

SYNOPSIS INC  
Form 10-Q  
September 02, 2011  
Table of Contents

**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, 2011

OR

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

COMMISSION FILE NUMBER: 0-19807

**SYNOPSIS, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: SYNOPSIS INC - Form 10-Q

**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

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

**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)

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 29, 2011, there were 144,053,580 shares of the registrant's common stock outstanding.

---

**Table of Contents**

**SYNOPSIS, INC.**

**QUARTERLY REPORT ON FORM 10-Q**

**FOR THE FISCAL QUARTER ENDED JULY 31, 2011**

**TABLE OF CONTENTS**

	<b>Page</b>
PART I. <u>Financial Information</u>	3
ITEM 1. <u>Financial Statements</u>	3
<u>Unaudited Condensed Consolidated Balance Sheets</u>	3
<u>Unaudited Condensed Consolidated Statements of Operations</u>	4
<u>Unaudited Condensed Consolidated Statements of Cash Flows</u>	5
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	6
ITEM 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
ITEM 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
ITEM 4. <u>Controls and Procedures</u>	33
PART II. <u>Other Information</u>	33
ITEM 1. <u>Legal Proceedings</u>	33
ITEM 1A. <u>Risk Factors</u>	33
ITEM 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	40
ITEM 3. <u>Defaults Upon Senior Securities</u>	40
ITEM 4. <u>(Removed and Reserved)</u>	40
ITEM 5. <u>Other Information</u>	40
ITEM 6. <u>Exhibits</u>	41
<u>Signatures</u>	42

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****SYNOPSISYS, INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except par value amounts)**

	<b>July 31, 2011</b>	<b>October 31, 2010</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 889,886	\$ 775,407
Short-term investments	148,395	163,154
<b>Total cash, cash equivalents and short-term investments</b>	<b>1,038,281</b>	<b>938,561</b>
Accounts receivable, net of allowances of \$3,060 and \$2,727, respectively	175,386	181,102
Deferred income taxes	73,604	73,465
Income taxes receivable	21,477	18,425
Prepaid and other current assets	53,548	36,202
<b>Total current assets</b>	<b>1,362,296</b>	<b>1,247,755</b>
Property and equipment, net	159,059	148,580
Goodwill	1,258,286	1,265,843
Intangible assets, net	203,739	249,656
Long-term deferred income taxes	278,203	268,759
Other long-term assets	107,055	105,948
<b>Total assets</b>	<b>\$ 3,368,638</b>	<b>\$ 3,286,541</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 284,463	\$ 312,850
Accrued income taxes	3,091	8,349
Deferred revenue	694,536	600,569
<b>Total current liabilities</b>	<b>982,090</b>	<b>921,768</b>
Long-term accrued income taxes	98,049	128,603
Other long-term liabilities	107,849	101,885
Long-term deferred revenue	59,143	34,103
<b>Total liabilities</b>	<b>1,247,131</b>	<b>1,186,359</b>
Stockholders equity:		
Preferred Stock, \$0.01 par value: 2,000 shares authorized; none outstanding		
Common Stock, \$0.01 par value: 400,000 shares authorized; 143,666 and 148,479 shares outstanding, respectively	1,437	1,485
Capital in excess of par value	1,542,225	1,541,383
Retained earnings	931,281	770,674
Treasury stock, at cost: 13,599 and 8,786 shares, respectively	(351,896)	(197,586)
Accumulated other comprehensive loss	(1,540)	(15,774)

Edgar Filing: SYNOPSIS INC - Form 10-Q

Total stockholders' equity	2,121,507	2,100,182
Total liabilities and stockholders' equity	\$ 3,368,638	\$ 3,286,541

See accompanying notes to unaudited condensed consolidated financial statements.

**Table of Contents****SYNOPSIS, INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands, except per share amounts)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
<b>Revenue:</b>				
Time-based license	\$ 322,147	\$ 286,563	\$ 936,518	\$ 847,710
Upfront license	19,013	14,650	70,562	47,811
Maintenance and service	45,635	35,716	138,029	109,681
<b>Total revenue</b>	<b>386,795</b>	<b>336,929</b>	<b>1,145,109</b>	<b>1,005,202</b>
<b>Cost of revenue:</b>				
License	52,089	43,996	153,758	130,140
Maintenance and service	19,275	14,697	59,796	46,475
Amortization of intangible assets	13,368	8,050	41,511	24,736
<b>Total cost of revenue</b>	<b>84,732</b>	<b>66,743</b>	<b>255,065</b>	<b>201,351</b>
<b>Gross margin</b>	<b>302,063</b>	<b>270,186</b>	<b>890,044</b>	<b>803,851</b>
<b>Operating expenses:</b>				
Research and development	122,547	105,649	366,456	319,931
Sales and marketing	90,732	83,812	269,618	242,791
General and administrative	27,052	27,371	86,387	81,937
Amortization of intangible assets	3,553	2,561	11,057	8,339
<b>Total operating expenses</b>	<b>243,884</b>	<b>219,393</b>	<b>733,518</b>	<b>652,998</b>
<b>Operating income</b>	<b>58,179</b>	<b>50,793</b>	<b>156,526</b>	<b>150,853</b>
<b>Other (expense) income, net</b>	<b>(2,212)</b>	<b>(3,046)</b>	<b>9,032</b>	<b>8,109</b>
<b>Income before provision for income taxes</b>	<b>55,967</b>	<b>47,747</b>	<b>165,558</b>	<b>158,962</b>
<b>Provision (benefit) for income taxes</b>	<b>3,885</b>	<b>8,420</b>	<b>(15,864)</b>	<b>(52,700)</b>
<b>Net income</b>	<b>\$ 52,082</b>	<b>\$ 39,327</b>	<b>\$ 181,422</b>	<b>\$ 211,662</b>
<b>Net income per share:</b>				
Basic	\$ 0.36	\$ 0.27	\$ 1.23	\$ 1.43
Diluted	\$ 0.35	\$ 0.26	\$ 1.20	\$ 1.40
<b>Shares used in computing per share amounts:</b>				
Basic	144,960	148,006	147,479	147,909
Diluted	148,045	151,106	151,598	151,459

See accompanying notes to unaudited condensed consolidated financial statements.



**Table of Contents****SYNOPSIS, INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)**

	<b>Nine Months Ended July 31,</b>	
	<b>2011</b>	<b>2010</b>
<b>Cash flow from operating activities:</b>		
Net income	\$ 181,422	\$ 211,662
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Amortization and depreciation	96,959	71,772
Stock compensation	41,430	45,214
Allowance for doubtful accounts	910	(851)
Write-down of long-term investments	999	468
Gain on sale of investments	(829)	(3,114)
Deferred income taxes	(4,891)	(31,297)
<b>Net changes in operating assets and liabilities, net of acquired assets and liabilities:</b>		
Accounts receivable	6,780	(19,181)
Prepaid and other current assets	(7,560)	(7,497)
Other long-term assets	(7,681)	(2,470)
Accounts payable and accrued liabilities	(17,285)	(21,270)
Income taxes	(38,998)	(31,445)
Deferred revenue	116,034	32,153
<b>Net cash provided by operating activities</b>	<b>367,290</b>	<b>244,144</b>
<b>Cash flows from investing activities:</b>		
Proceeds from sales and maturities of short-term investments	104,013	352,124
Purchases of short-term investments	(92,611)	(209,564)
Purchases of property and equipment	(42,836)	(27,593)
Cash paid for acquisitions and intangible assets, net of cash acquired	(5,382)	(137,681)
Capitalization of software development costs	(2,269)	(2,116)
<b>Net cash used in investing activities</b>	<b>(39,085)</b>	<b>(24,830)</b>
<b>Cash flows from financing activities:</b>		
Principal payments on capital leases	(4,592)	(3,609)
Issuances of common stock	119,826	87,241
Purchases of treasury stock	(334,985)	(125,257)
<b>Net cash used in financing activities</b>	<b>(219,751)</b>	<b>(41,625)</b>
Effect of exchange rate changes on cash and cash equivalents	6,025	4,139
<b>Net change in cash and cash equivalents</b>	<b>114,479</b>	<b>181,828</b>
Cash and cash equivalents, beginning of year	775,407	701,613
<b>Cash and cash equivalents, end of period</b>	<b>\$ 889,886</b>	<b>\$ 883,441</b>

See accompanying notes to unaudited condensed consolidated financial statements.





**Table of Contents**

**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 providing technology solutions used to develop electronics and electronic systems. The Company supplies 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 supplies software and hardware used to develop the systems that incorporate integrated circuits and the software that runs on those integrated circuits. The Company's intellectual property (IP) products are pre-designed circuits that engineers use as components of larger chip designs rather than redesigning those circuits themselves. To complement these product offerings, the Company provides technical services and helps customers develop chips and electronic systems.

**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 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, 2010 as filed with the SEC on December 17, 2010 and amended on February 9, 2011.

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 ends on the Saturday nearest to October 31. The Company's third quarter of fiscal 2011 ended on July 30, 2011. The Company's third quarter of fiscal 2010 ended on July 31, 2010. Fiscal 2011 and 2010 are both 52-week years. For presentation purposes, the unaudited condensed consolidated financial statements and accompanying notes refer to the closest calendar month end.

*Basis of Presentation.* An immaterial amount within net cash provided by operating activities in the prior period unaudited condensed consolidated statements of cash flows has been reclassified to conform to the current period presentation. This reclassification had no impact on net cash provided by operating activities.

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

**Table of Contents****Note 3. Financial Assets and Liabilities**

*Cash, Cash Equivalents and Investments.* Short-term investments include money market funds and municipal securities and are classified as available-for-sale securities. Cash, cash equivalents and investments are detailed as follows:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses Less Than 12 Months (in thousands)	Gross Unrealized Losses 12 Months or Longer	Estimated Fair Value(1)
Balance at July 31, 2011					
Classified as current assets:					
Non-interest bearing cash (U.S. and International)	\$ 165,107	\$	\$	\$	\$ 165,107
Money market funds (U.S.)	161,703				161,703
Cash deposits and money market funds (International)	563,076				563,076
Municipal securities	147,948	457	(10)		148,395
	1,037,834	457	(10)		1,038,281
Classified as non-current assets:					
Strategic investments	3,981				3,981
Total	\$ 1,041,815	\$ 457	\$ (10)	\$	\$ 1,042,262

	Cost	Gross Unrealized Gains	Gross Unrealized Losses Less Than 12 Months (in thousands)	Gross Unrealized Losses 12 Months or Longer	Estimated Fair Value(1)
Balance at October 31, 2010					
Classified as current assets:					
Non-interest bearing cash (U.S. and International)	\$ 45,687	\$	\$	\$	\$ 45,687
Money market funds (U.S.)	68,099				68,099
Cash deposits and money market funds (International)	661,621				661,621
Municipal securities	162,440	723	(9)		163,154
	937,847	723	(9)		938,561
Classified as non-current assets:					
Strategic investments	7,360				7,360
Total	\$ 945,207	\$ 723	\$ (9)	\$	\$ 945,921

(1) See Note 4 for further discussion on fair values of money market funds, municipal securities, and non-marketable equity securities. As of July 31, 2011, the stated maturities of the Company's short-term investments are:

Edgar Filing: SYNOPSIS INC - Form 10-Q

	<b>Fair Value (in thousands)</b>
Due in 1 year or less	\$ 74,581
Due in 1 - 5 years	30,661
Due in 6 - 10 years	4,375
Due after 10 years	38,778
<b>Total</b>	<b>\$ 148,395</b>

---

## **Table of Contents**

Actual maturities may differ from the stated maturities because borrowers may have the right to call or prepay certain obligations. These investments are classified as available-for-sale and are recorded on the balance sheet at fair market value with unrealized gains or losses, net of tax, reported as a component of accumulated other comprehensive income (loss), or OCI. The cost of securities sold is based on the specific identification method and realized gains and losses are included in other (expense) income, net. Realized gains and losses on sales of short-term investments have not been material in any period presented.

*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 one month to 20 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 sheet. 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 20 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 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.

Hedging effectiveness is evaluated monthly using spot rates, with any gain or loss caused by hedging ineffectiveness recorded in other (expense) income, net. The premium/discount component of the forward contracts is recorded to other (expense) income, 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 (expense) income, 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 (expense) income, 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 (expense) income, 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.

**Table of Contents**

The effect on the changes in the fair values of non-designated forward contracts is summarized as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(in thousands)			
Gain (loss) recorded in other (expense) income, net	\$ (110)	\$ (3,016)	\$4,258	\$ (4,502)

Foreign currency forward contracts outstanding is as follows:

	As of July 31, 2011	As of October 31, 2010
	(In thousands)	
Total gross notional amount	\$ 553,430	\$ 691,343
Net fair value	\$ 2,321	\$ (7,500)

The notional amounts for derivative instruments provide one measure of the transaction volume outstanding as of July 31, 2011 and October 31, 2010, respectively, and 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	Fair Values of derivative instruments not designated as hedging instruments
	(in thousands)	
As of July 31, 2011		
Other current assets	\$ 8,853	\$
Accrued liabilities	\$ 6,320	\$ 212
As of October 31, 2010		
Other current assets	\$ 5,680	\$
Accrued liabilities	\$ 11,626	\$ 1,554

**Table of Contents**

The following table represents the unaudited condensed consolidated statements of operations location and amount of gains and losses on 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) (in thousands)	Location of gain (loss) reclassified from OCI	Amount of gain (loss) reclassified from OCI (effective portion)
<b>Three months ended July 31, 2011</b>				
Foreign exchange contracts	Revenue	\$ (4,365)	Revenue	\$ (1,389)
Foreign exchange contracts	Operating expenses	650	Operating expenses	3,121
Total		\$ (3,715)		\$ 1,732
<b>Three months ended July 31, 2010</b>				
Foreign exchange contracts	Revenue	\$ (3,644)	Revenue	\$ 703
Foreign exchange contracts	Operating expenses	(3,413)	Operating expenses	(236)
Total		\$ (7,057)		\$ 467
<b>Nine months ended July 31, 2011</b>				
Foreign exchange contracts	Revenue	\$ (2,562)	Revenue	\$ (6,284)
Foreign exchange contracts	Operating expenses	7,653	Operating expenses	3,374
Total		\$ 5,091		\$ (2,910)
<b>Nine months ended July 31, 2010</b>				
Foreign exchange contracts	Revenue	\$ (2,565)	Revenue	\$ 1,601
Foreign exchange contracts	Operating expenses	(9,783)	Operating expenses	2,615
Total		\$ (12,348)		\$ 4,216

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

	Amount of gain (loss) recognized in statement of operations on derivatives (ineffective portion) (1)	Amount of gain (loss) recognized in statement of operations on derivatives (excluded from effectiveness testing)(2)
	(in thousands)	
<b>Three months ended July 31, 2011</b>		
Foreign exchange contracts	\$ 121	\$ (247)
<b>Three months ended July 31, 2010</b>		
Foreign exchange contracts	\$ 320	\$ (892)
<b>Nine months ended July 31, 2011</b>		

## Edgar Filing: SYNOPSIS INC - Form 10-Q

Foreign exchange contracts	\$ 75	\$	(267)
Nine months ended July 31, 2010			
Foreign exchange contracts	\$ 278	\$	(1,051)

- (1) The ineffective portion includes forecast inaccuracies.
- (2) The portion excluded from effectiveness includes the discount earned or premium paid for the contracts.



## **Table of Contents**

### **Note 4. 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, short-term investments, non-qualified deferred compensation plan assets, foreign currency derivative contracts and contingent consideration associated with business combinations.

The Company's cash equivalents and short-term investments 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.

During fiscal 2010, the Company recorded a liability for contingent consideration of \$7.8 million arising from a business combination which is payable over three years upon achievement of certain milestones. The fair value of the contingent consideration was determined at the acquisition date using the income approach based on the net present value of estimated payments and is re-measured at the end of each reporting period. The contingent consideration was classified within Level 3 as management assumptions for the valuation included discount rates and estimated probabilities of achievement of certain technical milestones which are unobservable in the market. Changes in fair value of the contingent consideration due to revisions to the estimated probabilities of achievement of technical milestones are recorded as operating expenses while changes due to time value are recorded in other (expense) income, net. The Company recorded a reduction of \$0.4 million and \$3.8 million during the three and nine months ended July 31, 2011, respectively, in research and development expenses due to the change in fair value of the liability for the contingent consideration. As of July 31, 2011, the fair value of the liability for contingent consideration was estimated at \$4.2 million.

**Table of Contents****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, 2011:

Description	Total as of July 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Fair Value Measurement Using	
			Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)				
<b>Assets</b>				
Cash and cash equivalents:				
Money market funds	\$ 579,702	\$ 579,702	\$	\$
Short-term investments:				
Municipal securities	148,395		148,395	
Prepaid and other current assets:				
Foreign currency derivative contracts	8,853		8,853	
Other long-term assets:				
Deferred compensation plan assets	93,253	93,253		
<b>Total assets</b>	<b>\$ 830,203</b>	<b>\$ 672,955</b>	<b>\$ 157,248</b>	<b>\$</b>
<b>Liabilities</b>				
Accounts payable and accrued liabilities:				
Foreign currency derivative contracts	\$ 6,532	\$	\$ 6,532	\$
Contingent consideration	2,065			2,065
Other long-term liabilities:				
Contingent consideration	2,161			2,161
<b>Total liabilities</b>	<b>\$ 10,758</b>	<b>\$</b>	<b>\$ 6,532</b>	<b>\$ 4,226</b>

**Table of Contents**

Assets and liabilities measured at fair value on a recurring basis are summarized below as of October 31, 2010:

Description	Total as of October 31, 2010	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)				
<b>Assets</b>				
Cash and cash equivalents:				
Money market funds	\$ 487,199	\$ 487,199	\$	\$
Short-term investments:				
Municipal securities	163,154		163,154	
Prepaid and other current assets:				
Foreign currency derivative contracts	5,680		5,680	
Other long-term assets:				
Deferred compensation plan assets	83,330	83,330		
<b>Total assets</b>	<b>\$ 739,363</b>	<b>\$ 570,529</b>	<b>\$ 168,834</b>	<b>\$</b>
<b>Liabilities</b>				
Accounts payable and accrued liabilities:				
Foreign currency derivative contracts	\$ 13,180	\$	\$ 13,180	\$
Contingent consideration	3,121			3,121
Other long-term liabilities:				
Contingent consideration	4,935			4,935
<b>Total liabilities</b>	<b>\$ 21,236</b>	<b>\$</b>	<b>\$ 13,180</b>	<b>\$ 8,056</b>

Equity investments in privately-held companies are accounted for under the cost method of accounting. These equity investments (also called non-marketable equity securities) 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. During the three months ended July 31, 2011, an equity investment with a cost basis of \$2.4 million was sold for \$3.2 million resulting in a \$0.8 million gain. As of July 31, 2011, the carrying value of equity investments was \$4.0 million.

The following non-marketable equity securities were measured and recorded at fair value within other long-term assets on a non-recurring basis. The losses on these securities were recorded in other (expense) income, net.

	Balance as of July 31, 2011	Significant Unobservable Inputs (Level 3)	Total	Total
			(losses) during three months ended July 31, 2011	(losses) during nine months ended July 31, 2011
(in thousands)				
Non-marketable equity securities	\$ 92	\$ 92	\$	\$ (999)
	Balance as of July 31, 2010	Significant Unobservable Inputs (Level 3)	Total (losses) during three months ended July 31, 2010	Total (losses) during nine months ended July 31, 2010

Edgar Filing: SYNOPSIS INC - Form 10-Q

	(in thousands)			
Non-marketable equity securities	\$ 452	\$ 452	\$ (468)	\$ (468)

**Table of Contents****Note 5. Goodwill and Intangible Assets**

Goodwill as of July 31, 2011 consisted of the following:

	(in thousands)
Balance at October 31, 2010	\$ 1,265,843
Adjustments(1)	(7,557)
<b>Balance at July 31, 2011</b>	<b>\$ 1,258,286</b>

(1) Adjustments relate to changes in estimates for acquisitions that closed in the prior fiscal year for which the purchase price allocation is still preliminary and achievement of certain milestones for an acquisition that closed prior to fiscal 2010.

Intangible assets as of July 31, 2011 consisted of the following:

	Gross Assets(1)	Accumulated Amortization(1) (in thousands)	Net Assets
Core/developed technology	\$ 209,326	\$ 93,399	\$ 115,927
Customer relationships	78,400	28,029	50,371
Contract rights intangible	32,400	17,489	14,911
Covenants not to compete	2,200	2,033	167
Trademarks and trade names	6,200	2,306	3,894
In-process research and development (IPR&D)	15,025		15,025
Capitalized software development costs	11,245	7,801	3,444
<b>Total</b>	<b>\$ 354,796</b>	<b>\$ 151,057</b>	<b>\$ 203,739</b>

(1) Intangible assets as of July 31, 2011 decreased as compared to October 31, 2010 primarily due to the retirement of fully amortized assets. Intangible assets as of October 31, 2010 consisted of the following:

	Gross Assets	Accumulated Amortization (in thousands)	Net Assets
Core/developed technology	\$ 263,592	\$ 118,587	\$ 145,005
Customer relationships	113,020	55,040	57,980
Contract rights intangible	30,400	9,522	20,878
Covenants not to compete	2,200	1,884	316
Trademarks and trade names	6,200	1,541	4,659
In-process research and development (IPR&D)	17,525		17,525
Capitalized software development costs	8,873	5,580	3,293
<b>Total</b>	<b>\$ 441,810</b>	<b>\$ 192,154</b>	<b>\$ 249,656</b>

Amortization expense related to intangible assets consisted of the following:

Edgar Filing: SYNOPSYS INC - Form 10-Q

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(in thousands)			
Core/developed technology	\$ 10,901	\$ 7,710	\$ 33,877	\$ 23,212
Customer relationships	3,248	2,088	9,809	6,607
Contract rights intangible	2,467	589	7,967	2,264
Covenants not to compete	50	88	150	563
Trademarks and trade names	255	136	765	429
Capitalized software development costs(1)	741	741	2,221	2,223
<b>Total</b>	<b>\$ 17,662</b>	<b>\$ 11,352</b>	<b>\$ 54,789</b>	<b>\$ 35,298</b>

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

**Table of Contents**

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

Fiscal Year	(in thousands)
Remainder of fiscal 2011	\$ 16,959
2012	59,561
2013	46,621
2014	28,250
2015	17,104
2016 and thereafter	20,219
IPR&D(1)	15,025
 Total	 \$ 203,739

- (1) IPR&D projects are estimated to be completed within two years as of July 31, 2011. Amortization will begin upon project completion or the asset will be written off upon abandonment.

**Note 6. Liabilities**

*Accounts Payable and Accrued Liabilities.* Accounts payable and accrued liabilities consist of:

	July 31, 2011	October 31, 2010
	(in thousands)	
Payroll and related benefits	\$ 217,484	\$ 216,079
Other accrued liabilities	52,099	73,230
Accounts payable	11,627	16,331
Acquisition related liabilities	3,253	7,210
 Total	 \$ 284,463	 \$ 312,850

*Other Long-term Liabilities.* Other long-term liabilities consist of:

	July 31, 2011	October 31, 2010
	(in thousands)	
Deferred compensation liability	\$ 93,253	\$ 83,330
Other long-term liabilities	14,596	18,555
 Total	 \$ 107,849	 \$ 101,885

**Note 7. Credit Facility**

On October 20, 2006, the Company entered into a five-year, \$300.0 million senior unsecured revolving credit facility providing for loans to the Company and certain of its foreign subsidiaries. The facility contains financial covenants requiring the Company to maintain a minimum leverage ratio and specified levels of cash, as well as other non-financial covenants. The facility terminates on October 20, 2011. Borrowings under the facility bear interest at the greater of the administrative agent's prime rate or the federal funds rate plus 0.50%; however, the Company has the option to pay interest based on the outstanding amount at Eurodollar rates plus a spread between 0.50% and 0.70% based on a pricing grid tied to a financial covenant. In addition, commitment fees are payable on the facility at rates between 0.125% and 0.175% per year based on

## Edgar Filing: SYNOPSIS INC - Form 10-Q

a pricing grid tied to a financial covenant. As of July 31, 2011, the Company had no outstanding borrowings under this credit facility and was in compliance with all the covenants.



**Table of Contents****Note 8. Comprehensive Income**

The following table presents the components of comprehensive income:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(in thousands)			
Net income	\$ 52,082	\$ 39,327	\$ 181,422	\$ 211,662
Change in unrealized gains (losses) on investments, net of tax of \$(9) and \$104, for the three and nine months ended July 31, 2011, respectively, and of \$43 and \$1,102 for each of the same periods in fiscal 2010, respectively	14	(66)	(163)	(1,670)
Deferred gains (losses) on cash flow hedges, net of tax of \$575 and \$(1,287), for the three and nine months ended July 31, 2011, respectively, and of \$1,461 and \$1,940 for each of the same periods in fiscal 2010, respectively	(3,646)	(7,321)	5,169	(12,570)
Reclassification adjustment on deferred (gains) losses on cash flow hedges, net of tax of \$401 and \$(541), for the three and nine months ended July 31, 2011, respectively, and of \$474 and \$2,095 for each of the same periods in fiscal 2010, respectively	(1,731)	(468)	2,910	(4,216)
Foreign currency translation adjustment	3,194	(126)	6,318	(1,502)
Total	\$ 49,913	\$ 31,346	\$ 195,656	\$ 191,704

**Note 9. 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 most recently replenished the stock repurchase program up to \$500.0 million on May 25, 2011. The Company repurchases shares to offset dilution caused by ongoing stock issuances from existing plans for equity compensation awards, 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, 2011, \$412.6 million remained available for further repurchases under the program. The following table summarizes stock repurchase activities as well as the reissuance of treasury stock for employee stock compensation purposes:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(in thousands, except per share price)			
Shares repurchased	3,830	3,476	12,439	5,755
Average purchase price per share	\$ 26.11	\$ 21.58	\$ 26.93	\$ 21.76
Aggregate purchase price	\$ 100,000	\$ 75,000	\$ 334,985	\$ 125,257
Reissuance of treasury stock	1,010	1,211	7,626	6,353

**Table of Contents****Note 10. Stock Compensation**

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(in thousands)			
Cost of license	\$ 1,375	\$ 1,585	\$ 4,092	\$ 5,116
Cost of maintenance and service	361	490	993	1,531
Research and development expense	6,157	6,366	19,868	19,863
Sales and marketing expense	2,812	3,030	7,987	9,544
General and administrative expense	2,810	3,043	8,490	9,160
Stock compensation expense before taxes	13,515	14,514	41,430	45,214
Income tax benefit	(3,671)	(3,327)	(11,252)	(10,363)
Stock compensation expense after taxes	\$ 9,844	\$ 11,187	\$ 30,178	\$ 34,851

As of July 31, 2011, there was \$112.2 million of unamortized share-based compensation expense which is expected to be amortized over a weighted-average period of approximately 2.8 years.

The intrinsic value of equity awards exercised during the periods below are as follow:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(in thousands)			
Intrinsic value of awards exercised	\$ 4,503	\$ 5,696	\$ 32,356	\$ 18,663

**Note 11. 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 effect of potential common shares outstanding such as stock options and unvested restricted stock units and awards during the period using the treasury stock method.

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 July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(in thousands)			
Numerator:				
Net income	\$ 52,082	\$ 39,327	\$ 181,422	\$ 211,662
Denominator:				
Weighted-average common shares for basic net income per share	144,960	148,006	147,479	147,909
Dilutive effect of common share equivalents from equity-based compensation	3,085	3,100	4,119	3,550
Weighted-average common shares for diluted net income per share	148,045	151,106	151,598	151,459

## Edgar Filing: SYNOPSIS INC - Form 10-Q

Anti-dilutive employee stock-based awards excluded(1)	5,469	12,188	3,593	10,995
---	-------	--------	-------	--------

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

**Table of Contents****Note 12. 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 Maker (CODM) in deciding how to allocate resources and in assessing performance. The Company's CODMs are the Company's Chief Executive Officer and Chief Operating Officer.

The Company provides software and hardware products and consulting services. The Company operates in a single segment. 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 of the Company's products are used 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.

The following table presents the revenues related to operations by geographic areas:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(in thousands)			
Revenue:				
United States	\$ 176,811	\$ 165,841	\$ 526,126	\$ 489,112
Europe	55,548	45,245	155,010	136,482
Japan	67,978	61,261	206,276	187,504
Asia-Pacific and other	86,458	64,582	257,697	192,104
Consolidated	\$ 386,795	\$ 336,929	\$ 1,145,109	\$ 1,005,202

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

One customer accounted for 10.5% and 10.9% of the Company's consolidated revenue for the three months ended July 31, 2011 and 2010, respectively, and accounted for 10.5% and 10.9% of the Company's consolidated revenue for the nine months ended July 31, 2011 and 2010, respectively.

**Note 13. Other (expense) income, net**

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011	2010	2011	2010
	(in thousands)			
Interest income	\$ 521	\$ 1,315	\$ 1,686	\$ 4,545
(Loss) gain on assets related to deferred compensation plan	(2,774)	(2,165)	5,845	3,662
Foreign currency exchange (loss) gain	(483)	(1,234)	1,732	(1,201)
Write-down of long-term investments		(468)	(999)	(468)
Other, net (1)	524	(494)	768	1,571
Total	\$ (2,212)	\$ (3,046)	\$ 9,032	\$ 8,109

## Edgar Filing: SYNOPSIS INC - Form 10-Q

- (1) Includes a \$0.8 million gain on the sale of an equity investment during the three and nine months ended July 31, 2011, and a \$2.1 million gain on the sale of an equity investment during the nine months ended July 31, 2010.

**Table of Contents****Note 14. 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 (benefit) for income taxes and the effective tax rates:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2011 (in thousands)	2010	2011 (in thousands)	2010
Income before income taxes	\$ 55,967	\$ 47,747	\$ 165,558	\$ 158,962
Provision (benefit) for income tax	\$ 3,885	\$ 8,420	\$ (15,864)	\$ (52,700)
Effective tax rate	6.9%	17.6%	(9.6)%	(33.2)%

The Company's effective tax rate for the three months ended July 31, 2011 is substantially lower than the statutory federal income tax rate of 35% primarily due to lower tax rates applicable to its non-U.S. operations partially offset by state taxes and non-deductible stock compensation. The provision for income taxes for the three and nine months ended July 31, 2011 also included the benefit of additional tax credits and deductions which were higher than those previously estimated as a result of the filing of the Company's federal tax return for fiscal 2010. The effective tax rates for the nine months ended July 31, 2011 and 2010 are both negative primarily due to the tax impact of favorable IRS settlements. The Company files income tax returns in the U.S. and various state and local jurisdictions. Its subsidiaries file tax returns in various foreign jurisdictions, including Ireland, Hungary, Taiwan and Japan. The Company remains subject to income tax examinations in the U.S. for fiscal years after 2009. In Ireland, Hungary, Taiwan and Japan, the Company's subsidiaries remain subject to tax examinations for fiscal years after 2005. See *IRS Examinations* below for the status of our current federal income tax audits.

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 sheet classification of current and non-current assets and liabilities. The Company believes that in the coming twelve months, it is reasonably possible that the statute of limitations on certain state and foreign income and withholding taxes will expire. 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 \$85 million.

**IRS Examinations**

The Company is regularly audited by the IRS. In the second quarter of fiscal 2011, the Company reached a final settlement with the Examination Division of the IRS for its audits of fiscal years 2006 through 2009. As a result of the settlement, the Company's unrecognized tax benefits decreased by \$35.9 million and the impact to other balance sheet tax accounts was not material. The net tax benefit resulting from the settlement was \$32.8 million.

The audit of certain returns filed by Synplicity, Inc. prior to its acquisition by the Company in May 2008 was finalized in the first quarter of fiscal 2011, which resulted in a decrease in unrecognized tax benefits of \$4.0 million.

In fiscal 2010, the Company reached a settlement with the IRS that resolved certain disputes related to the Company's acquisition of Avant! Corporation in 2002 that arose in the audit of its fiscal years 2002 through 2004. This settlement resulted in a decrease in the Company's tax expense for fiscal 2010 of approximately \$94.3 million, which is primarily due to the release of previously established tax liabilities of \$67.8 million, as well as a release of a valuation allowance of \$21.6 million for foreign tax credits which were utilized in connection with the settlement.

As a result of the IRS settlement of fiscal years 2002 through 2004, the Company's net deferred tax assets increased by \$55.4 million. The change is due primarily to increases in its deferred tax assets of \$72.3 million for certain costs that have been capitalized for tax purposes and will be amortized in future periods, partially offset by a decrease to deferred tax assets of \$25.2 million, due to the use of the Company's foreign tax credit carryover, net of the reversal of a valuation allowance.



## **Table of Contents**

### ***Non-U.S. Examinations***

The Company's subsidiaries are being audited in a number of jurisdictions, including Taiwan (for fiscal 2008) and Hungary (for fiscal 2007 and fiscal 2008). To date, the Company has not received any notices of proposed adjustments resulting from these audits. The Company believes that it has adequately provided for potential tax adjustments in both jurisdictions.

### **Note 15. Contingencies**

The Company is subject to routine legal proceedings, as well as demands, claims and threatened litigation that arise in the normal course of its business. The ultimate outcome of any litigation is uncertain and unfavorable outcomes could have a negative impact on the Company's financial position and results of operations.

### **Note 16. Effect of New Accounting Pronouncements**

Beginning in the first quarter of fiscal 2011, the Company adopted recent accounting guidance for revenue arrangements with multiple deliverables on a prospective basis. This guidance addresses whether to treat individual deliverables or groups of deliverables in a multiple-element arrangement as separate units of accounting and how to allocate the arrangement consideration to the separate units of accounting. The guidance also requires that arrangement consideration be allocated to software deliverables (as a group) and to non-software deliverables (individually) based on relative standalone selling prices and provides guidance for estimating standalone selling prices for purposes of allocating arrangement consideration. The guidance does not affect the accounting for contracts which do not contain non-software deliverables.

The Company infrequently enters into multiple-element arrangements that contain both software and non-software deliverables such as hardware which are impacted by the new guidance. Such contracts are not material either individually or in the aggregate to the unaudited condensed consolidated financial statements. Accordingly, the adoption of the new guidance was not material to the Company's unaudited condensed consolidated financial statements and is not expected to have a material effect on subsequent periods.

In June 2011, the FASB issued new guidance regarding the presentation of comprehensive income in financial statements to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of equity. The new guidance will be effective on a retrospective basis in the first quarter of fiscal 2013 and early adoption is permitted. The Company is currently assessing the impact of adoption of the guidance on its consolidated financial statements.

In May 2011, the FASB issued new guidance for fair value measurements to achieve common fair value measurement and disclosure requirements. The new requirements are effective on a prospective basis in the first quarter of fiscal 2013. The Company is currently assessing the impact of adoption of the guidance on its consolidated financial statements.

With the exception of the discussion above, the effect of recent accounting pronouncements has not changed from the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 2010.



**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This Quarterly Report on Form 10-Q, and in particular the following discussion, 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). These statements can, in some cases, be identified by the use of terms such as may, will, could, would, should, anticipate, expect, intend, believe, estimate, project or continue, the negatives of such terms, or other comparable terminology. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are 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 the expected growth in the semiconductor industry, our positive business outlook, the ability of our prior acquisitions to drive revenue growth, the percent of revenue with which we expect to enter each quarter, our expectations with respect to organic and inorganic growth opportunities, our ability to make adjustments to our business as market conditions change, our ability to successfully execute our strategies, the sufficiency of our cash, cash equivalents and short-term investments and cash generated from operations, and our future liquidity requirements.*

*These statements involve certain known and unknown risks and uncertainties that could cause our actual results 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 is given as of the filing date of this Form 10-Q with the Securities and Exchange Commission (SEC) and future events or circumstances could differ significantly from these forward-looking statements. Accordingly, we caution readers not to place undue reliance on these statements. Unless required by law, we undertake no obligation to update publicly any forward-looking statements. 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 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, 2010, as filed with the SEC on December 17, 2010 and amended on February 9, 2011.*

*Fiscal Year End. Our fiscal year ends on the Saturday nearest to October 31. Our third quarter of fiscal 2011 ended on July 30, 2011. Fiscal 2011 and fiscal 2010 are both 52-week fiscal years. For presentation purposes, this Form 10-Q, including the unaudited condensed consolidated financial statements and accompanying notes, refers to the closest calendar month end.*

**Overview***Business Summary*

Synopsys is a world leader in providing technology solutions used to develop electronics 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 supply software and hardware used to develop the systems that incorporate integrated circuits and the software that runs on those integrated circuits. Our intellectual property (IP) products are pre-designed circuits that engineers use as components of larger chip designs rather than redesigning those circuits themselves. To complement these product offerings, we provide technical services to support our solutions and we help our customers develop chips and electronic systems.

Our customers are generally large semiconductor and electronics manufacturers. 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 impacted by their business outlook and their willingness to invest in new and increasingly complex chip designs.

Despite recent 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 recurring revenue business model. Under this model, a substantial majority of our customers pay for their licenses over time and we typically recognize this recurring revenue over the life of the contract, which averages approximately three years. Recurring revenue generally represents more than 90% of our



## **Table of Contents**

total revenue. The revenue we recognize in a particular period generally results from selling efforts in prior periods rather than the current period. We typically enter each quarter with greater than 90% of our revenue for that particular quarter already committed from our customers, providing for stability and predictability of results. Due to our business model, decreases as well as increases in customer spending do not immediately affect our revenues in a significant way.

The semiconductor industry has experienced moderate growth to date in 2011. However, our semiconductor customers remain cautious and focused on their costs due to the cyclical nature of the industry, the increasing complexity of product development and macroeconomic factors. The recent instability of global markets may create a more challenging environment for our customers to plan investment in research and development.

Nevertheless, our business outlook is positive based on growth forecasts for the semiconductor industry and our strong financials, diligent expense management, and acquisition strategy. Through our recent acquisitions, we have enhanced our technology and expanded our product portfolio and our total addressable market, especially in IP and system-level solutions, which we believe will help drive revenue growth. We expect to explore both organic and inorganic growth opportunities, including acquiring companies or technology that can contribute to the strategic, operational and financial performance of our business. We will continue to monitor worldwide economic growth rates, the considerable volatility of current global markets and other macroeconomic factors and may make adjustments to our business in the event that the semiconductor industry is unable to maintain current spending levels for our solutions. We believe that the combination of our solid financials, leading technology and strong customer relationships will help us successfully execute our strategies.

### *Financial Performance Summary for the Three Months Ended July 31, 2011*

We continued to derive more than 90% of our revenue from time-based licenses, maintenance and services.

Our total revenue of \$386.8 million increased by \$49.9 million, or 15%, from \$336.9 million in the same period of fiscal 2010. The increase was attributable to our overall growth, including sales of products associated with our prior-year acquisitions, which resulted in increased time-based license revenue, upfront license revenue and professional services revenue.

Our cost of revenue and operating expenses increased compared to the same period in fiscal 2010 primarily due to increases in employee-related costs driven by increased headcount and other direct costs from our prior-year acquisitions.

Our net income of \$52.1 million increased by \$12.8 million, or 33%, from \$39.3 million in the same period of fiscal 2010. The increase was primarily due to overall revenue growth and a lower effective tax rate in fiscal 2011.

Our net cash from operating activities of \$367.3 million for the nine months ended July 31, 2011, an increase of \$123.2 million, or 50%, from \$244.1 million in the same period of fiscal 2010. This increase was primarily from increased customer collections due to our volume of contracts and the timing of billings to customers.

### ***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 U.S. 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.

We describe our revenue recognition policy below. Our remaining 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, 2010, filed with the SEC on December 17, 2010 and amended on February 9, 2011.

---

**Table of Contents**

*Revenue Recognition.*

Software license revenue consists of fees associated with the licensing of our software. Maintenance and service revenue consists of maintenance fees associated with perpetual and term licenses and professional services fees. Hardware revenue consists of Field Programmable Gate Array (FPGA) board-based 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 also enter into arrangements in which portions of revenue are contingent upon the occurrence of uncertain future events, for example, royalty arrangements. We refer to this revenue as contingent revenue. Contingent revenue is recognized if and when the applicable event occurs. It is reported as time-based revenue in the unaudited condensed consolidated statements of operations. Historically, these arrangements have not been material to our total revenue.

We recognize revenue from hardware sales in full upon shipment if all other revenue recognition criteria are met. Revenue attributable to these hardware sales is reported as upfront license revenue in the unaudited condensed consolidated statements of operations. Hardware sales have not been material to our total revenue.

## Edgar Filing: SYNOPSYS INC - Form 10-Q

We infrequently enter into multiple-element arrangements that contain both software and non-software deliverables such as hardware. On a prospective basis beginning in our first quarter of fiscal 2011, we apply recently issued accounting guidance for revenue arrangements with multiple deliverables for these contracts. The adoption of the new guidance did not have a material effect on our unaudited condensed consolidated financial statements, is not expected to have a material effect on subsequent periods and did not affect the accounting for contracts which do not contain non-software deliverables. The recent accounting guidance addresses whether to treat individual deliverables or groups of deliverables in a multiple-element arrangement as separate units of accounting and how to allocate the arrangement consideration to the separate units of accounting. The guidance also requires that arrangement consideration be allocated to software deliverables (as a group) and to non-software deliverables (individually) based on relative standalone selling prices and provides guidance for estimating standalone selling prices for purposes of allocating arrangement consideration.

---

**Table of Contents**

We have determined that the software and non-software deliverables in our contracts are separate units of accounting. Prior to our first quarter of fiscal 2011, all deliverables in our contracts were considered one unit of accounting unless we had vendor-specific objective evidence (VSOE) of fair value for all undelivered elements. We now allocate arrangement consideration to separate units of accounting based on estimated standalone selling prices (ESP) because we do not have objective evidence of standalone selling prices. We estimate the standalone selling prices of our separate units of accounting considering both market conditions and our own specific conditions. For hardware deliverables, we determine ESP using cost plus a margin because we have consistent pricing practices and gross margins for these products. Determining the ESP for software deliverables requires significant judgment. We determine ESP for software deliverables after considering customer geographies, market demand and competition at the time of contract negotiation, gross margin objectives, existing portfolio pricing practices, contractually stated prices and prices for similar historical transactions.

Under the recent accounting guidance we recognize revenue for our separate units of accounting when all revenue recognition criteria are met. Revenue allocated to hardware units of accounting is recognized upon delivery when all other revenue recognition criteria are met. Revenue allocated to software units of accounting is recognized according to the methods described above depending on the software license type (TSL, term license or perpetual license).

We recognize revenue from maintenance fees ratably over the maintenance period to the extent cash has been received or fees become due and payable, and recognize revenue from professional services and training fees as such services are performed and accepted by the customer. Revenue attributable to maintenance, professional services and training is reported as maintenance and service revenue in the unaudited condensed consolidated statements of operations.

We also enter into arrangements to deliver software products, either alone or together with other products or services that require significant modification, or customization of the software. We account for such arrangements using the percentage of completion method as we have the ability to make reasonably dependable estimates that relate to the extent of progress toward completion, contract revenues and costs. We measure the progress towards completion using the labor hours incurred to complete the project. Revenue attributable to these arrangements is reported as maintenance and service revenue in the unaudited condensed consolidated statements of operations.

We determine the fair value of each element in multiple element software arrangements based on VSOE. We limit our assessment of VSOE of fair value for each element to the price charged when such element is sold separately. We have analyzed all of the elements included in our multiple-element software arrangements and have determined that we have sufficient VSOE to allocate revenue to the maintenance components of our perpetual and term license products and to professional services. Accordingly, assuming all other revenue recognition criteria are met, we recognize license revenue from perpetual and term licenses upon delivery using the residual method, recognize revenue from maintenance ratably over the maintenance term, and recognize revenue from professional services as services are performed or as milestones are met and accepted. We recognize revenue from TSLs ratably over the term of the license, assuming all other revenue recognition criteria are met, since there is not sufficient VSOE to allocate the TSL fee between license and maintenance services.

We make significant judgments related to revenue recognition. Specifically, in connection with each transaction involving our products, we must evaluate whether: (1) persuasive evidence of an arrangement exists, (2) delivery of software or services has occurred, (3) the fee for such software or services is fixed or determinable, and (4) collectability of the full license or service fee is probable. All four of these criteria must be met in order for us to recognize revenue with respect to a particular arrangement. We apply these revenue recognition criteria as follows:

**Persuasive Evidence of an Arrangement Exists.** Prior to recognizing revenue on an arrangement, our customary policy is to have a written contract, signed by both the customer and by us or a purchase order from those customers that have previously negotiated a standard end-user license arrangement or purchase agreement.

**Delivery Has Occurred.** We deliver our products to our customers electronically or physically. For electronic deliveries, delivery occurs when we provide access to our customers to take immediate possession of the software through downloading it to the customer's hardware. For physical deliveries, the standard transfer terms are typically FOB shipping point. We generally ship our products or license keys promptly after acceptance of customer orders. However, a number of factors can affect the timing of product shipments and, as a result, timing of revenue recognition, including the delivery dates requested by customers and our operational capacity to fulfill product orders at the end of a fiscal quarter.

**Table of Contents**

The Fee is Fixed or Determinable. Our determination that an arrangement fee is fixed or determinable depends principally on the arrangement's payment terms. Our standard payment terms for perpetual and term licenses require 75% or more of the license fee and 100% of the maintenance fee to be paid within one year. If the arrangement includes these terms, we regard the fee as fixed or determinable, and recognize all license revenue under the arrangement in full upon delivery (assuming all other revenue recognition criteria are met). If the arrangement does not include these terms, we do not consider the fee to be fixed or determinable and generally recognize revenue when customer installments are due and payable. In the case of a TSL, because of the right to exchange products or receive unspecified future technology and because VSOE for maintenance services does not exist for a TSL, we recognize revenue ratably over the term of the license, but not in advance of when customer's installments become due and payable.

Collectability is Probable. We judge collectability of the arrangement fees on a customer-by-customer basis pursuant to our credit review policy. We typically sell to customers with whom we have a history of successful collection. For a new customer, or when an existing customer substantially expands its commitments, we evaluate the customer's financial position and ability to pay and typically assign a credit limit based on that review. We increase the credit limit only after we have established a successful collection history with the customer. If we determine at any time that collectability is not probable under a particular arrangement based upon our credit review process or the customer's payment history, we recognize revenue under that arrangement as customer payments are actually received.

***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. Under current accounting rules and policies, 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. Substantially all of our current time-based licenses are TSLs with an average license term of approximately three years. Revenue on maintenance orders is recognized ratably over the maintenance period (normally one year). Revenue on professional services orders is generally recognized upon completion and customer acceptance of contractually agreed milestones. 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.

Our revenue in any fiscal quarter is equal to the sum of our time-based license, upfront license, maintenance and professional services and hardware revenue for the period. We derive time-based license revenue in any quarter 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 the quarter. We derive maintenance revenue in any quarter largely from maintenance orders received in prior quarters 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, 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, perpetual and term licenses with greater than 75% of the license fee due within one year from shipment typically generate current quarter revenue but no future revenue (e.g., a \$120,000 order for a perpetual license 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



**Table of Contents**

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*

	2011	July 31, 2010	Dollar Change	% Change
	(dollars in millions)			
Three months ended	\$ 386.8	\$ 336.9	\$ 49.9	15%
Nine months ended	\$ 1,145.1	\$ 1,005.2	\$ 139.9	14%

Our revenues are subject to fluctuations, primarily due to customer requirements, including payment terms, the timing and value of contract renewals and the sale of products associated with prior-year acquisitions.

The increase in total revenue for the three and nine months ended July 31, 2011 compared to the same periods in fiscal 2010 was due to our overall growth and the related increase in time-based revenue, upfront revenue and professional services revenue primarily driven by the timing and value of contract renewals, sales of products and professional services contracts including contracts assumed from our prior-year acquisitions.

*Time-Based License Revenue*

	2011	July 31, 2010	Dollar Change	% Change
	(dollars in millions)			
Three months ended	\$ 322.1	\$ 286.6	\$ 35.5	12%
Percentage of total revenue	83%	85%		
Nine months ended	\$ 936.5	\$ 847.7	\$ 88.8	10%
Percentage of total revenue	82%	84%		

The increase in time-based license revenue for the three months and nine months ended July 31, 2011 compared to the same periods in fiscal 2010 was primarily attributable to increases in TSL license revenue from arrangements booked in prior periods, higher contingent revenue and product sales from prior-year acquisitions.

*Upfront License Revenue*

	2011	July 31, 2010	Dollar Change	% Change
	(dollars in millions)			
Three months ended	\$ 19.0	\$ 14.7	\$ 4.3	29%
Percentage of total revenue	5%	4%		
Nine months ended	\$ 70.6	\$ 47.8	\$ 22.8	48%
Percentage of total revenue	6%	5%		

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 increase in upfront license revenue for the three and nine months ended July 31, 2011 compared to the same periods in fiscal 2010 was primarily attributable to the increase in sales of our hardware products, perpetual licenses and new products associated with prior-year acquisitions.

**Table of Contents***Maintenance and Service Revenue*

	2011	July 31, 2010	Dollar Change (dollars in millions)	% Change
<b>Three months ended</b>				
Maintenance revenue	\$ 18.7	\$ 19.9	\$ (1.2)	(6)%
Professional services and other revenue	26.9	15.8	11.1	70%
<b>Total maintenance and services revenue</b>	<b>\$ 45.6</b>	<b>\$ 35.7</b>	<b>\$ 9.9</b>	<b>28%</b>
Percentage of total revenue	12%	11%		
<b>Nine months ended</b>				
Maintenance revenue	\$ 59.0	\$ 59.0	\$	%
Professional services and other revenue	79.0	50.7	28.3	56%
<b>Total maintenance and services revenue</b>	<b>\$ 138.0</b>	<b>\$ 109.7</b>	<b>\$ 28.3</b>	<b>26%</b>

Percentage of total revenue 12% 11%

Maintenance revenue was relatively flat for the three and nine months ended July 31, 2011 compared to the same periods in fiscal 2010 primarily due to the timing of renewals of maintenance contracts.

Professional services and other revenue increased substantially in the three and nine months ended July 31, 2011 compared to the same periods in fiscal 2010, primarily due to professional services contracts assumed from prior acquisitions.

*Cost of Revenue*

	2011	July 31, 2010	Dollar Change (dollars in millions)	% Change
<b>Three months ended</b>				
Cost of license revenue	\$ 52.1	\$ 44.0	\$ 8.1	18%
Cost of maintenance and service revenue	19.2	14.7	4.5	31%
Amortization of intangible assets	13.4	8.0	5.4	68%
<b>Total</b>	<b>\$ 84.7</b>	<b>\$ 66.7</b>	<b>\$ 18.0</b>	<b>27%</b>
Percentage of total revenue	22%	20%		
<b>Nine months ended</b>				
Cost of license revenue	\$ 153.8	\$ 130.2	\$ 23.6	18%
Cost of maintenance and service revenue	59.8	46.5	13.3	29%
Amortization of intangible assets	41.5	24.7	16.8	68%
<b>Total</b>	<b>\$ 255.1</b>	<b>\$ 201.4</b>	<b>\$ 53.7</b>	<b>27%</b>

Percentage of total revenue 22% 20%

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.

## Edgar Filing: SYNOPSIS INC - Form 10-Q

*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 which 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.

**Table of Contents**

*Amortization of intangible assets.* Intangible assets are amortized to cost of revenue and operating expenses, and include the contract rights associated with certain contracts and core/developed technology, trademarks, trade names, customer relationships, covenants not to compete and other intangibles related to acquisitions.

The increase in cost of revenue in the three months ended July 31, 2011 compared to the same period in fiscal 2010 was primarily due to an increase of \$6.4 million in personnel-related costs as a result of headcount increases from our prior-year acquisitions, an increase of \$5.0 million in maintenance and professional services driven by higher consulting service activities, and an increase of \$5.4 million for amortization of intangible assets due to our prior-year acquisitions.

The increase in cost of revenue in the nine months ended July 31, 2011 compared to the same period in fiscal 2010 was primarily due to an increase in \$15.0 million in personnel-related costs as a result of headcount increases from our prior-year acquisitions, an increase of \$15.1 million in maintenance and professional services, an increase of \$3.9 million in hardware and license costs, and an increase of \$16.8 million for amortization of intangible assets due to our prior-year acquisitions.

As a percentage of total revenue, cost of revenue marginally increased in the three and nine months ended July 31, 2011 compared to the same periods in fiscal 2010 due to an increase in professional services contracts and an increase in amortization of intangible assets assumed in our prior-year acquisitions.

**Operating Expenses***Research and Development*

	2011	July 31, 2010	Dollar Change (dollars in millions)	% Change
Three months ended	\$ 122.5	\$ 105.6	\$ 16.9	16%
Percentage of total revenue	32%	31%		
Nine months ended	\$ 366.5	\$ 319.9	\$ 46.6	15%
Percentage of total revenue	32%	32%		

The increase in research and development expenses in the three months ended July 31, 2011 compared to the same period in fiscal 2010 was primarily due to an increase of \$13.3 million in personnel-related costs and an increase of \$2.9 million in functionally allocated expenses as a result of headcount increases from our prior-year acquisitions.

The increase in research and development expenses for the nine months ended July 31, 2011 compared with the same period in fiscal 2010 was primarily due to an increase of \$33.7 million in personnel-related costs, an increase of \$11.1 million in functionally allocated expenses as a result of headcount increases from our prior-year acquisitions, and \$3.6 million of other expenses including third party contractor services, partially offset by a decrease of \$3.7 million due to change in the fair value of contingent consideration related to a prior-year acquisition.

*Sales and Marketing*

	2011	July 31, 2010	Dollar Change (dollars in millions)	% Change
Three months ended	\$ 90.7	\$ 83.8	\$ 6.9	8%
Percentage of total revenue	23%	25%		
Nine months ended	\$ 269.6	\$ 242.8	\$ 26.8	11%
Percentage of total revenue	24%	24%		

The increase in sales and marketing expenses for the three months ended July 31, 2011 compared to the same period in fiscal 2010 was primarily attributable to higher variable compensation of \$2.4 million driven by timing of shipments based on contract requirements and the increase in license revenues, and an increase of \$4.3 million in other personnel-related costs due to an increase in headcount from prior-year acquisitions.

## Edgar Filing: SYNOPSIS INC - Form 10-Q

The increase in sales and marketing expenses for the nine months ended July 31, 2011 compared to the same period in fiscal 2010 was primarily attributable to higher variable compensation of \$12.8 million driven by the volume of contracts and timing of shipments based on contract requirements and the increase in license revenues, an increase of \$10.0 million in other personnel-related costs due to an increase in headcount from prior-year acquisitions, and an increase of \$2.3 million in travel-related costs.

**Table of Contents***General and Administrative*

	2011	July 31, 2010	Dollar Change (dollars in millions)	% Change
Three months ended	\$ 27.1	\$ 27.4	\$ (0.3)	(1)%
Percentage of total revenue	7%	8%		
Nine months ended	\$ 86.4	\$ 81.9	\$ 4.5	5%
Percentage of total revenue	8%	8%		

General and administrative expenses for the three months ended July 31, 2011 compared to the same period in fiscal 2010 were relatively flat. The decrease of \$2.3 million in functionally allocated expenses as a result of increased headcount in other functional areas was offset by an increase of \$2.8 million in personnel-related costs and facility expenses as a result of headcount increases from our prior-year acquisitions.

The increase in general and administrative expenses for the nine months ended July 31, 2011 compared to the same period in fiscal 2010 was primarily due to an increase of \$5.7 million in personnel-related costs, \$6.7 million in facility expenses and \$4.0 million in other general and administrative expenses primarily as a result of headcount increases from our prior-year acquisitions. The increases were partially offset by a decrease of \$13.5 million in functionally allocated expenses as a result of increased headcount in other functional areas.

*Amortization of Intangible Assets*

	2011	July 31, 2010	Dollar Change (dollars in millions)	% Change
Three months ended				
Included in cost of revenue	\$ 13.4	\$ 8.0	\$ 5.4	68%
Included in operating expenses	3.6	2.6	1.0	38%
Total	\$ 17.0	\$ 10.6	\$ 6.4	60%
Percentage of total revenue	4%	3%		
Nine months ended				
Included in cost of revenue	\$ 41.5	\$ 24.7	\$ 16.8	68%
Included in operating expenses	11.1	8.3	2.8	34%
Total	\$ 52.6	\$ 33.0	\$ 19.6	59%
Percentage of total revenue	5%	3%		

The increase in amortization of intangible assets for the three and nine months ended July 31, 2011 compared to the same periods in fiscal 2010 was due to the amortization of intangible assets from our prior-year acquisitions, partially offset by certain intangible assets becoming fully amortized. See Note 5 to *Notes to Unaudited Condensed Consolidated Financial Statements* for a schedule of future amortization amounts.

**Table of Contents****Other (expense) income, net**

	July 31, 2011	July 31, 2010	Dollar Change (dollars in millions)	% Change
<b>Three months ended</b>				
Interest income	\$ 0.5	\$ 1.3	\$ (0.8)	(62)%
Loss on assets related to deferred compensation plan	(2.8)	(2.2)	(0.6)	27%
Foreign currency exchange (loss) gain	(0.4)	(1.2)	0.8	(67)%
Write-down of long-term investments		(0.5)	0.5	(100)%
Other, net	0.5	(0.4)	0.9	(225)%
<b>Total</b>	<b>\$ (2.2)</b>	<b>\$ (3.0)</b>	<b>\$ 0.8</b>	<b>(27)%</b>
<b>Nine months ended</b>				
Interest income	\$ 1.7	\$ 4.5	\$ (2.8)	(62)%
Gain on assets related to deferred compensation plan	5.8	3.7	2.1	57%
Foreign currency exchange (loss) gain	1.7	(1.2)	2.9	(242)%
Write-down of long-term investments	(1.0)	(0.5)	(0.5)	100%
Other, net	0.8	1.6	(0.8)	(50)%
<b>Total</b>	<b>\$ 9.0</b>	<b>\$ 8.1</b>	<b>\$ 0.9</b>	<b>11%</b>

Other (expense) income, net, increased during the three and nine months ended July 31, 2011 compared to the same periods in fiscal 2010 due to the changes described above.

**Taxes**

Our effective tax rate for the three months ended July 31, 2011 as compared to the three months ended July 31, 2010 is lower principally due to the benefit of additional tax credits and deductions which were higher than those previously estimated as a result of the filing of the Company's federal tax return for the fiscal 2010, the impact of an entire year of federal research and development tax credit in fiscal 2011 versus only two months in fiscal 2010 and the reversal of valuation allowance for capital losses in the third quarter of fiscal 2011. Our effective tax rates for the nine months ended July 31, 2011 and 2010 are negative, primarily due to the tax impact of a final settlement with the IRS for fiscal years 2006 through 2009 of \$32.8 million in fiscal 2011 and the final settlement with the IRS for fiscal years 2002 through 2004 of \$94.3 million in fiscal 2010. Without the impact of the settlements, the tax rate for the nine months ended July 31, 2011 and 2010 would have been 10.2% and 26.2%, respectively.

For further discussion of the effective tax rate and the IRS settlement, see Note 14 of the *Notes to Unaudited Condensed Consolidated Financial Statements*.

**Liquidity and Capital Resources**

Our sources of cash, cash equivalents and short-term investments are funds generated from our business operations and funds that may be drawn down under our credit facility.

As of July 31, 2011, we held an aggregate of \$337.7 million in cash, cash equivalents and short-term investments in the U.S. and an aggregate of \$700.6 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.

The following sections discuss changes in our balance sheet and cash flows, and other commitments on our liquidity and capital resources during fiscal 2011.





**Table of Contents***Cash and Cash Equivalents and Short-Term Investments*

	July 31, 2011	October 31, 2010 (dollars in millions)	Dollar Change	% Change
Cash and cash equivalents	\$ 889.9	\$ 775.4	\$ 114.5	15%
Short-term investments	148.4	163.2	(14.8)	(9)%
<b>Total</b>	<b>\$ 1,038.3</b>	<b>\$ 938.6</b>	<b>\$ 99.7</b>	<b>11%</b>

During the nine months ended July 31, 2011, our primary sources and uses of cash consisted of (1) cash provided by operating activities of \$367.3 million, (2) proceeds from sales and maturities of short-term investments of \$104.0 million, (3) purchases of investments of \$92.6 million, (4) cash paid for purchases of property and equipment of \$42.8 million, (5) proceeds from the issuance of common stock of \$119.8 million for stock awards and (6) repurchases of common stock of \$335.0 million.

*Cash Flows*

	July 31, 2011	July 31, 2010 (dollars in millions)	Dollar Change	% Change
<b>Nine months ended</b>				
Cash provided by operating activities	\$ 367.3	\$ 244.1	\$ 123.2	50%
Cash used in investing activities	(39.1)	(24.8)	(14.3)	58%
Cash used in financing activities	(219.8)	(41.6)	(178.2)	428%

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, 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 contrast, payment terms for TSLs are generally extended and the license fee is typically paid either quarterly or annually over the term of the license.

*Cash provided by operating activities.* Cash provided by operations is dependent primarily upon the payment terms of our license agreements. To be classified as upfront revenue, we require that 75% of a term or perpetual license fee be paid within the first year. Conversely, terms for TSLs are generally extended and the license fee is typically paid either quarterly or annually over the term of the license. Accordingly, we generally receive cash from upfront license revenue much sooner than from time-based license revenue.

Cash provided by operating activities increased in the nine months ended July 31, 2011 compared to the same period in fiscal 2010, primarily due to fluctuation in operating assets and liabilities resulting from changes in deferred revenue balances based on timing of release, an increase in collections from customers, offset by higher payments to vendors, and an increase in inventory balances.

*Cash used in investing activities.* The decrease in cash used in investing activities in the nine months ended July 31, 2011 compared to the same period in fiscal 2010 is due to higher cash used for capital expenditures in fiscal 2011 and higher net proceeds from short-term investments activity in fiscal 2010, offset by lower cash payments for acquisitions in 2011.

*Cash used in financing activities.* The increase in cash used in financing activities in the nine months ended July 31, 2011 compared to the same period in fiscal 2010 primarily relates to common stock repurchases under our stock repurchase program, partially offset by issuances of our common stock under our stock compensation plans. See Note 9 of *Notes to Unaudited Condensed Consolidated Financial Statements* for details of our stock repurchase program.

**Table of Contents***Accounts Receivable, net*

	July 31, 2011	October 31, 2010 (dollars in millions)	Dollar Change	% Change
	\$ 175.4	\$181.1	\$(5.7)	(3)%

Our accounts receivable and Days Sales Outstanding (DSO) are primarily driven by our billing and collections activities. Our DSO was 41 days at July 31, 2011, and 44 days at October 31, 2010. The decrease in DSO and in net accounts receivable primarily relates to the timing of billings to customers during fiscal 2011.

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

	July 31, 2011	October 31, 2010 (dollars in millions)	Dollar Change	% Change
Current assets	\$ 1,362.3	\$ 1,247.8	\$ 114.5	9%
Current liabilities	982.1	921.8	60.3	7%
Working capital	\$ 380.2	\$ 326.0	\$ 54.2	17%

Changes in our working capital were primarily due to (1) a \$99.7 million increase in cash, cash equivalents and short-term investments, (2) a decrease of \$28.4 million in accounts payable and accrued liabilities, (3) a \$94.0 million increase in deferred revenue due to timing of our billings and (4) a net \$14.8 million increase in accounts receivable and other current assets balances primarily related to movements in foreign exchange contract fair values, timing of inventory purchases, income tax balances and increased receivables from the sale of strategic investments during the first 3 quarters of our fiscal year.

*Other Commitments - Revolving Credit Facility.* On October 20, 2006, we entered into a five-year, \$300.0 million senior unsecured revolving credit facility providing for loans to us and certain of our foreign subsidiaries. The facility contains financial covenants requiring us to maintain a minimum leverage ratio and specified levels of cash, as well as other non-financial covenants. The facility terminates on October 20, 2011. Borrowings under the facility bear interest at the greater of the administrative agent's prime rate or the federal funds rate plus 0.50%; however, we have the option to pay interest based on the outstanding amount at Eurodollar rates plus a spread between 0.50% and 0.70% based on a pricing grid tied to a financial covenant. In addition, commitment fees are payable on the facility at rates between 0.125% and 0.175% per year based on a pricing grid tied to a financial covenant. As of July 31, 2011, we had no outstanding borrowings under this credit facility and were in compliance with all covenants.

*Other*

Our cash equivalent and short-term investment portfolio as of July 31, 2011, consists of investment grade municipal securities, 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. The policy sets forth credit quality standards and limits our exposure to any one issuer. As of July 31, 2011, we had no direct holdings in structured investment vehicles, sub-prime mortgage-backed securities or collateralized debt obligations and no exposure to these financial instruments through our indirect holdings in money market mutual funds. During the three and nine months ended July 31, 2011 and 2010, we had no impairment charge associated with our short-term investment portfolio. While we cannot predict future market conditions or market liquidity, we regularly review our investments and associated risk profiles, which we believe will allow us to effectively manage the risks of our investment portfolio.

As a result of the challenging conditions in the financial markets, we proactively manage our cash and cash equivalents and investments balances and closely monitor our capital and stock repurchase expenditures to ensure ample liquidity. Additionally, we believe the overall credit quality of our portfolio is strong, with our global excess cash, and our cash equivalents and fixed income portfolio invested in banks and securities with a weighted-average credit rating exceeding AA. After the recent downgrade of the U.S. long-term sovereign credit rating by Standard & Poor's, our portfolio maintained its weighted average credit rating above AA. The majority of our investments are classified as Level

## Edgar Filing: SYNOPSIS INC - Form 10-Q

1 or Level 2 investments, as measured under fair value guidance. See Notes 3 and 4 of the *Notes to Unaudited Condensed Consolidated Financial Statements*.

We believe that our current cash, cash equivalents, short-term investments, and cash generated from operations will satisfy our business requirements for at least the next twelve months.

---

**Table of Contents**

***Effect of New Accounting Pronouncements***

See Note 16 of the *Notes to Unaudited Condensed Consolidated Financial Statements*.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As of July 31, 2011, our exposure to market risk has not changed materially since October 31, 2010. The average yield at purchase for our short-term investment portfolio remains approximately the same as of October 31, 2010. For more information on financial market risks related to changes in interest rates and foreign currency exchange 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, 2010, filed with the SEC on December 17, 2010 and amended on February 9, 2011.

**ITEM 4. CONTROLS AND PROCEDURES**

- (a) *Evaluation of Disclosure Controls and Procedures.* As of July 31, 2011 (the Evaluation Date), Synopsys carried out an evaluation under the supervision and with the participation of Synopsys management, including the Chief Executive Officer 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 Chief Executive Officer and Chief Financial Officer have concluded that, as of July 31, 2011, (1) Synopsys disclosure controls and procedures were designed to provide reasonable assurance of achieving their objectives, and (2) 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 Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding its required disclosure.
- (b) *Changes in Internal Control Over Financial Reporting.* There were no changes in Synopsys internal control over financial reporting during the three months ended July 31, 2011, that have materially affected, or are reasonably likely to materially affect, Synopsys internal control over financial reporting.

**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.

**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.*

## Edgar Filing: SYNOPSYS INC - Form 10-Q

As a result of the recent global recession, the global economy experienced significant uncertainty, stock market volatility, tightened credit markets, concerns about both deflation and inflation, reduced demand for products, lower consumer confidence, reduced capital spending, liquidity concerns and business insolvencies. Further declines, and uncertainty about future economic conditions, could negatively impact our customers' businesses, reducing demand for our products and adversely affecting our business.

The recent global recession adversely affected the semiconductor industry. Semiconductor companies generally remain cautious and focused on their costs, including their research and development budgets which capture spending on EDA products and services. These factors could among other things limit our ability to maintain or increase our sales or recognize revenue from committed contracts and in turn adversely affect our business, operating results and financial condition.

## **Table of Contents**

Under our business model, we generally expect more than 90% of our total revenue to be recurring revenue, as a substantial majority of our customers pay for licenses over a three-year period. However, the turmoil and uncertainty caused by recent economic conditions caused some of our customers to postpone their decision-making, decrease their spending and/or delay their payments to us. Future periods of decreased committed average annual revenue, customer bankruptcies, or consolidation among our customers, could adversely affect our year-over-year revenue growth.

The recent global recession also adversely affected the banking and financial industry. If the global economy continues to experience uncertainty, our ability to obtain credit on favorable terms could be jeopardized. Furthermore, we rely on several large financial institutions to act as counterparties under our foreign currency forward contracts, provide credit and banking transactions and deposit services worldwide. Should any of our banking partners declare bankruptcy or otherwise default on their obligations, it could adversely affect our financial results and our business.

We cannot predict if or when global economic confidence will be restored. Accordingly, our future business and financial results are subject to considerable uncertainty, and our stock price is at risk of volatile change. If economic conditions fail to significantly improve for any extended period of time or deteriorate in the future, or, in particular, if semiconductor industry revenues do not continue to 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.

### ***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;

Cancellations or changes to levels of license orders or the mix between upfront and time-based license revenue;

Our ability to implement effective cost control measures;

Delay of one or more orders for a particular period, particularly orders generating upfront revenue;

Our dependence on a relatively small number of large customers for a large portion of our revenue;

Changes in or challenges to our revenue recognition model;

Amendments or renewals of customer contracts which provide discounts or require the deferral of revenue to later periods;

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.

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

***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 SoCs and ICs, and customers' concerns about managing costs, have in recent periods led to a decrease in design starts and design activity in general, with some customers focusing more on one discrete phase of the design process. Demand for our products and services could fall and our financial condition and results of operations could be adversely affected if the semiconductor and electronics industries do not continue to grow, or grow at a slower rate. Additionally, as the EDA industry matures, consolidation has caused increased levels of competition for a greater share of our customers' EDA spending. 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.

## **Table of Contents**

***If we do not successfully compete in the industries in which we operate, our business and financial condition will be harmed.***

We compete against EDA vendors that offer a variety of products and services, primarily Cadence Design Systems, Inc., Mentor Graphics Corporation and Magma Design Automation, Inc. 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 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.

These industries 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. In addition, our customers continue to demand an overall lower total cost of design, which can lead to the consolidation of their purchases with one vendor. 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, 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 offering 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, and the ability to purchase pools of technology; and

Our ability to compete on the basis of payment terms which continue to lengthen over time.

If we fail to successfully manage these competitive factors, or if we fail to address new competitive forces, our business will be adversely affected.

***We may not be able to acquire businesses and technology and we may not be able to realize the potential financial or strategic benefits of the acquisitions we complete, 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, including the acquisitions of CoWare, Inc., VaST Systems Technology Corporation, and Virage Logic Corporation. 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;



## Edgar Filing: SYNOPSYS INC - Form 10-Q

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;

Failure to realize expected synergies or cost savings;

Dilution of our current stockholders through the issuance of common stock, a substantial reduction of our cash resources and/or the incurrence of debt;

Assumption of unknown liabilities, including tax and litigation, and the related expenses and diversion of resources;

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*, which became applicable to us in the first quarter of fiscal 2010.

If we do not manage these risks, the acquisitions that we complete may have an adverse effect on our business and financial condition. For instance, if we are unable to successfully integrate the products and technology from our acquisition of Virage Logic, we may not be able to achieve the anticipated revenue growth from this transaction. Additionally, if we determine we cannot use or sell the acquired products or technology, we will be required to write down the associated intangible assets, which would negatively impact our operating results.

---

**Table of Contents**

***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.

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

Our success depends in part upon protecting our proprietary technology. 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, 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 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;

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 harmed. 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.

***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. GAAP. These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles and guidance. A change in these principles or guidance can have a significant effect on our reported results and may retroactively affect previously reported results. Additionally, proposed accounting standards could have a significant impact on our operational processes, revenues and expenses, and could cause unexpected financial reporting fluctuations.

***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 by existing 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 research and development expenses are likely to fluctuate from time to time to the extent we make periodic incremental investments in research and development. These investments may be independent of our level of revenue which could negatively impact our financial results.

***Unfavorable tax law changes, an unfavorable government review of our tax returns or changes in our geographical earnings mix or forecasts of foreign source income could adversely affect our effective tax rate and our operating results.***

## Edgar Filing: SYNOPSIS INC - Form 10-Q

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. Currently, a substantial portion of our revenue is generated from customers located outside the United States, and a substantial portion of our assets, including employees, are located outside the United States. United States income taxes and foreign withholding taxes have not been provided on undistributed earnings for certain non-United States subsidiaries to the extent such earnings are considered to be indefinitely reinvested in the operations of those subsidiaries. On August 10,

---

**Table of Contents**

2010, the Education Jobs and Medicaid Assistance Act of 2010 (P.L. 111-226) was enacted, which may limit our ability to use foreign tax credits, effective for transactions entered into after our fiscal year 2010. Additionally, on February 14, 2011, the President of the United States and the U.S. Treasury Department proposed changes to the U.S. tax rules for U.S. corporations doing business outside the United States. Specific legislation regarding such changes has not yet been enacted, but it is possible that these or other changes in the U.S. tax laws could increase our U.S. income tax liability in the future. 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.

Our tax filings are subject to review or audit by the IRS 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. The IRS examinations of our federal tax returns for the years 2000 through 2001 and 2002 through 2004 resulted in significant proposed adjustments which were subsequently settled without a material financial statement impact. In addition, we are currently being audited in jurisdictions outside the U.S. 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 have operations both in the United States 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 increase our effective tax rate. Furthermore, we maintain deferred tax assets related to federal foreign tax credits and certain state tax credits. Our ability to use these credits is dependent upon having sufficient future foreign source income in the United States, 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 which could materially affect our financial results.

*The global nature of our operations exposes us to increased risks and compliance obligations which 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 United States. 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 and ensure intellectual property protection outside of the United States. Our international operations and sales subject us to a number of increased risks, including:

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;

Ineffective legal protection of intellectual property rights;

Financial risks such as longer payment cycles and difficulty in collecting accounts receivable;

Inadequate local infrastructure that could result in business disruptions;

Additional taxes and penalties; and

Other factors beyond our control such as natural disasters, terrorism, civil unrest, war and infectious diseases.

## Edgar Filing: SYNOPSIS INC - Form 10-Q

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.

---

## **Table of Contents**

### ***Our operating results are affected by foreign currency exchange rate fluctuations.***

Our operating results are affected by fluctuations in foreign currency exchange rates. Our results of operations can be adversely affected when the U.S. dollar weakens relative to other currencies, as a result of the translation of expenses of our foreign operations denominated in foreign currencies into the U.S. dollar. Exchange rates are subject to significant and rapid fluctuations, and therefore we cannot predict the prospective impact of exchange rate fluctuations on our business, results of operations and financial condition. Although we engage in foreign currency hedging activity, we may be unable to hedge all of our foreign currency risk. If foreign currency exchange rates deteriorate our operating results would be adversely affected by reducing the amount of revenue derived from outside of the United States.

### ***From time to time we are subject to claims that our products infringe on third party intellectual property rights.***

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. As a result, we are from time to time subject to claims that our products infringe on these third party rights. For example, we have recently defended some of our customers against claims that their use of one of our products infringes on a patent held by a Japanese electronics company. Although we were successful in that case, there can be no assurances that we will prevail in defending against any future claims of infringement. In addition, these types of 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.

### ***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 IC 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.

### ***Customer payment defaults or related issues could harm our operating results.***

The majority of our revenue backlog consists of customer payment obligations not yet due that are attributable to software we have already delivered. A significant portion of the revenue we recognize in any period comes from backlog and is dependent upon our receipt of cash from customers. We will not achieve expected revenue and cash flow if customers default, declare bankruptcy, or otherwise fail to pay amounts owed. Moreover, existing customers may seek to renegotiate pre-existing contractual commitments due to adverse changes in their own businesses. Our customers' financial condition, and in turn their ability or willingness to fulfill their contractual and financial obligations, could be adversely affected by current economic conditions. If payment defaults by our customers significantly increase or we experience significant reductions in existing contractual commitments, our operating results would be harmed.

### ***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, 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.

### ***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 would harm our business, results of operations and financial condition. Additionally,

efforts to recruit and retain qualified employees could negatively impact our operating expenses.

---

**Table of Contents**

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 U.S. GAAP to recognize compensation expense in our results from operations for employee share-based equity compensation under our equity grants and our employee stock purchase plan, which has increased the pressure to limit share-based compensation. These factors may make it more difficult for us to grant attractive share-based packages in the future, which could adversely impact and limit our ability to attract and retain key employees.

***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-regulated organizations, including the SEC, the NASDAQ Global Market, and the Financial Accounting Standards Board. 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, Congress recently passed the Dodd-Frank Wall Street Reform and Protection Act. Our efforts to comply with the Dodd-Frank 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.***

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. Failure of our control systems to prevent error or fraud could have a material adverse impact on our business.

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

Our cash equivalent and short-term investment portfolio as of July 31, 2011 consists of investment grade municipal bonds, tax-exempt money market mutual funds, taxable money market mutual funds and bank deposits. Our investment portfolio carries both interest rate risk and credit risk. Fixed rate debt securities may have their market value adversely impacted due to a credit downgrade or a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall or a credit downgrade occurs. As a result of current adverse financial market conditions, including the recent downgrade by Standard and Poor's (S&P) of the U.S. long-term sovereign credit rating, 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 our publicly traded debt or equity investments is judged to be other-than-temporary. In addition, we may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in the issuer's credit quality or changes in interest rates.

***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, including such events as the recent earthquake and tsunami in Japan. 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, cyber-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 any of our data centers or our critical business or information technology systems would severely affect our ability to conduct normal business operations and, as a result, our operating results would be adversely affected.



**Table of Contents****ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The table below sets forth information regarding repurchases of Synopsys common stock by Synopsys during the three months ended July 31, 2011.

Period (1)	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced program	Approximate dollar value of shares that may yet be purchased under the program
Month #1				
May 1, 2011 through June 4, 2011	1,034,900	\$ 26.8583	1,034,900	\$ 484,767,595
Month #2				
June 5, 2011 through July 2, 2011	2,794,660	\$ 25.8365	2,794,660	\$ 412,563,351
Month #3				
July 3, 2011 through July 30, 2011				\$ 412,563,351
<b>Total</b>	<b>3,829,560</b>	<b>\$ 21.1126</b>	<b>3,829,560</b>	<b>\$ 412,563,351</b>

(1) All months shown are Synopsys fiscal months.

Our Board of Directors previously approved a stock repurchase program pursuant to which we were authorized to purchase up to \$500.0 million of our common stock, and has periodically replenished the stock repurchase program to such amount. Our Board most recently replenished the stock repurchase program up to \$500.0 million on May 25, 2011. Funds are available until expended or until the program is suspended by our Chief Financial Officer or Board of Directors. As of July 31, 2011, \$412.6 million remained available for future repurchases under the program. See Note 9 of *Notes to Unaudited Condensed Consolidated Financial Statements* for further information regarding our stock repurchase program.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

**ITEM 4. (REMOVED AND RESERVED)****ITEM 5. OTHER INFORMATION**

Not applicable.

**Table of Contents****ITEM 6. EXHIBITS**

Exhibit Number	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	09/15/03	
3.2	Restated Bylaws	8-K	000-19807	3.2	06/03/09	
4.1	Specimen Common Stock Certificate	S-1	33-45138	4.3	02/24/92 (effective date)	
10.1	Form of Indemnification Agreement for directors and executive officers	8-K	000-19807	99.2	07/14/11	
10.34+	Form of Notice of Grant of Stock Options and Option Agreement under the 2006 Employee Equity Incentive Plan					X
10.37+	Form of Restricted Stock Unit Grant Notice and Award Agreement under the 2006 Employee Equity Incentive Plan					X
31.1	Certification of Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
31.2	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 Principal Executive Officer 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

+ Indicates a management contract, compensatory plan or arrangement.

\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

**Table of Contents**

**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: September 2, 2011

By:

/s/ **BRIAN M. BEATTIE**  
**Brian M. Beattie**

**Chief Financial Officer**

**(Principal Financial Officer)**

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

Exhibit Number	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	09/15/03	
3.2	Restated Bylaws	8-K	000-19807	3.2	06/03/09	
4.1	Specimen Common Stock Certificate	S-1	33-45138	4.3	02/24/92 (effective date)	
10.1	Form of Indemnification Agreement for directors and executive officers	8-K	000-19807	99.2	07/14/11	
10.34+	Form of Notice of Grant of Stock Options and Option Agreement under the 2006 Employee Equity Incentive Plan					X
10.37+	Form of Restricted Stock Unit Grant Notice and Award Agreement under the 2006 Employee Equity Incentive Plan					X
31.1	Certification of Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
31.2	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 Principal Executive Officer 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

+ Indicates a management contract, compensatory plan or arrangement.

\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.