and other revenue	41.0	36.8	4.2	11%
Total maintenance and service revenue	\$59.0	\$55.9	\$3.1	6%
Percentage of total revenue	11	% 12	%	
Nine months ended				
Maintenance revenue	\$56.1	\$59.9	\$(3.8)	(6)%
Professional services and other revenue	105.0	115.4	(10.4)	(9)%
Total maintenance and service revenue	\$161.1	\$175.3	\$(14.2)	(8)%
Percentage of total revenue	11	% 12	%	

Changes in maintenance revenue are generally attributable to timing and type of contracts that bundle maintenance.

The changes in professional services and other revenue for the three and nine months ended July 31, 2014 compared to the same periods in fiscal 2013 was primarily due to the timing of IP customization projects that are accounted for using the percentage of completion method.

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## Cost of Revenue

	July 31, 2014	2013	\$ Change	% Change	
	(dollars in millions)				
Three months ended					
Cost of license revenue	\$68.5	\$69.9	\$(1.4)	(2)	)%
Cost of maintenance and service revenue	20.7	19.2	1.5	8	%
Amortization of intangible assets	26.3	26.5	(0.2)	(1)	)%
Total	\$115.5	\$115.6	\$(0.1)	—	%
Percentage of total revenue	22	% 24	%		
Nine months ended					
Cost of license revenue	\$198.7	\$195.9	\$2.8	1	%
Cost of maintenance and service revenue	62.1	59.1	3.0	5	%
Amortization of intangible assets	74.7	79.4	(4.7)	(6)	)%
Total	\$335.5	\$334.4	\$1.1	—	%
Percentage of total revenue	22	% 23	%		

We divide cost of revenue into three categories: cost of license revenue, cost of maintenance and service revenue, and amortization of intangible assets. We segregate expenses directly associated with consulting and training services from cost of license revenue associated with internal functions providing license delivery and post-customer contract support services. We then allocate these group costs between cost of license revenue and cost of maintenance and service revenue based on license and maintenance and service revenue reported.

**Cost of license revenue.** Cost of license revenue includes costs related to products sold and software licensed, allocated operating costs related to product support and distribution costs, royalties paid to third party vendors, and the amortization of capitalized research and development costs associated with software products that have reached technological feasibility.

**Cost of maintenance and service revenue.** Cost of maintenance and service revenue includes operating costs related to maintaining the infrastructure necessary to operate our services and training organization, and costs associated with the delivery of our consulting services, such as hotline and on-site support, production services and documentation of maintenance updates.

**Amortization of intangible assets.** Amortization of intangible assets, which is recorded to cost of revenue and operating expenses, includes the amortization of certain contract rights and the amortization of core/developed technology, trademarks, trade names, customer relationships, and covenants not to compete related to acquisitions.

Cost of revenue for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was flat due to increases in (a) personnel-related costs of \$5.9 million driven by higher headcount and (b) consultant and contractor costs of \$1.5 million, being offset by lower product costs of \$7.5 million, primarily due to lower hardware sales and purchase accounting adjustments that were recorded in fiscal 2013.

Cost of revenue for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 remained relatively flat, primarily due to increases in (a) personnel-related costs of \$8.4 million driven by higher headcount and (b) \$4.0 million in consultant and contractor costs, being offset by lower product costs of \$6.6 million, primarily due to lower hardware sales, and purchase accounting adjustments that were recorded in fiscal 2013, and a decrease in amortization of intangible assets due to certain intangible assets being fully amortized.

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Research and Development

	July 31,				
	2014	2013	\$ Change	% Change	
	(dollars in millions)				
Three months ended	\$182.8	\$166.7	\$16.1	10	%
Percentage of total revenue	35	% 35	%		
Nine months ended	\$528.4	\$494.1	\$34.3	7	%
Percentage of total revenue	35	% 34	%		

The increase in research and development expenses in the three months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to an increase of \$12.8 million in personnel-related costs primarily as a result of headcount increases, including those from acquisitions, and functionally allocated expenses that were higher by \$3.6 million.

The increase in research and development expenses for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to an increase of \$22.4 million in personnel-related costs primarily as a result of headcount increases, including those from acquisitions, functionally allocated expenses that were higher by \$8.9 million, and a \$3.4 million increase in consultant and contractor costs.

## Sales and Marketing

	July 31,				
	2014	2013	\$ Change	% Change	
	(dollars in millions)				
Three months ended	\$112.3	\$105.4	\$6.9	7	%
Percentage of total revenue	22	% 22	%		
Nine months ended	\$332.8	\$311.1	\$21.7	7	%
Percentage of total revenue	22	% 21	%		

The increase in sales and marketing expenses in the three months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to an increase of \$6.5 million in personnel-related costs as a result of headcount increases, including those from acquisitions.

The increase in sales and marketing expenses in the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to increases of \$14.7 million in personnel-related costs as a result of headcount increases, including those from acquisitions, and \$6.6 million in variable compensation due to higher shipments.

## General and Administrative

	July 31,				
	2014	2013	\$ Change	% Change	
	(dollars in millions)				
Three months ended	\$37.4	\$34.5	\$2.9	8	%
Percentage of total revenue	7	% 7	%		
Nine months ended	\$112.2	\$104.7	\$7.5	7	%
Percentage of total revenue	7	% 7	%		

The increase in general and administrative expenses for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to increases of \$4.4 million in facilities and depreciation expenses and \$2.4 million in personnel costs. The increases were partially offset by higher allocation of \$5.3 million in expenses to other functions compared to the same period in fiscal 2013, resulting from increased headcount in other functions.





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The increase in general and administrative expenses for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was primarily due to increases of \$7.2 million in facilities and depreciation expenses, \$5.5 million in professional service costs and \$3.5 million of acquisition-related costs. In addition, bad debt expense decreased by \$1.8 million compared to the same period in fiscal 2013 primarily due to larger increases in the bad debt reserve in the prior year. The increases were partially offset by higher allocations of \$11.1 million in expenses to other functions compared to the same period in fiscal 2013, resulting from increased headcount in other functions.

## Amortization of Intangible Assets

	July 31, 2014	2013	\$ Change	% Change
	(dollars in millions)			
Three months ended				
Included in cost of revenue	\$26.3	\$26.5	\$(0.2)	(1)%
Included in operating expenses	6.5	5.8	0.7	12%
Total	\$32.8	\$32.3	\$0.5	2%
Percentage of total revenue	6	% 7	%	
Nine months ended				
Included in cost of revenue	\$74.7	\$79.4	\$(4.7)	(6)%
Included in operating expenses	18.3	17.6	0.7	4%
Total	\$93.0	\$97.0	\$(4.0)	(4)%
Percentage of total revenue	6	% 7	%	

Amortization of intangible assets for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was relatively flat as additions of intangible assets from our 2014 acquisitions were offset by certain intangible assets being fully amortized prior to the three months ended July 31, 2014.

The decrease in amortization of intangible assets for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was due to certain intangible assets being fully amortized prior to the three months ended July 31, 2014, partially offset by additions of intangible assets from our fiscal 2014 acquisitions. See Note 4 of the Notes to Unaudited Condensed Consolidated Financial Statements for a schedule of future amortization amounts.

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## Other Income (Expense), net

	July 31, 2014	2013	\$ Change	% Change	
	(dollars in millions)				
Three months ended					
Interest income	\$0.3	\$0.3	\$—	—	%
Interest (expense)	(0.7	) (0.4	) (0.3	) 75	%
Gain on assets related to executive deferred compensation plan assets	3.1	2.9	0.2	7	%
Foreign currency exchange gain	0.1	0.2	(0.1	) (50	)%
Other, net	0.7	0.2	0.5	250	%
Total	\$3.5	\$3.2	\$0.3	9	%
Nine months ended					
Interest income	\$1.0	\$1.5	\$(0.5	) (33	)%
Interest (expense)	(1.7	) (1.3	) (0.4	) 31	%
Gain on assets related to executive deferred compensation plan assets	7.5	12.5	(5.0	) (40	)%
Foreign currency exchange gain	0.9	6.1	(5.2	) (85	)%
Other, net	11.1	2.3	8.8	383	%
Total	\$18.8	\$21.1	\$(2.3	) (11	)%

Other income (expense), net for the three months ended July 31, 2014 compared to the same period in fiscal 2013 was flat.

Other income (expense), net for the nine months ended July 31, 2014 compared to the same period in fiscal 2013 was lower primarily due to decreased foreign currency exchange gains as a result of less movement in foreign currency exchange rates and lower gains in the market value of our executive deferred compensation plan assets. The aforementioned decreases were partially offset by a gain from the sale of a non-marketable equity investment in fiscal 2014 that was recorded in other, net.

## Taxes

Our effective tax rate decreased in the three months ended July 31, 2014, as compared to the same period in fiscal 2013, primarily due to statutes of limitations lapses that resulted in the recognition of an unrecognized tax benefit. The effective tax rate decreased in the nine months ended July 31, 2014, as compared to the same period in fiscal 2013, primarily due to the benefit of audit settlements with the Internal Revenue Service and Taiwan in the first and second quarter of fiscal 2014, respectively, statutes of limitations lapses in the third quarter of fiscal 2014, and changes in geographical earnings mix, partially offset by the reinstatement of the research tax credit and the reversal of deferred taxes resulting from the merger of a foreign affiliate in the first quarter of fiscal 2013. For further discussion of the provision for income taxes, see Note 15 of the Notes to Unaudited Condensed Consolidated Financial Statements.

## Liquidity and Capital Resources

Our sources of cash and cash equivalents are funds generated from our business operations and funds that may be drawn down under our revolving credit and term loan facilities.

As of July 31, 2014, we held an aggregate of \$109.3 million in cash and cash equivalents in the United States and an aggregate of \$793.7 million in our foreign subsidiaries. Funds held in our foreign subsidiaries are generated from revenue outside North America. At present, such foreign funds are considered to be indefinitely reinvested in foreign countries to the extent of indefinitely reinvested foreign earnings. However, in the event funds from foreign operations were needed to fund cash needs in the U.S. and if U.S. taxes have not already been previously accrued, we would be required to accrue and pay additional U.S. taxes in order to repatriate these funds.

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The following sections discuss changes in our unaudited condensed consolidated balance sheets and statements of cash flow, and other commitments of our liquidity and capital resources during the nine months ended July 31, 2014.

## Cash and Cash Equivalents

	July 31, 2014	October 31, 2013	\$ Change	% Change
	(dollars in millions)			
Cash and cash equivalents	\$903.0	\$1,022.4	\$(119.4)	(12)%

Cash and cash equivalents decreased primarily due to our cash paid for acquisitions, treasury stock, and property and equipment during fiscal 2014, which were partially offset by the cash provided by our operating activities.

## Cash Flows

	July 31, 2014	2013	\$ Change
	(dollars in millions)		
Nine months ended			
Cash provided by operating activities	\$378.0	\$305.4	\$72.6
Cash used in investing activities	(430.1)	(48.1)	(382.0)
Cash used in financing activities	(62.7)	(52.2)	(10.5)

We expect cash from our operating activities to fluctuate in future periods as a result of a number of factors, including the timing of our billings and collections, our operating results, and the timing and amount of tax and other liability payments. Cash provided by our operations is dependent primarily upon the payment terms of our license agreements. We generally receive cash from upfront license revenue much sooner than from time-based license revenue, in which the license fee is typically paid either quarterly or annually over the term of the license.

Cash provided by operating activities. Cash provided by operating activities for the nine months ended July 31, 2014 was higher compared to the same period in fiscal 2013 primarily due to higher cash collections which were partially offset by higher disbursements to vendors.

Cash used in investing activities. Cash used in investing activities for the nine months ended July 31, 2014 was higher compared to the same period in fiscal 2013, primarily driven by cash paid for acquisitions and intangible assets, net of cash acquired, of \$373.5 million.

Cash used in financing activities. Cash used in financing activities for the nine months ended July 31, 2014 was higher compared to the same period in fiscal 2013 primarily due to an increase of \$9.7 million in purchases of treasury stock. We repaid our senior unsecured revolving credit facility balance of \$200.0 million in the current quarter, which had been drawn down during the second quarter of fiscal 2014.

## Accounts Receivable, net

	July 31, 2014	October 31, 2013	\$ Change	% Change
	(dollars in millions)			
Accounts Receivable, net	\$238.9	\$256.0	\$(17.1)	(7)%

Our accounts receivable and days sales outstanding (DSO) are primarily driven by our billing and collections activities. Our DSO was 42 days at July 31, 2014, and 46 days at October 31, 2013. Accounts receivable and DSO decreased primarily due to increased cash collections.

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Working Capital. Working capital is comprised of current assets less current liabilities, as shown on our unaudited condensed consolidated balance sheets:

	July 31, 2014	October 31, 2013	\$ Change	% Change
	(dollars in millions)			
Current assets	\$1,314.8	\$1,448.0	\$(133.2)	(9)%
Current liabilities	1,227.3	1,222.9	4.4	—%
Working capital	\$87.5	\$225.1	\$(137.6)	(61)%

Decreases in our working capital were primarily due to (1) a decrease of \$119.4 million in cash and cash equivalents, (2) an increase of \$30.0 million in current deferred revenue due to the timing of our billings, and (3) a decrease of \$17.2 million in accounts receivable, net of allowances. These decreases in working capital were partially offset by a decrease of \$36.5 million in accounts payable and accrued liabilities due to higher disbursements.

#### Other Commitments—Credit Facility

On February 17, 2012, we entered into an agreement with several lenders (the Credit Agreement) providing for (i) a \$350.0 million senior unsecured revolving credit facility (the Revolver) and (ii) a \$150.0 million senior unsecured term loan facility (the Term Loan). Principal payments on a portion of the Term Loan are due in equal quarterly installments of \$7.5 million, with the remainder due when the Credit Agreement expires in October 2016. We can elect to make prepayments on the Term Loan, in whole or in part, without premium or penalty. Subject to obtaining additional commitments from lenders, the principal amount of the loans provided under the Credit Agreement may be increased by us by up to an additional \$150.0 million through October 13, 2015. The Credit Agreement contains financial covenants requiring us to operate within a maximum leverage ratio and maintain specified levels of cash, as well as other non-financial covenants.

During the second quarter of fiscal 2014, we drew down \$200.0 million under the Revolver to finance a portion of the purchase price for the acquisition of Coverity on March 24, 2014. During the three month period ended July 31, 2014, we made principal payments of \$200.0 million and \$7.5 million under the Revolver and Term Loan, respectively. As of July 31, 2014, we had an \$82.5 million outstanding balance under the Term Loan, of which \$52.5 million is classified as long-term, and no outstanding balance under the Revolver. As of October 31, 2013, we had a \$105.0 million outstanding balance under the Term Loan, of which \$75.0 million was classified as long-term, and no outstanding balance under the Revolver. Borrowings bear interest at a floating rate based on a margin over our choice of market-observable base rates as defined in the Credit Agreement. At July 31, 2014, borrowings under the Term Loan bore interest at LIBOR + 1.125% and the applicable interest rate for the Revolver was LIBOR + 0.975%. In addition, commitment fees are payable on the Revolver at rates between 0.150% and 0.300% per year based on our leverage ratio on the daily amount of the revolving commitment.

As a result of the Coverity acquisition, we assumed Coverity's credit facility with a U.S. bank that had an original expiration date of December 31, 2014. The facility provided a maximum borrowing limit of \$7.0 million. During the third quarter of fiscal 2014, we chose to terminate the Coverity credit facility prior to the original expiration date.

#### Other

As of July 31, 2014, our cash equivalents consisted of cash deposits, tax-exempt money market mutual funds, and taxable money market mutual funds. We follow an established investment policy and set of guidelines to monitor, manage and limit our exposure to interest rate and credit risk.

We proactively manage our cash and cash equivalents balances and closely monitor our capital and stock repurchase expenditures to ensure ample liquidity. Our cash equivalents are classified within Level 1 under fair value guidance. See Notes 5 and 6 of the Notes to Unaudited Condensed Consolidated Financial Statements.

We believe that our current cash and cash equivalents, cash generated from operations, and available credit under our Revolver will satisfy our routine business requirements for at least the next twelve months and the foreseeable future.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

See Other Commitments—Credit Facility, Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations, regarding borrowings under our senior unsecured revolving credit facility.

As of July 31, 2014, our exposure to market risk has not changed materially since October 31, 2013. For more information on financial market risks related to changes in interest rates, reference is made to Item 7A. Quantitative and Qualitative Disclosure About Market Risk contained in Part II of our Annual Report on Form 10-K for the fiscal year ended October 31, 2013, filed with the SEC on December 20, 2013.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures. As of July 31, 2014, Synopsys carried out an evaluation under the supervision and with the participation of Synopsys’ management, including the Co-Chief Executive Officers and Chief Financial Officer, of the effectiveness of the design and operation of Synopsys’ disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable, not absolute, assurance of achieving their control objectives. Our Co-Chief Executive Officers and Chief Financial Officer have concluded that, as of July 31, 2014, Synopsys’ disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the reports Synopsys files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required, and that such information is accumulated and communicated to Synopsys’ management, including the Co-Chief Executive Officers and Chief Financial Officer, to allow timely decisions regarding its required disclosure.

Changes in Internal Control over Financial Reporting. There were no changes in Synopsys’ internal control over (a) financial reporting during the three months ended July 31, 2014 that have materially affected, or are reasonably likely to materially affect, Synopsys’ internal control over financial reporting.

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## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

We are subject to routine legal proceedings, as well as demands, claims and threatened litigation that arise in the normal course of our business. The ultimate outcome of any litigation is uncertain and unfavorable outcomes could have a negative impact on our results of operations and financial condition. Regardless of outcome, litigation can have an adverse impact on Synopsys because of the defense costs, diversion of management resources and other factors.

**Mentor Patent Litigation**

We are engaged in complex patent litigation with Mentor Graphics Corporation (Mentor) involving several actions in different forums. We acquired Emulation & Verification Engineering S.A. (EVE) on October 4, 2012. At the time of the acquisition, EVE and EVE-USA, Inc. (collectively, the EVE Parties) were defendants in three patent infringement lawsuits filed by Mentor. Mentor filed suit against the EVE Parties in federal district court in the District of Oregon on August 16, 2010 alleging that EVE's ZeBu products infringe Mentor's United States Patent No. 6,876,962. Mentor filed an additional suit in federal district court in the District of Oregon on August 17, 2012 alleging that EVE's ZeBu products infringe Mentor's United States Patent No. 6,947,882. Both cases seek compensatory damages, including lost profits and royalties, and a permanent injunction. Mentor also filed a patent infringement lawsuit against Nihon EVE K.K. in Tokyo District Court in 2010 alleging that EVE's ZeBu series of products infringes Mentor's Japanese Patent No. P3,588,324. This case seeks compensatory damages, a permanent injunction and destruction of inventory. On September 27, 2012, Synopsys and the EVE Parties filed an action for declaratory relief against Mentor in federal district court in the Northern District of California, seeking a determination that Mentor's United States Patents Nos. 6,009,531; 5,649,176 and 6,240,376, which were the subject of a patent infringement lawsuit filed by Mentor against EVE in 2006 and settled in the same year, are invalid and not infringed by EVE's products, and that Mentor is without right or authority to threaten or maintain suit against the plaintiffs on such patents. Mentor has asserted patent infringement counterclaims in this action based on the same three patents and is seeking compensatory damages, including lost profits and royalties, and a permanent injunction. In April 2013, this action was transferred to the federal district court in Oregon and consolidated with the two Mentor lawsuits in that district (the Oregon Action). In the Oregon Action, Synopsys and the EVE Parties have further asserted patent infringement counterclaims against Mentor based on Synopsys' United States Patents Nos. 6,132,109 and 7,069,526, seeking compensatory damages and a permanent injunction. On February 21, 2014, the court in the Oregon Action granted Mentor's motion for partial summary judgment based on assignor estoppel, in which Mentor argued Synopsys was barred from challenging the validity of Mentor's '376 patent in the Oregon Action. In July 2014, the court granted Synopsys' motion for partial summary judgment on the '531 and '176 patents, finding that Mentor was barred from asserting those patents under the doctrine of res judicata. The court also granted cross-motions for partial summary judgment brought by both parties, finding that Mentor's '962 and '882 patents and Synopsys' '109 and '526 patents were non-infringed and/or invalid. As a result of these rulings, the only patent remaining at issue in the Oregon Action is Mentor's '376 patent. On September 26, 2012, Synopsys filed two inter partes review requests with the U.S. Patent and Trademark Office (the PTO) challenging the validity of Mentor's '376 and '882 patents. The PTO granted review of the '376 patent and denied review of the '882 patent. On February 19, 2014, the PTO issued its final decision in the review of the '376 patent, finding some of the challenged claims invalid and some of the challenged claims valid. On April 22, 2014, Synopsys appealed to the Federal Circuit from the PTO's decision. Mentor filed a cross-appeal on May 2, 2014. On December 21, 2012, Synopsys filed an action for patent infringement against Mentor in federal district court in the Northern District of California, alleging that Mentor's Veloce products infringe Synopsys' United States Patents Nos. 5,748,488, 5,530,841, 5,680,318 and 6,836,420. This case seeks compensatory damages and a permanent injunction. On December 21, 2013, Mentor filed an inter partes review request with the PTO challenging the validity of Synopsys' '420 patent. The PTO granted review of the '420 patent.

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Item 1A. Risk Factors

We describe our risk factors below.

The continued uncertainty in the global economy, and its potential impact on the semiconductor and electronics industries in particular, may negatively affect our business, operating results and financial condition.

While the global economy is improving, there are still uncertainties surrounding the strength of the recovery.

Weakness in the global economy has adversely affected consumer confidence and the growth of the semiconductor industry in recent years, causing semiconductor companies to behave cautiously and focus on their costs, including their research and development budgets, which capture spending on electronic design automation (EDA) products and services. For example, uncertainty caused by the global recession led some of our customers to postpone their decision-making, decrease their spending and/or delay their payments to us. Continuing caution by semiconductor companies could, among other things, limit our ability to maintain or increase our sales or recognize revenue from committed contracts and in turn could adversely affect our business, operating results and financial condition.

We cannot predict when widespread global economic confidence will be restored. Events such as the timing and execution of the tapering of asset purchases by the U.S. Federal Reserve may continue to drive stock market and interest rate volatility, consumer confidence and product demand. In addition, should further economic instability affect the banking and financial services industry and result in credit downgrades of the banks we rely on for foreign currency forward contracts, credit and banking transactions and deposit services, or cause them to default on their obligations, it could adversely affect our financial results and our business. Accordingly, our future business and financial results are subject to uncertainty, and our stock price is at risk of volatile change. If economic conditions deteriorate in the future, or, in particular, if the semiconductor industry does not grow, our future revenues and financial results could be adversely affected. Conversely, in the event of future improvements in economic conditions for our customers, the positive impact on our revenues and financial results may be deferred due to our business model.

The growth of our business depends on the semiconductor and electronics industries.

The growth of the EDA industry as a whole, and our business in particular, is dependent on the semiconductor and electronics industries. A substantial portion of our business and revenue depends upon the commencement of new design projects by semiconductor manufacturers and their customers. The increasing complexity of designs of systems-on-chips and integrated circuits, and customers' concerns about managing costs, have previously led and in the future could lead to a decrease in design starts and design activity in general, with some customers focusing more on one discrete phase of the design process or opting for less advanced, but less risky, manufacturing processes that may not require the most advanced EDA products. Demand for our products and services could decrease and our financial condition and results of operations could be adversely affected if growth in the semiconductor and electronics industries slows or stalls. Additionally, as the EDA industry matures, consolidation may result in stronger competition from companies better able to compete as sole source vendors. This increased competition may cause our revenue growth rate to decline and exert downward pressure on our operating margins, which may have an adverse effect on our business and financial condition.

Furthermore, the semiconductor and electronics industries have become increasingly complex ecosystems. Many of our customers outsource the manufacture of their semiconductor designs to foundries. Our customers also frequently incorporate third-party intellectual property (IP), whether provided by us or other vendors, into their designs to improve the efficiency of their design process. We work closely with major foundries to ensure that our EDA, IP, and manufacturing solutions are compatible with their manufacturing processes. Similarly, we work closely with other major providers of semiconductor IP, particularly microprocessor IP, to optimize our EDA tools for use with their IP designs and to assure that their IP and our own IP products, which may each provide for the design of separate components on the same chip, work effectively together. If we fail to optimize our EDA and IP solutions for use with major foundries' manufacturing processes or major IP providers' products, or if our access to such foundry processes or third-party IP products is hampered, then our solutions may become less desirable to our customers, resulting in an adverse effect on our business and financial condition.





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We may not be able to realize the potential financial or strategic benefits of the acquisitions we complete, or find suitable target businesses and technology to acquire, which could hurt our ability to grow our business, develop new products or sell our products.

Acquisitions are an important part of our growth strategy. We have completed a significant number of acquisitions in recent years. We expect to make additional acquisitions in the future, but we may not find suitable acquisition targets or we may not be able to consummate desired acquisitions due to unfavorable credit markets or other risks, which could harm our operating results. Acquisitions are difficult, time-consuming, and pose a number of risks, including:

- Potential negative impact on our earnings per share;
- Failure of acquired products to achieve projected sales;
- Problems in integrating the acquired products with our products;
- Difficulties entering into new markets in which we are not experienced;
- Potential downward pressure on operating margins due to lower operating margins of acquired businesses, increased headcount costs and other expenses associated with adding and supporting new products;
- Difficulties in retaining and integrating key employees;
- Substantial reductions of our cash resources and/or the incurrence of debt;
- Failure to realize expected synergies or cost savings;
- Dilution of our current stockholders through the issuance of common stock as part of the merger consideration;
- Assumption of unknown liabilities, including tax and litigation, and the related expenses and diversion of resources;
- Disruption of ongoing business operations, including diversion of management's attention and uncertainty for employees and customers, particularly during the post-acquisition integration process;
- Potential negative impact on our relationships with customers, distributors and business partners; and
- Negative impact on our earnings resulting from the application of ASC 805, Business Combinations.

If we do not manage these risks, the acquisitions that we complete may have an adverse effect on our business and financial condition. For example, we recently completed our acquisition of Coverity, Inc. (Coverity), a leading provider of software quality, testing, and security tools. This is a new, though adjacent, market for us, and it may have different and unfamiliar characteristics from the markets we currently serve. If, for example, we are unable to meet Coverity customer needs and service requirements, retain key Coverity employees, or effectively compete against Coverity competitors, we may not realize the expected financial and strategic benefits of the acquisition.

Consolidation among our customers, as well as within the industries in which we operate, may negatively impact our operating results.

A number of business combinations, including mergers, asset acquisitions and strategic partnerships, among our customers and in the semiconductor and electronics industries have occurred recently, and more could occur in the future. Consolidation among our customers could lead to fewer customers or the loss of customers, increased customer bargaining power, or reduced customer spending on software and services. Moreover, business combinations within the industries in which we compete may result in stronger competition from companies that are better able to compete as sole source vendors to customers. The loss of customers or reduced customer spending could adversely affect our business and financial condition.

In addition, we and our competitors from time to time acquire business and technologies to complement and expand our respective product offerings. If any of our competitors consolidate or acquire businesses and technologies which we do not offer, they may be able to offer a larger technology portfolio, a larger support and service capability, or lower prices, which could negatively impact our business and operating results.

Changes in accounting principles or standards, or in the way they are applied, could result in unfavorable accounting charges or effects and unexpected financial reporting fluctuations, and could adversely affect our reported operating results.

We prepare our consolidated financial statements in conformity with U.S. Generally Accepted Accounting Principles (GAAP). These principles are subject to interpretation by the Securities and Exchange Commission (SEC) and various bodies formed to interpret and create appropriate accounting principles and guidance. A change in existing principles or guidance can have a significant effect on our reported results and may retroactively affect previously reported results. Accounting standard changes could have a significant impact on our revenues and



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expenses, may require costly changes to our operational processes, and could cause unexpected financial reporting fluctuations.

For example, the Financial Accounting Standards Board (FASB) is currently working together with the International Accounting Standards Board (IASB) to converge certain accounting principles and facilitate more comparable financial reporting between companies that are required to follow GAAP and those that are required to follow International Financial Reporting Standards (IFRS). In connection with this initiative, the FASB issued a new accounting standard for revenue recognition in May 2014 – Accounting Standards Update (ASU) 2014-09, "Revenue from Contracts with Customers (Topic 606)" – that supersedes nearly all existing GAAP revenue recognition guidance. Although we are currently in the process of evaluating the impact of ASU 2014-09 on our consolidated financial statements, it could change the way we account for certain of our sales transactions. Adoption of the standard could have a significant impact on our financial statements and may retroactively affect the accounting treatment of transactions completed before adoption.

Further efforts by the FASB and IASB to converge GAAP and IFRS accounting principles could result in different accounting principles under GAAP, which may have a material impact on the way in which we report financial results in areas including, but not limited to, lease accounting and financial statement presentation. The SEC may make a determination in the future regarding the incorporation of IFRS into the financial reporting system for U.S. companies. Changes in accounting principles from GAAP to IFRS or to converged accounting principles may have a material impact on our financial statements and may retroactively affect the accounting treatment of previously reported transactions.

Our operating results may fluctuate in the future, which may adversely affect our stock price.

Our operating results are subject to quarterly and annual fluctuations, which may adversely affect our stock price. Our historical results should not be viewed as indicative of our future performance due to these periodic fluctuations.

Many factors may cause our revenue or earnings to fluctuate, including:

- Changes in demand for our products due to fluctuations in demand for our customers' products and due to constraints in our customers' budgets for research and development and EDA products and services;
  - Product competition in the EDA industry, which can change rapidly due to industry or customer consolidation and technological innovation;
  - Our ability to innovate and introduce new products and services or effectively integrate products and technologies that we acquire;
  - Failures or delays in completing sales due to our lengthy sales cycle, which often includes a substantial customer evaluation and approval process because of the complexity of our products and services;
  - Our ability to implement effective cost control measures;
  - Our dependence on a relatively small number of large customers, and on such customers continuing to renew licenses and purchase additional products from us, for a large portion of our revenue;
  - Expenses related to our acquisition and integration of businesses and technology;
  - Changes to our effective tax rate;
  - Delays, increased costs or quality issues resulting from our reliance on third parties to manufacture our hardware products; and
  - General economic and political conditions that affect the semiconductor and electronics industries.
- The timing of revenue recognition may also cause our revenue or earnings to fluctuate, due to factors that include:
- Cancellations or changes to levels of license orders or the mix between upfront license revenue and time-based license revenue;
  - Delay of one or more orders for a particular period, particularly orders generating upfront license revenue;
  - Delay in the completion of professional services projects that require significant modification or customization and are accounted for using the percentage of completion method;
  - Delay in the completion and delivery of IP products in development that customers have paid for early access to;
  - Customer contract amendments or renewals that provide discounts or defer revenue to later periods;
  -

The levels of our hardware revenues, which are recognized upfront and are primarily dependent upon our ability to provide the latest technology and meet customer requirements, and which can therefore increase variability in our recognized revenue; such variability in turn may impact our levels of excess and obsolete inventory expenses; and

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Changes in or challenges to our revenue recognition model.

These factors, or any other factors or risks discussed herein, could negatively impact our revenue or earnings and cause our stock price to decline.

We operate in highly competitive industries, and if we do not continue to meet our customers' demand for innovative technology at lower costs, our business and financial condition will be harmed.

We compete against EDA vendors that offer a variety of products and services, such as Cadence Design Systems, Inc. and Mentor Graphics Corporation. We also compete with other EDA vendors, including frequent new entrants to the marketplace, that offer products focused on one or more discrete phases of the integrated circuit (IC) design process, as well as vendors of IP products and system-level solutions. Moreover, our customers internally develop design tools and capabilities that compete with our products.

The industries in which we operate are highly competitive and the demand for our products and services is dynamic and depends on a number of factors, including demand for our customers' products, design starts and our customers' budgetary constraints. Technology in these industries evolves rapidly and is characterized by frequent product introductions and improvements and changes in industry standards and customer requirements. Semiconductor device functionality requirements continually increase while feature widths decrease, substantially increasing the complexity, cost and risk of chip design and manufacturing. At the same time, our customers and potential customers continue to demand an overall lower total cost of design, which can lead to the consolidation of their purchases with one vendor. In order to succeed in this environment, we must successfully meet our customers' technology requirements and increase the value of our products, while also striving to reduce their overall costs and our own operating costs. We compete principally on the basis of technology, product quality and features (including ease-of-use), license or usage terms, post-contract customer support, interoperability among products, and price and payment terms.

Specifically, we believe the following competitive factors affect our success:

• Our ability to anticipate and lead critical development cycles and technological shifts, innovate rapidly and efficiently, improve our existing products, and successfully develop or acquire new products;

• Our ability to offer products that provide both a high level of integration into a comprehensive platform and a high level of individual product performance;

• Our ability to enhance the value of our offerings through more favorable terms such as expanded license usage, future purchase rights, price discounts and other unique rights, such as multiple tool copies, post-contract customer support, "re-mix" rights that allow customers to exchange the software they initially licensed for other Synopsys products, and the ability to purchase pools of technology; and

• Our ability to compete on the basis of payment terms.

If we fail to successfully manage these competitive factors, fail to successfully balance the conflicting demands for innovative technology and lower overall costs, or fail to address new competitive forces, our business and financial condition will be adversely affected.

If we fail to protect our proprietary technology, our business will be harmed.

Our success depends in part upon protecting our proprietary technology. Our efforts to protect our technology may be costly and unsuccessful. We rely on agreements with customers, employees and others and on intellectual property laws worldwide to protect our proprietary technology. These agreements may be breached, and we may not have adequate remedies for any breach. Additionally, despite our measures to prevent piracy, other parties may attempt to illegally copy or use our products, which could result in lost revenue. Some foreign countries do not currently provide effective legal protection for intellectual property and our ability to prevent the unauthorized use of our products in those countries is therefore limited. Our trade secrets may also be stolen, otherwise become known, or be independently developed by competitors.

We may need to commence litigation or other legal proceedings in order to:

• Assert claims of infringement of our intellectual property;

• Defend our products from piracy;

• Protect our trade secrets or know-how; or

• Determine the enforceability, scope and validity of the propriety rights of others.

If we do not obtain or maintain appropriate patent, copyright or trade secret protection, for any reason, or cannot fully defend our intellectual property rights in some jurisdictions, our business and operating results would be

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harmful. In addition, intellectual property litigation is lengthy, expensive and uncertain and legal fees related to such litigation will increase our operating expenses and may reduce our net income.

Unfavorable tax law changes, changes in our forecasted or actual geographical earnings mix, or an unfavorable government review of our tax returns could adversely affect our effective tax rate and our operating results.

Our operations are subject to income and transaction taxes in the United States and in multiple foreign jurisdictions. A change in the tax law in the jurisdictions in which we do business, including an increase in tax rates or an adverse change in the treatment of an item of income or expense, could result in a material increase in our tax expense. U.S. income taxes and foreign withholding taxes have not been provided for on undistributed earnings for certain of our non-U.S. subsidiaries to the extent such earnings are considered to be indefinitely reinvested in the operations of those subsidiaries. A number of proposals for broad reform of the corporate tax system in the U.S. are under evaluation by various legislative and administrative bodies, but it is not possible to determine accurately the overall impact of such proposals on our effective tax rate at this time.

We have operations in the U.S. and in multiple foreign jurisdictions with a wide range of statutory tax rates.

Therefore, any changes in our geographical earnings mix in various tax jurisdictions, including those resulting from transfer pricing adjustments, could materially impact our effective tax rate. Furthermore, we maintain significant deferred tax assets related to federal research credits and foreign tax credits and certain state tax credits. Our ability to use these credits is dependent upon having sufficient future taxable income, including foreign source income in the U.S., as well as sufficient taxable income in certain states. Changes in our forecasts of future income could result in an adjustment to the deferred tax asset and a related charge to earnings that could materially affect our financial results. The computation of our annual effective tax rate is complex as it is based on the laws of numerous taxing jurisdictions and requires significant judgment on the application of complicated rules governing accounting for tax provisions under U.S. GAAP. Income tax expense (benefit) for interim quarters is based on a forecast of our worldwide effective tax rate. This forecast includes forward looking financial projections by jurisdiction as well as a number of other estimates and assumptions. Various items cannot be accurately forecasted and future events may be treated as discrete to the period in which they occur. For these reasons, our worldwide effective tax rate may be materially different than our forecast and fluctuate throughout the year.

Our tax filings are subject to review or audit by the Internal Revenue Service and state, local and foreign taxing authorities. We exercise judgment in determining our worldwide provision for income taxes and, in the ordinary course of our business, there may be transactions and calculations where the ultimate tax determination is uncertain. We are also liable for potential tax liabilities of businesses we acquire. Although we believe our tax estimates are reasonable, we can provide no assurance that any final determination in an audit will not be materially different than the treatment reflected in our historical income tax provisions and accruals. An assessment of additional taxes as a result of an audit could adversely affect our income tax provision and net income in the period or periods for which that determination is made.

We may have to invest more resources in research and development than anticipated, which could increase our operating expenses and negatively affect our operating results.

We devote substantial resources to research and development. New competitors, technological advances in the semiconductor industry or by competitors, our acquisitions, our entry into new markets, or other competitive factors may require us to invest significantly greater resources than we anticipate. If we are required to invest significantly greater resources than anticipated without a corresponding increase in revenue, our operating results could decline. Additionally, our periodic research and development expenses may be independent of our level of revenue which could negatively impact our financial results. Finally, there can be no guarantee that our research and development investments will result in products that create significant, or even any, revenue.

The global nature of our operations exposes us to increased risks and compliance obligations that may adversely affect our business.

We derive more than half of our revenue from sales outside the United States, and we expect our orders and revenue to continue to depend on sales to customers outside the U.S. In addition, we have expanded our non-U.S. operations significantly in the past several years. This strategy requires us to recruit and retain qualified technical and managerial employees, manage multiple remote locations performing complex software development projects





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and ensure intellectual property protection outside of the U.S. Our international operations and sales subject us to a number of increased risks, including:

- Ineffective legal protection of intellectual property rights;
- International economic and political conditions, such as political tensions between countries in which we do business;
- Difficulties in adapting to cultural differences in the conduct of business;
- Financial risks such as longer payment cycles and difficulty in collecting accounts receivable;
  - Inadequate local infrastructure that could result in business disruptions;
- Government trade restrictions, including tariffs or other trade barriers;
- Additional taxes and penalties; and
- Other factors beyond our control such as natural disasters, terrorism, civil unrest, war and infectious diseases.

If any of the foreign economies in which we do business deteriorate or if we fail to effectively manage our global operations, our business and results of operations will be harmed.

In addition, our global operations are subject to numerous U.S. and foreign laws and regulations, including those related to anti-corruption, tax, corporate governance, imports and exports, financial and other disclosures, privacy and labor relations. These laws and regulations are complex and may have differing or conflicting legal standards, making compliance difficult and costly. If we violate these laws and regulations we could be subject to fines, penalties or criminal sanctions, and may be prohibited from conducting business in one or more countries. Although we have implemented policies and procedures to ensure compliance with these laws and regulations, there can be no assurance that our employees, contractors or agents will not violate these laws and regulations. Any violation individually or in the aggregate could have a material adverse effect on our operations and financial condition.

Our financial statements are also affected by fluctuations in foreign currency exchange rates. A weakening U.S. dollar relative to other currencies increases expenses of our foreign subsidiaries when they are translated into U.S. dollars in our consolidated statement of operations. Likewise, a strengthening U.S. dollar relative to other currencies, especially the Japanese Yen, reduces revenue of our foreign subsidiaries upon translation and consolidation. Exchange rates are subject to significant and rapid fluctuations, and therefore we cannot predict the prospective impact of exchange rate fluctuations. Although we engage in foreign currency hedging activity, we may be unable to hedge all of our foreign currency risk, which could have a negative impact on our results of operations.

Liquidity requirements in our U.S. operations may require us to raise cash in uncertain capital markets, which could negatively affect our financial condition.

As of July 31, 2014, approximately 87.9% of our worldwide cash and cash equivalents balance is held by our international subsidiaries in their own accounts outside the United States. At present, such foreign funds are considered to be indefinitely reinvested abroad to the extent they derive from indefinitely reinvested foreign earnings. We have a credit agreement with several lenders providing for a \$150 million term loan facility and a \$350 million revolving credit facility, and as of July 31, 2014, we had outstanding debt of \$82.5 million under our term loan facility and no outstanding debt under our revolving credit facility. Should our cash spending needs in the U.S. rise and exceed our existing U.S. balances, available credit under our revolving credit and term loan facilities, and future U.S. cash flows, we may be required to incur additional debt at higher than anticipated interest rates or access other funding sources, which could negatively affect our results of operations, capital structure or the market price of our common stock.

From time to time we are subject to claims that our products infringe on third-party intellectual property rights. We are from time to time subject to claims alleging our infringement of third-party intellectual property rights, including patent rights. For example, we and EVE, a company we acquired in October 2012, are party to ongoing patent infringement lawsuits involving Mentor Graphics Corporation. Further information regarding the EVE lawsuits is contained in Part II, Item 1, Legal Proceedings. In addition, under our customer agreements and other license agreements, we agree in many cases to indemnify our customers if our products infringe a third party's intellectual property rights. Infringement claims can result in costly and time-consuming litigation, require us to enter into royalty arrangements, subject us to damages or injunctions restricting our sale of products, invalidate a patent or family of patents, require us to refund license fees to our customers or to forgo future payments or require us to redesign certain

of our products, any one of which could harm our business and operating results.

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Product errors or defects could expose us to liability and harm our reputation and we could lose market share. Software products frequently contain errors or defects, especially when first introduced, when new versions are released or when integrated with technologies developed by acquired companies. Product errors could affect the performance or interoperability of our products, could delay the development or release of new products or new versions of products and could adversely affect market acceptance or perception of our products. In addition, allegations of manufacturability issues resulting from use of our IP products could, even if untrue, adversely affect our reputation and our customers' willingness to license IP products from us. Any such errors or delays in releasing new products or new versions of products or allegations of unsatisfactory performance could cause us to lose customers, increase our service costs, subject us to liability for damages and divert our resources from other tasks, any one of which could materially and adversely affect our business and operating results.

Security breaches could compromise sensitive information belonging to us or our customers and could harm our business and reputation.

We store sensitive data, including intellectual property, our proprietary business information and that of our customers, and confidential employee information, in our data centers and on our networks. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions that could result in unauthorized disclosure or loss of sensitive information. Because the techniques used to obtain unauthorized access to networks, or to sabotage systems, change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventative measures. Furthermore, in the operation of our business we also use third-party vendors that store certain sensitive data, including confidential information about our employees, and these third parties are subject to their own cybersecurity threats. Any security breach of our own or a third-party vendor's systems could cause us to be non-compliant with applicable laws or regulations, subject us to legal claims or proceedings, disrupt our operations, damage our reputation, and cause a loss of confidence in our products and services, any of which could adversely affect our business.

We may be subject to litigation proceedings that could harm our business.

We may be subject to legal claims or regulatory matters involving stockholder, consumer, employment, competition, and other issues on a global basis. Litigation is subject to inherent uncertainties, and unfavorable rulings could occur. An unfavorable ruling could include monetary damages or, in cases for which injunctive relief is sought, an injunction prohibiting us from manufacturing or selling one or more products. If we were to receive an unfavorable ruling on a matter, our business and results of operations could be materially harmed. Further information regarding material pending lawsuits, other than ordinary routine litigation incidental to our business, is contained in Part II, Item 1, Legal Proceedings.

If we fail to timely recruit and retain senior management and key employees, our business may be harmed.

We depend in large part upon the services of key members of our senior management team to drive our future success. If we were to lose the services of any member of our senior management team, our business could be adversely affected. To be successful, we must also attract and retain key technical, sales and managerial employees, including those who join Synopsys in connection with acquisitions. There are a limited number of qualified EDA and IC design engineers, and competition for these individuals is intense and has increased. Our employees are often recruited aggressively by our competitors and our customers. Any failure to recruit and retain key technical, sales and managerial employees could harm our business, results of operations and financial condition. Additionally, efforts to recruit and retain qualified employees could be costly and negatively impact our operating expenses.

We issue stock options and restricted stock units and maintain employee stock purchase plans as a key component of our overall compensation. We face pressure to limit the use of such equity-based compensation due to its dilutive effect on stockholders. In addition, we are required under GAAP to recognize compensation expense in our results of operations for employee share-based equity compensation under our equity grants and our employee stock purchase plan, which has increased the pressure to limit equity-based compensation. These factors may make it more difficult for us to grant attractive equity-based packages in the future, which could adversely impact and limit our ability to attract and retain key employees.



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Our business is subject to evolving corporate governance and public disclosure regulations that have increased both our compliance costs and the risk of noncompliance, which could have an adverse effect on our stock price. We are subject to changing rules and regulations promulgated by a number of governmental and self-regulatory organizations, including the SEC, the NASDAQ Stock Market, and the FASB. These rules and regulations continue to evolve in scope and complexity and many new requirements have been created in response to laws enacted by Congress, making compliance more difficult and uncertain. For example, our efforts to comply with the Dodd-Frank Wall Street Reform and Consumer Protection Act and other new regulations have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

There are inherent limitations on the effectiveness of our controls and compliance programs.

Regardless of how well designed and operated it is, a control system can provide only reasonable assurance that its objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Moreover, although we have implemented compliance programs and compliance training for employees, such measures may not prevent our employees, contractors or agents from breaching or circumventing our policies or violating applicable laws and regulations. Failure of our control systems and compliance programs to prevent error, fraud or violations of law could have a material adverse impact on our business.

Our investment portfolio may be impaired by the deterioration of capital markets.

Our cash equivalent portfolio currently consists of tax-exempt money market mutual funds, taxable money market mutual funds and bank deposits. In general, our investment portfolio may carry both interest rate risk and credit risk. We may hold fixed rate debt securities that can have their market value adversely impacted due to a credit downgrade or a rise in interest rates, or floating rate securities that may produce less income than expected if interest rates fall or a credit downgrade occurs. As a result of capital pressures on certain banks, especially in Europe, and the continuing low interest rate environment, some of our financial instruments may become impaired.

Our future investment income may fall short of expectations due to changes in interest rates or if the decline in fair value of investments held by us is judged to be other-than-temporary.

In preparing our financial statements we make certain assumptions, judgments and estimates that affect amounts reported in our consolidated financial statements, which, if not accurate, may significantly impact our financial results. We make assumptions, judgments and estimates for a number of items, including the fair value of financial instruments, goodwill, long-lived assets and other intangible assets, the realizability of deferred tax assets, the recognition of revenue and the fair value of stock awards. We also make assumptions, judgments and estimates in determining the accruals for employee-related liabilities, including commissions and variable compensation, and in determining the accruals for uncertain tax positions, allowances for doubtful accounts, and legal contingencies. These assumptions, judgments and estimates are drawn from historical experience and various other factors that we believe are reasonable under the circumstances as of the date of the consolidated financial statements. Actual results could differ materially from our estimates, and such differences could significantly impact our financial results.

Catastrophic events may disrupt our business and harm our operating results.

Due to the global nature of our business, our operating results may be negatively impacted by catastrophic events throughout the world. We rely on a global network of infrastructure applications, enterprise applications and technology systems for our development, marketing, operational, support and sales activities. A disruption or failure of these systems in the event of a major earthquake, fire, telecommunications failure, cybersecurity attack, terrorist attack, or other catastrophic event could cause system interruptions, delays in our product development and loss of critical data and could prevent us from fulfilling our customers' orders. Moreover, our corporate headquarters, a significant portion of our research and development activities, our data centers, and certain other critical business operations are located in California, near major earthquake faults. A catastrophic event that results in the destruction or disruption of our data centers or our critical business or information technology systems would



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severely affect our ability to conduct normal business operations and, as a result, our operating results would be adversely affected.

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

We did not repurchase any shares of our common stock during the three months ended July 31, 2014 and, as of such date, \$420.3 million remained available for further repurchases under our stock repurchase program. See Note 10 of Notes to Unaudited Condensed Consolidated Financial Statements for further information regarding our stock repurchase program.

Item 6. Exhibit Number	Exhibits Exhibit Description	Incorporated By Reference				Filed Herewith
		Form	File No.	Exhibit	Filing Date	
3.1	Amended and Restated Certificate of Incorporation	10-Q	000-19807	3.1	9/15/2003	
3.2	Amended and Restated Bylaws	8-K	000-19807	3.2	5/23/2012	
4.1	Specimen Common Stock Certificate	S-1	33-45138	4.3	02/24/92 (effective date)	
31.1	Certification of Co-Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
31.2	Certification of Co-Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
31.3	Certification of Principal Financial Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
32.1	Certification of Co-Principal Executive Officers and Principal Financial Officer furnished pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X



101.LAB	XBRL Taxonomy Extension Label Linkbase Document	X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	X

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SIGNATURES

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

SYNOPSIS, INC.

Date: August 25, 2014

By: /s/ BRIAN M. BEATTIE  
Brian M. Beattie  
Chief Financial Officer  
(Principal Financial Officer)

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## EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporated By Reference			Filing Date	Filed Herewith
		Form	File No.	Exhibit		
3.1	Amended and Restated Certificate of Incorporation	10-Q	000-19807	3.1	9/15/2003	
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4.1	Specimen Common Stock Certificate	S-1	33-45138	4.3	02/24/92 (effective date)	
31.1	Certification of Co-Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
31.2	Certification of Co-Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
31.3	Certification of Principal Financial Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
32.1	Certification of Co-Principal Executive Officers and Principal Financial Officer furnished pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					X