

SYNOPSIS INC
Form 10-Q
August 30, 2013
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, 2013

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 0-19807

SYNOPSYS, INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

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 28, 2013, there were 154,408,347 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, 2013

TABLE OF CONTENTS

	Page
PART I. <u>Financial Information</u>	1
Item 1. <u>Financial Statements</u>	1
<u>Unaudited Condensed Consolidated Balance Sheets</u>	1
<u>Unaudited Condensed Consolidated Statements of Operations</u>	2
<u>Unaudited Condensed Consolidated Statements of Comprehensive Income</u>	3
<u>Unaudited Condensed Consolidated Statements of Cash Flows</u>	4
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	5
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	18
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	28
Item 4. <u>Controls and Procedures</u>	29
PART II. <u>Other Information</u>	30
Item 1. <u>Legal Proceedings</u>	30
Item 1A. <u>Risk Factors</u>	30
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	38
Item 3. <u>Defaults upon Senior Securities</u>	38
Item 4. <u>Mine Safety Disclosures</u>	38
Item 5. <u>Other Information</u>	38
Item 6. <u>Exhibits</u>	39
<u>Signatures</u>	40

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****SYNOPSIS, INC.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except par value amounts)**

	July 31, 2013	October 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 892,370	\$ 700,382
Accounts receivable, net of allowances of \$5,355 and \$6,072, respectively	278,878	292,668
Deferred income taxes	77,509	74,712
Income taxes receivable and prepaid taxes	18,352	17,267
Prepaid and other current assets	62,975	55,627
Total current assets	1,330,084	1,140,656
Property and equipment, net	194,198	191,243
Goodwill	1,976,964	1,976,987
Intangible assets, net	364,005	466,322
Long-term prepaid taxes	8,644	9,429
Long-term deferred income taxes	270,745	239,412
Other long-term assets	143,832	123,607
Total assets	\$ 4,288,472	\$ 4,147,656
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 321,103	\$ 383,093
Accrued income taxes	16,189	4,682
Deferred revenue	804,390	834,864
Short-term debt	30,000	30,000
Total current liabilities	1,171,682	1,252,639
Long-term accrued income taxes	45,855	52,645
Long-term deferred revenue	67,605	67,184
Long-term debt	82,500	105,000
Other long-term liabilities	184,700	126,217
Total liabilities	1,552,342	1,603,685
Stockholders equity:		
Preferred Stock, \$0.01 par value: 2,000 shares authorized; none outstanding		
Common Stock, \$0.01 par value: 400,000 shares authorized; 154,348 and 150,899 shares outstanding, respectively	1,543	1,509
Capital in excess of par value	1,581,340	1,585,034
Retained earnings	1,283,068	1,098,694
Treasury stock, at cost: 2,916 and 6,365 shares, respectively	(89,650)	(168,090)
Accumulated other comprehensive income (loss)	(40,171)	(15,461)

Edgar Filing: SYNOPSIS INC - Form 10-Q

Total Synopsys stockholders' equity	2,736,130	2,501,686
Non-controlling interest		42,285
Total stockholders' equity	2,736,130	2,543,971
Total liabilities and stockholders' equity	\$ 4,288,472	\$ 4,147,656

See accompanying notes to unaudited condensed consolidated financial statements.

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

(in thousands, except per share amounts)

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
Revenue:				
Time-based license	\$ 387,088	\$ 362,788	\$ 1,186,538	\$ 1,082,262
Upfront license	39,957	25,423	95,525	76,268
Maintenance and service	55,900	55,536	175,276	143,274
Total revenue	482,945	443,747	1,457,339	1,301,804
Cost of revenue:				
License	69,857	57,415	195,918	172,729
Maintenance and service	19,253	21,218	59,074	59,177
Amortization of intangible assets	26,537	21,156	79,451	58,243
Total cost of revenue	115,647	99,789	334,443	290,149
Gross margin	367,298	343,958	1,122,896	1,011,655
Operating expenses:				
Research and development	166,668	143,955	494,140	428,060
Sales and marketing	105,381	100,004	311,069	304,244
General and administrative	34,510	31,769	104,702	115,556
Amortization of intangible assets	5,744	4,835	17,506	13,261
Total operating expenses	312,303	280,563	927,417	861,121
Operating income	54,995	63,395	195,479	150,534
Other income (expense), net	3,177	(2,310)	21,130	7,869
Income before provision for income taxes	58,172	61,085	216,609	158,403
Provision (benefit) for income taxes	5,875	(14,571)	25,699	5,082
Net income	\$ 52,297	\$ 75,656	\$ 190,910	\$ 153,321
Net income per share:				
Basic	\$ 0.34	\$ 0.51	\$ 1.25	\$ 1.05
Diluted	\$ 0.33	\$ 0.50	\$ 1.22	\$ 1.03
Shares used in computing per share amounts:				
Basic	153,915	147,801	152,969	145,827
Diluted	157,056	150,644	156,215	149,095

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(in thousands)			
Net income	\$ 52,297	\$ 75,656	\$ 190,910	\$ 153,321
Other comprehensive income (loss):				
Change in foreign currency translation adjustment	(6,234)	(2,871)	(20,746)	(9,929)
Cash flow hedges:				
Deferred gains (losses), net of tax of \$804 and \$3,336, for the three and nine months ended July 31, 2013, respectively, and of \$2,227 and \$2,608 for each of the same periods in fiscal 2012, respectively	(2,189)	(10,100)	1,507	(10,221)
Reclassification adjustment on deferred (gains) losses included in net income, net of tax of \$601 and \$401, for the three and nine months ended July 31, 2013, respectively, and of \$(1,247) and \$(2,840) for each of the same periods in fiscal 2012, respectively	(3,741)	3,890	(5,471)	9,460
Change in unrealized (losses) gains on investments, net of tax of \$0 and \$58, for the three and nine months ended July 31, 2012.				(88)
Other comprehensive income (loss), net of tax effects	(12,164)	(9,081)	(24,710)	(10,778)
Comprehensive income	\$ 40,133	\$ 66,575	\$ 166,200	\$ 142,543

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Nine Months Ended July 31,	
	2013	2012
Cash flow from operating activities:		
Net income	\$ 190,910	\$ 153,321
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization and depreciation	141,756	115,076
Stock compensation	49,719	54,078
Allowance for doubtful accounts	901	973
Write-down of long-term investments		452
Gain on sale of investments	(101)	(650)
Deferred income taxes	7,272	10,553
Net changes in operating assets and liabilities, net of acquired assets and liabilities:		
Accounts receivable	8,207	14,401
Prepaid and other current assets	(14,617)	6,116
Other long-term assets	(20,292)	(7,146)
Accounts payable and other liabilities	(48,188)	(15,490)
Income taxes	(475)	(32,370)
Deferred revenue	(9,722)	83,822
Net cash provided by operating activities	305,370	383,136
Cash flows from investing activities:		
Proceeds from sales and maturities of short-term investments		166,132
Purchases of short-term investments		(18,179)
Proceeds from sales of long-term investments	222	506
Proceeds from sale of property and equipment	2,000	
Purchases of property and equipment	(47,624)	(32,718)
Cash paid for acquisitions and intangible assets, net of cash acquired		(584,418)
Capitalization of software development costs	(2,681)	(2,308)
Net cash used in investing activities	(48,083)	(470,985)
Cash flows from financing activities:		
Principal payments on capital leases	(3,751)	(5,177)
Acquisition of non-controlling interests	(44,004)	
Proceeds from credit facility and term loan		250,000
Repayment of debt	(22,975)	(128,656)
Issuances of common stock	90,529	128,556
Purchases of treasury stock	(69,999)	(40,000)
Other	(2,030)	
Net cash (used in) provided by financing activities	(52,230)	204,723
Effect of exchange rate changes on cash and cash equivalents	(13,069)	(8,184)
Net change in cash and cash equivalents	191,988	108,690
Cash and cash equivalents, beginning of year	700,382	855,077

Edgar Filing: SYNOPSIS INC - Form 10-Q

Cash and cash equivalents, end of period	\$ 892,370	\$ 963,767
--	------------	------------

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 supplying the electronic design automation (EDA) software that engineers use to design, create prototypes for and test integrated circuits, also known as chips. The Company also provides 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 designing those circuits themselves. To complement these product offerings, the Company provides technical services to support our solutions and we help our 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, comprehensive income and cash flows. The Company's interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in Synopsys' Annual Report on Form 10-K for the fiscal year ended October 31, 2012 as filed with the SEC on December 20, 2012.

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

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

Fiscal Year End. The Company's fiscal year generally ends on the Saturday nearest to October 31 and consists of 52 weeks, with the exception that approximately every five years, the Company has a 53-week year. When a 53-week year occurs, the Company includes the additional week in the first quarter to realign fiscal quarters with calendar quarters. Fiscal 2013 is a 52-week year and will end on November 2, 2013, and fiscal 2012 was a 53-week year and ended on November 3, 2012. The results of operations for the first nine months of fiscal 2013 and 2012 included 39 weeks and 40 weeks, respectively. The third fiscal quarters, and first nine months of fiscal 2013 and 2012 ended on August 3, 2013 and August 4, 2012, respectively. For presentation purposes, the unaudited condensed consolidated financial statements and accompanying notes refer to the closest calendar month end.

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

Note 3. Business Combinations and Acquisition of Non-controlling Interest

Fiscal 2013 Acquisition of Non-controlling Interest

During the first quarter of fiscal 2013, the Company completed the acquisition of the non-controlling interest in SpringSoft, Inc. (SpringSoft), a company organized under the laws of the Republic of China (Taiwan), in which the remaining 8.4% of outstanding shares of SpringSoft along with the remaining outstanding vested stock options of SpringSoft were exchanged for cash of \$44.0 million.

Table of Contents**Note 4. Financial Assets and Liabilities**

Cash, Cash Equivalents and Investments. 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, 2013					
Classified as current assets:					
Non-interest bearing cash	\$ 185,124	\$	\$	\$	\$ 185,124
Cash deposits and money market funds	707,246				707,246
	892,370				892,370
Classified as other long-term assets:					
Strategic investments	11,437				11,437
Total	\$ 903,807	\$	\$	\$	\$ 903,807

	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, 2012					
Classified as current assets:					
Non-interest bearing cash	\$ 167,161	\$	\$	\$	\$ 167,161
Cash deposits and money market funds	533,221				533,221
	700,382				700,382
Classified as other long-term assets:					
Strategic investments	11,744				11,744
Total	\$ 712,126	\$	\$	\$	\$ 712,126

(1) See Note 5 for further discussion of fair values.

Strategic Investments. The Company's strategic investment portfolio consists of non-marketable equity securities in privately held companies. The securities accounted for under cost method investments are reported at cost net of impairment losses. Securities accounted for under equity method investments are recorded at cost plus the proportional share of the issuers' income or loss, which is recorded in the Company's other income (expense), net. The cost basis of securities sold is based on the specific identification method. Refer to *Note 5. Fair Value Measures*.

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

Edgar Filing: SYNOPSYS INC - Form 10-Q

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

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

Table of Contents***Cash Flow Hedging Activities***

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

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

Non-designated Hedging Activities

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

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

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(in thousands)			
Gain (loss) recorded in other income (expense), net	\$ (586)	\$ (1,387)	\$ 3,344	\$ 631

The notional amounts in the table below for derivative instruments provide one measure of the transaction volume outstanding as of July 31, 2013 and October 31, 2012, respectively:

	As of July 31, 2013	As of October 31, 2012
	(in thousands)	
Total gross notional amount	\$ 606,049	\$ 618,978
Net fair value	\$ 5,687	\$ 390

These notional amounts 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.

Table of Contents

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, 2013		
Other current assets	\$ 10,083	\$ 980
Other current liabilities	\$ 5,340	\$ 36
As of October 31, 2012		
Other current assets	\$ 5,149	\$ 68
Other current liabilities	\$ 4,739	\$ 88

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

	Location of gain (loss) recognized in OCI on derivatives	Amount of gain (loss) recognized in OCI on derivatives (effective portion)	Location of gain (loss) reclassified from OCI	Amount of gain (loss) reclassified from OCI (effective portion)
		(in thousands)		
Three months ended July 31, 2013				
Foreign exchange contracts	Revenue	\$ (158)	Revenue	\$ 3,771
Foreign exchange contracts	Operating expenses	(2,106)	Operating expenses	(30)
Total		\$ (2,264)		\$ 3,741
Three months ended July 31, 2012				
Foreign exchange contracts	Revenue	\$ (359)	Revenue	\$ (55)
Foreign exchange contracts	Operating expenses	(9,736)	Operating expenses	(3,835)
Total		\$ (10,095)		\$ (3,890)
Nine months ended July 31, 2013				
Foreign exchange contracts	Revenue	\$ 2,701	Revenue	\$ 6,325
Foreign exchange contracts	Operating expenses	(1,165)	Operating expenses	(854)
Total		\$ 1,536		\$ 5,471
Nine months ended July 31, 2012				
Foreign exchange contracts	Revenue	\$ 4,635	Revenue	\$ (1,689)
Foreign exchange contracts	Operating expenses	(14,631)	Operating expenses	(7,771)
Total		\$ (9,996)		\$ (9,460)

Table of Contents

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

	Amount of gain (loss) recognized in income statement on derivatives (ineffective portion)(1)	Amount of gain (loss) recognized in income statement on derivatives (excluded from effectiveness testing)(2)
	(in thousands)	
For the three months ended July 31, 2013		
Foreign exchange contracts	\$ 90	\$ 260
For the three months ended July 31, 2012		
Foreign exchange contracts	\$ 3	\$ 518
For the nine months ended July 31, 2013		
Foreign exchange contracts	\$ 256	\$ 1,522
For the nine months ended July 31, 2012		
Foreign exchange contracts	\$ 57	\$ 1,385

(1) The ineffective portion includes forecast inaccuracies.

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

Note 5. 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 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.

Edgar Filing: SYNOPSYS INC - Form 10-Q

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

The Company's liabilities for contingent consideration are classified within Level 3 because these valuations are based on management assumptions including discount rates and estimated probabilities of achievement of certain milestones which are unobservable in the market. The Company did not record any changes during the three and nine months ended July 31, 2013 and the three months ended July 31, 2012. For the nine months ended July 31, 2012, the Company recorded a reduction of \$3.0 million in research and development expenses due to the change in fair value of the liability for contingent consideration. As of July 31, 2013 and October 31, 2012, the fair value of the liabilities for contingent consideration was estimated at \$0.4 million and \$0.8 million, respectively.

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, 2013:

Description	Total	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)				
Assets				
Cash equivalents:				
Money market funds	\$ 454,189	\$ 454,189	\$	\$
Prepaid and other current assets:				
Foreign currency derivative contracts	11,063		11,063	
Other long-term assets:				
Deferred compensation plan assets	119,869	119,869		
Total assets	\$ 585,121	\$ 574,058	\$ 11,063	\$
Liabilities				
Accounts payable and accrued liabilities:				
Foreign currency derivative contracts	\$ 5,376	\$	\$ 5,376	\$
Contingent consideration	387			387
Total liabilities	\$ 5,763	\$	\$ 5,376	\$ 387

Assets and liabilities measured at fair value on a recurring basis are summarized below as of October 31, 2012:

Description	Total	Fair Value Measurement Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
(in thousands)				
Assets				
Cash equivalents:				
Money market funds	\$ 239,770	\$ 239,770	\$	\$
Prepaid and other current assets:				
Foreign currency derivative contracts	5,217		5,217	
Other long-term assets:				
Deferred compensation plan assets	100,645	100,645		
Total assets	\$ 345,632	\$ 340,415	\$ 5,217	\$
Liabilities				
Accounts payable and accrued liabilities:				
Foreign currency derivative contracts	\$ 4,827	\$	\$ 4,827	\$
Contingent consideration	469			469
Other long-term liabilities:				
Contingent consideration	355			355
Total liabilities	\$ 5,651	\$	\$ 4,827	\$ 824

Edgar Filing: SYNOPSIS INC - Form 10-Q

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

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

Table of Contents

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 income (expense), net.

	Balance as of July 31, 2012	Significant Unobservable Inputs (Level 3)	Total (losses) during three months ended July 31, 2012 (in thousands)	Total (losses) during nine months ended July 31, 2012
Non-marketable equity securities	\$	\$	\$ (452)	\$ (452)

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

As of July 31, 2013, the fair value of the Company's non-marketable securities was \$11.4 million, of which \$6.9 million and \$4.5 million were accounted for under the cost method and equity method, respectively. As of October 31, 2012, the fair value of non-marketable securities was \$11.7 million, of which \$7.0 million and \$4.7 million were accounted for under the cost method and equity method, respectively.

Note 6. Goodwill and Intangible Assets

Goodwill as of July 31, 2013 consisted of the following:

	(in thousands)
Balance at October 31, 2012	\$ 1,976,987
Adjustment(1)	(23)
Balance at July 31, 2013	\$ 1,976,964

- (1) Adjustments relate to changes in estimates for acquisitions that closed in the prior fiscal year for which the purchase price allocation was still preliminary and effects of foreign currency fluctuations.

Intangible assets as of July 31, 2013 consisted of the following:

	Gross Assets	Accumulated Amortization (in thousands)	Net Assets
Core/developed technology	\$ 377,795	\$ 211,397	\$ 166,398
Customer relationships	176,554	64,368	112,186
Contract rights intangible	140,019	70,868	69,151
Covenants not to compete	2,530	2,452	78
Trademarks and trade names	10,854	5,121	5,733
In-process research and development (IPR&D)(1)	6,550		6,550
Capitalized software development costs	17,262	13,353	3,909
Total	\$ 731,564	\$ 367,559	\$ 364,005

- (1) IPR&D is reclassified to core/developed technology upon completion or is written off upon abandonment.

Edgar Filing: SYNOPSIS INC - Form 10-Q

Intangible assets as of October 31, 2012 consisted of the following:

	Gross Assets	Accumulated Amortization (in thousands)	Net Assets
Core/developed technology	\$ 367,321	\$ 159,691	\$ 207,630
Customer relationships	179,657	48,368	131,289
Contract rights intangible	142,641	43,843	98,798
Covenants not to compete	2,530	2,354	176
Trademarks and trade names	10,900	3,793	7,107
In-process research and development (IPR&D)(1)	17,696		17,696
Capitalized software development costs	14,581	10,955	3,626
 Total	 \$ 735,326	 \$ 269,004	 \$ 466,322

(1) IPR&D is reclassified to core/developed technology upon completion or is written off upon abandonment.

Table of Contents

Amortization expense related to intangible assets consisted of the following:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(in thousands)			
Core/developed technology	\$ 17,456	\$ 14,076	\$ 51,812	\$ 41,972
Customer relationships	5,352	4,472	16,088	12,211
Contract rights intangible	9,076	7,075	27,624	16,257
Covenants not to compete	33	58	99	199
Trademarks and trade names	363	310	1,333	865
Capitalized software development costs(1)	812	751	2,398	2,238
Total	\$ 33,092	\$ 26,742	\$ 99,354	\$ 73,742

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

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

Fiscal Year	(in thousands)
Remainder of fiscal 2013	\$ 30,849
2014	109,517
2015	91,981
2016	57,953
2017	25,423
2018 and thereafter	41,732
IPR&D(1)	6,550
Total	\$ 364,005

(1) IPR&D projects are estimated to be completed within one year as of July 31, 2013. Amortization will begin upon project completion or the asset will be written off upon abandonment.

Note 7. Liabilities

Accounts payable and accrued liabilities consist of:

	July 31, 2013	October 31, 2012
	(in thousands)	
Payroll and related benefits	\$ 254,950	\$ 299,961
Other accrued liabilities	49,965	53,277
Accounts payable	16,188	29,855
Total	\$ 321,103	\$ 383,093

Edgar Filing: SYNOPSIS INC - Form 10-Q

Other long-term liabilities consist of:

	July 31, 2013	October 31, 2012
	(in thousands)	
Deferred compensation liability	\$ 119,869	\$ 100,645
Other long-term liabilities	64,831	25,572
Total	\$ 184,700	\$ 126,217

Table of Contents**Note 8. Credit Facility**

On February 17, 2012, the Company entered into an agreement with several lenders (the Credit Agreement) providing for (i) a \$350.0 million senior unsecured revolving credit facility (the Revolver) and (ii) a \$150.0 million senior unsecured term loan facility (the Term Loan). Principal payments on a portion of the Term Loan are due in equal quarterly installments of \$7.5 million, with the remainder due when the Credit Agreement expires in October 2016. Subject to obtaining additional commitments from lenders, the principal amount of the loans provided under the Credit Agreement may be increased by the Company by up to an additional \$150.0 million through October 13, 2015.

As of July 31, 2013, the Company had no outstanding balance under the Revolver and a \$112.5 million outstanding balance under the Term Loan, of which \$82.5 million is classified as long-term. The interest paid on borrowings under the Credit Agreement and commitment fees paid on the Revolver are variable rates tied to LIBOR plus a spread based on the Company's leverage ratio.

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

Note 9. Accumulated Other Comprehensive Income (Loss)

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

	July 31, 2013	October 31, 2012
	(in thousands)	
Cumulative currency translation adjustments	\$ (34,868)	\$ (14,123)
Unrealized gain (loss) on derivative instruments, net of taxes	(5,303)	(1,338)
Total accumulated other comprehensive income (loss)	(\$ 40,171)	(\$ 15,461)

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
Reclassifications from accumulated other comprehensive income into unaudited condensed consolidated statement of operations:				
Gain (loss) on cash flow hedges, net of taxes				
Revenues	\$ 3,771	\$ (55)	\$ 6,325	\$ (1,689)
Operating expenses	(30)	(3,835)	(854)	(7,771)
Total reclassifications into net income	\$ 3,741	\$ (3,890)	\$ 5,471	\$ (9,460)

Amounts reclassified for the three and nine months ended July 31, 2013 and for the same periods in fiscal 2012 consisted of gains (losses) from the Company's cash flow hedging activities. Refer to *Note 4. Financial Assets and Liabilities*.

Note 10. Stock Repurchase Program

The Company's Board of Directors (Board) previously approved a stock repurchase program pursuant to which the Company was authorized to purchase up to \$500.0 million of its common stock, and has periodically replenished the stock repurchase program to such amount. The Board replenished the stock repurchase program up to \$500.0 million on May 25, 2011. The Company repurchases shares to offset dilution caused by ongoing stock issuances from existing equity 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

Table of Contents

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. In January 2012, the Company entered into an accelerated share repurchase program (ASR) to repurchase an aggregate of \$40.0 million of the Company's common stock during fiscal 2012 at an average purchase price per share of \$29.23. As of July 31, 2013, \$202.4 million remained available for further repurchases under the program.

Stock repurchase activities are as follow:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012(1)
	(in thousands, except per share price)			
Shares repurchased	970		1,973	2,474
Average purchase price per share	\$ 36.10	\$	\$ 35.49	\$ 29.64
Aggregate purchase price	\$ 35,000	\$	\$ 69,998	\$ 73,335
Reissuance of treasury stock	1,712	1,677	5,422	7,793

- (1) Includes \$33.3 million from the settlement of the Company's September 2011 ASR equity forward contract and \$20.0 million from the January 2012 ASR referenced above that was settled in the second quarter of fiscal 2012.

Note 11. Stock Compensation

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(in thousands)			
Cost of license	\$ 1,566	\$ 1,794	\$ 4,872	\$ 5,152
Cost of maintenance and service	366	436	1,210	1,264
Research and development expense	8,114	8,178	23,655	24,351
Sales and marketing expense	3,454	3,582	10,339	10,153
General and administrative expense	2,990	3,233	9,643	13,158
Stock compensation expense before taxes	16,490	17,223	49,719	54,078
Income tax benefit	(4,035)	(3,865)	(12,166)	(12,135)
Stock compensation expense after taxes	\$ 12,455	\$ 13,358	\$ 37,553	\$ 41,943

As of July 31, 2013, there was \$134.3 million of unamortized share-based compensation expense, which is expected to be amortized over a weighted-average period of approximately 2.6 years.

The intrinsic value of equity awards exercised during the periods below is as follows:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(in thousands)			
Intrinsic value of awards exercised	\$ 12,899	\$ 11,084	\$ 34,764	\$ 48,235

Note 12. Net Income per Share

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

Table of Contents

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,	
	2013	2012	2013	2012
	(in thousands)			
Numerator:				
Net income	\$ 52,297	\$ 75,656	\$ 190,910	\$ 153,321
Denominator:				
Weighted-average common shares for basic net income per share	153,915	147,801	152,969	145,827
Dilutive effect of potential common shares from equity-based compensation	3,141	2,843	3,246	3,268
Weighted-average common shares for diluted net income per share	157,056	150,644	156,215	149,095
Net income per share:				
Basic	\$ 0.34	\$ 0.51	\$ 1.25	\$ 1.05
Diluted	\$ 0.33	\$ 0.50	\$ 1.22	\$ 1.03
Anti-dilutive employee stock-based awards excluded(1)	1,648	3,995	2,179	3,522

- (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 antidilutive for the respective periods, they could be dilutive in the future.

Note 13. Segment Disclosure

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

The Company provides software and hardware products and consulting services in the EDA software industry. 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. Revenues related to operations in the United States and other geographic areas were:

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(in thousands)			
Revenue:				
United States	\$ 234,770	\$ 216,315	\$ 706,083	\$ 620,982
Europe	68,591	58,113	197,712	170,953
Japan	64,874	71,107	200,510	220,160
Asia-Pacific and Other	114,710	98,212	353,034	289,709
Consolidated	\$ 482,945	\$ 443,747	\$ 1,457,339	\$ 1,301,804

Edgar Filing: SYNOPSIS INC - Form 10-Q

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

One customer accounted for 11.5% and 10.8% of the Company's unaudited condensed consolidated revenue in the three months ended July 31, 2013 and 2012, respectively and accounted for 11.4% and 10.5% of the Company's unaudited condensed consolidated revenue in the nine months ended July 31, 2013 and 2012, respectively.

Table of Contents**Note 14. Other Income (Expense), net**

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(in thousands)			
Interest income	\$ 301	\$ 323	\$ 1,563	\$ 1,251
Interest expense	(404)	(736)	(1,325)	(1,463)
Gain (loss) on assets related to deferred compensation plan assets	2,841	(1,423)	12,511	4,997
Foreign currency exchange gain (loss)	217	(349)	6,127	1,637
Other, net	222	(125)	2,254	1,447
Total	\$ 3,177	\$ (2,310)	\$ 21,130	\$ 7,869

Note 15. Taxes**Effective Tax Rate**

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

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

	Three Months Ended July 31,		Nine Months Ended July 31,	
	2013	2012	2013	2012
	(in thousands)			
Income before income taxes	\$ 58,172	\$ 61,085	\$ 216,609	\$ 158,403
Provision (benefit) for income tax	\$ 5,875	\$ (14,571)	\$ 25,699	\$ 5,082
Effective tax rate	10.1%	(23.9)%	11.9%	3.2%

The Company's effective tax rates for the three and nine months ended July 31, 2013 are lower than the statutory federal income tax rate of 35% primarily due to the lower tax rates applicable to its non-U.S. operations, the reinstatement of the U.S. federal research tax credit, and the reversal of deferred taxes resulting from the merger of a foreign affiliate, partially offset by state taxes and non-deductible stock compensation. The effective tax rate increased in the three months ended July 31, 2013, as compared to the same period in fiscal 2012, primarily due to the tax impact of an Internal Revenue Service (IRS) settlement for fiscal years 2010 and 2011 and a settlement with the Taiwan tax authorities for fiscal year 2008 recorded in the third quarter of fiscal 2012. The effective tax rate increased in the nine months ended July 31, 2013, as compared to the same period in fiscal 2012, primarily due to the tax impact of IRS and Taiwan audit settlements recorded in fiscal 2012 offset by the reinstatement of the research tax credit and the reversal of deferred taxes resulting from the merger of a foreign affiliate in the first quarter of fiscal 2013.

On January 2, 2013, the President signed into law the *American Taxpayer Relief Act* which reinstated the research tax credit retroactive to January 1, 2012 and extended the credit through December 31, 2013. As a result of the new legislation, the Company recognized a benefit in the first quarter of fiscal 2013 related to 10 months of fiscal 2012 as well as a benefit to the annual effective tax rate for the full year research tax credit for fiscal 2013.

The Company's total gross unrecognized tax benefits at July 31, 2013 are \$100.8 million exclusive of interest and penalties. If the total gross unrecognized tax benefits at July 31, 2013 were recognized in the future, approximately \$88.2 million would decrease the effective tax rate.

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

Edgar Filing: SYNOPSIS INC - Form 10-Q

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

Table of Contents

The Company and/or its subsidiaries remain subject to tax examination in the following jurisdictions:

Jurisdiction	Year(s) Subject to Examination
United States Synopsys	Fiscal 2012
United States Magma Design Automation	Fiscal years after 2009
California Synopsys	Fiscal years after 2007
California Magma Design Automation	Fiscal years after 2008
Hungary	Fiscal years after 2006
Taiwan, Ireland and Japan	Fiscal years after 2007

In addition, the Company has made acquisitions with operations in several of its significant jurisdictions which may have years subject to examination different from the years indicated in the above table.

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

This Quarterly Report on Form 10-Q, includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act) and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), which are subject to the safe harbor created by those sections. Any statements herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as may, will, could, would, should, anticipate, expect, intend, believe, estimate, project or continue, and the negatives of such terms are intended to identify forward-looking statements. Without limiting the foregoing, forward-looking statements contained in this Quarterly Report on Form 10-Q include, but are not limited to, statements concerning expected growth in the semiconductor industry, our positive business outlook, the ability of our prior acquisitions to drive revenue growth, the sufficiency of our cash and cash equivalents and cash generated from operations, and our future liquidity requirements, and other statements that involve certain known and unknown risks, uncertainties and other factors that could cause our actual results, time frames or achievements to differ materially from those expressed or implied in our forward-looking statements. Such risks and uncertainties include, among others, those identified below in Part II, Item 1A. Risk Factors of this Form 10-Q. The information included herein represents our estimates and assumptions as of the date of this filing. Unless required by law, we undertake no obligation to update publicly any forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future. All subsequent written or oral forward-looking statements attributable to Synopsis 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, 2012, as filed with the Securities and Exchange Commission (SEC) on December 20, 2012.

Overview**Business Summary**

Synopsys is a global leader in providing software, intellectual property and services used to accelerate innovation in integrated circuits and electronic systems. We supply the electronic design automation (EDA) software that engineers use to design, create prototypes for and test integrated circuits, also known as chips. We also 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 and time to market. 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 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 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 approximately 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.

Even with the continued instability of global markets, our business outlook remains strong based on our leading technology, business model, strong financials, diligent expense management, and acquisition strategy. In addition, consumer demand for electronics has been solid, particularly the demand for mobile devices. 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 believe that the combination of our solid financials, leading technology and strong customer relationships will help us to continue to successfully execute our strategies.

Table of Contents

Fiscal Year End

Our fiscal year generally ends on the Saturday nearest to October 31 and consists of 52 weeks, with the exception that approximately every five years, we have a 53-week year. When a 53-week year occurs, we include the additional week in the first quarter to realign fiscal quarters with calendar quarters. Fiscal 2013 will be a 52-week year and will end on November 2, 2013. Fiscal 2012 was a 53-week year ending on November 3, 2012.

Our results of operations for the first nine months of fiscal 2013 and 2012 included 39 weeks and 40 weeks, respectively, and the quarters ended on August 3, 2013 and August 4, 2012, respectively. The extra week in the first quarter of fiscal 2012 resulted in approximately \$26 million of additional revenue, related primarily to time-based licenses, and approximately \$16 million of additional expenses.

For presentation purposes, this Form 10-Q, including the unaudited condensed consolidated financial statements and accompanying notes, refers to the applicable calendar month ends of July 31, 2013 and July 31, 2012 as the ends of the third quarters of fiscal 2013 and 2012, respectively.

Financial Performance Summary for the Three Months Ended July 31, 2013 (Compared to the Three Months Ended July 31, 2012)

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

Our total revenue was \$482.9 million, an increase of 9% primarily due to continued growth both organically and through our prior-year acquisitions.

Total operating expense and cost of revenue was \$428.0 million, an increase of 13%. Expenses related to prior-year acquisitions were the key driver of the change, resulting in higher employee-related costs, cost of products, and amortization and depreciation expenses.

Net income decreased by 31% or \$23.4 million, primarily due to larger tax settlements received in fiscal 2012 as well as the net effect of the above-mentioned factors.

Critical Accounting Policies and Estimates

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

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

Revenue recognition;

Valuation of stock compensation;

Valuation of intangible assets; and

Edgar Filing: SYNOPSYS INC - Form 10-Q

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, 2012, filed with the SEC on December 20, 2012.

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)-based emulation and prototyping systems.

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.

Table of Contents

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. Such revenue 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.

We infrequently enter into multiple-element arrangements that contain both software and non-software deliverables such as hardware. On a prospective basis beginning in the first quarter of fiscal 2011, we applied accounting guidance for revenue arrangements with multiple deliverables to these contracts. Such arrangements have not had a material effect on our unaudited condensed consolidated financial statements and are not expected to have a material effect on subsequent periods.

We have determined that the software and non-software deliverables in our contracts are separate units of accounting. Accordingly, we allocate the 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 gross 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.

We recognize revenue for the separate units of accounting when all revenue recognition criteria are met. Revenue allocated to hardware units of accounting is recognized upon shipment 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).

Table of Contents

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 that contain only software and software related deliverables based on vendor-specific objective evidence (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 and accepted by the customer. 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 Freight on Board (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.

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 customers' 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

Edgar Filing: SYNOPSIS INC - Form 10-Q

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.

Table of Contents**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. While the weighted average duration of our time-based licenses may fluctuate from period to period, substantially all of our current time-based licenses are TSLs with an average license term of approximately three years. Revenue on contracts requiring significant modification or development is accounted for using the percentage of completion method over the period of the development. Revenue on hardware product orders is generally recognized in full at the time the product is shipped. Contingent revenue is recognized if and when the applicable event occurs.

Revenue on maintenance orders is recognized ratably over the maintenance period (normally one year). Revenue on professional services orders is generally recognized after services are performed and accepted by the customer.

Our revenue in any 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 or on percentage of completion for arrangements requiring significant modification of our software, and not when they are booked. Our license revenue is sensitive to the mix of TSLs and perpetual or term licenses delivered during a reporting period. A TSL order typically yields lower current quarter revenue but contributes to revenue in future periods. For example, a \$120,000 order for a three-year TSL delivered on the last day of a quarter typically generates no revenue in that quarter, but \$10,000 in each of the twelve succeeding quarters. Conversely, a \$120,000 order for perpetual and term licenses with greater than 75% of the license fee due within one year from shipment typically generates \$120,000 in revenue in the quarter the product is delivered, but no future revenue. Additionally, revenue in a particular quarter may also be impacted by perpetual and term licenses in which less than 75% of the license fees and 100% of the maintenance fees are payable within one year from shipment as the related revenue will be recognized as revenue in the period when customer payments become due and payable.

Our customer arrangements are complex, involving hundreds of products and various license rights, and our customers bargain with us over many aspects of these arrangements. For example, they often demand a broader portfolio of solutions, support and services and seek more favorable terms such as expanded license usage, future purchase rights and other unique rights at an overall lower total cost. No single factor typically drives our customers' buying decisions, and we compete on all fronts to serve customers in a highly competitive EDA market. Customers generally negotiate the total value of the arrangement rather than just unit pricing or volumes.

Total Revenue

	July 31,			
	2013	2012	\$ Change	% Change
	(dollars in millions)			
Three months ended	\$ 482.9	\$ 443.7	\$ 39.2	9%
Nine months ended	\$ 1,457.3	\$ 1,301.8	\$ 155.5	12%

Our revenues are subject to fluctuations, primarily due to customer requirements, including payment terms and the timing and value of contract renewals.

The increase in total revenue for the three and nine months ended July 31, 2013 compared to the same periods in fiscal 2012 was primarily in time-based license revenue due to our organic growth and revenue from acquired companies. Additionally, the first quarter of fiscal 2012 included an extra week which had an impact of additional revenue of \$26.0 million. Excluding this impact, revenue was higher by \$181.5 million in the nine months ended July 31, 2013.

Table of Contents**Time-Based License Revenue**

	2013	July 31, 2012	\$ Change	% Change
		(dollars in millions)		
Three months ended	\$ 387.1	\$ 362.8	\$ 24.3	7%
Percentage of total revenue	80%	82%		
Nine months ended	\$ 1,186.5	\$ 1,082.3	\$ 104.2	10%
Percentage of total revenue	81%	83%		

The increase in time-based license revenue for the three and nine months ended July 31, 2013 compared to the same periods in fiscal 2012 was primarily attributable to increases in TSL license revenue from our organic growth, revenue from acquired companies and increases in contingent revenue.

The increase for the nine months ended July 31, 2013 was partially offset by the additional week of revenue during the first quarter of fiscal 2012.

Upfront License Revenue

	2013	July 31, 2012	\$ Change	% Change
		(dollars in millions)		
Three months ended	\$ 40.0	\$ 25.4	\$ 14.6	57%
Percentage of total revenue	8%	6%		
Nine months ended	\$ 95.5	\$ 76.3	\$ 19.2	25%
Percentage of total revenue	7%	6%		

Changes in upfront license revenue are generally attributable to normal fluctuations in customer requirements and sales volatility in hardware, which impact revenue of related products in any particular period.

The increase in upfront license revenue for the three and nine months ended July 31, 2013 compared to the same periods in fiscal 2012 was primarily attributable to an increase in product sales.

Maintenance and Service Revenue

	2013	July 31, 2012	\$ Change	% Change
		(dollars in millions)		
Three months ended				
Maintenance revenue	\$ 19.1	\$ 19.0	\$ 0.1	1%
Professional services and other revenue	36.8	36.5	0.3	1%
Total maintenance and service revenue	\$ 55.9	\$ 55.5	\$ 0.4	1%
Percentage of total revenue	12%	13%		
Nine months ended				
Maintenance revenue	\$ 59.9	\$ 54.3	\$ 5.6	10%
Professional services and other revenue	115.4	88.9	26.5	30%
Total maintenance and service revenue	\$ 175.3	\$ 143.2	\$ 32.1	22%

Edgar Filing: SYNOPSIS INC - Form 10-Q

Percentage of total revenue	12%	11%
-----------------------------	-----	-----

Maintenance revenue fluctuates primarily due to the timing of renewals of maintenance contracts.

Professional services and other revenue for the three months ended July 31, 2013 remained flat compared to the same period in fiscal 2012.

The increase in professional services and other revenue for the nine months ended July 31, 2013 compared to the same period in fiscal 2012 was primarily due to an increase in customer consulting, customization contracts and project completions.

Table of Contents**Cost of Revenue**

	2013	July 31, 2012	\$ Change	% Change
	(dollars in millions)			
Three months ended				
Cost of license revenue	\$ 69.9	\$ 57.4	\$ 12.5	22%
Cost of maintenance and service revenue	19.2	21.2	(2.0)	(9)%
Amortization of intangible assets	26.5	21.2	5.3	25%
Total	\$ 115.6	\$ 99.8	\$ 15.8	16%
Percentage of total revenue	24%	22%		
Nine months ended				
Cost of license revenue	\$ 195.9	\$ 172.7	\$ 23.2	13%
Cost of maintenance and service revenue	59.1	59.2	(0.1)	(0)%
Amortization of intangible assets	79.4	58.2	21.2	36%
Total	\$ 334.4	\$ 290.1	\$ 44.3	15%
Percentage of total revenue	23%	22%		

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

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

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

The increase in cost of license revenue in the three and nine months ended July 31, 2013 compared to the same periods in fiscal 2012 was primarily due to an increase in product sales.

The marginal decrease in cost of maintenance and service revenue in the three months ended July 31, 2013 compared to the same period in fiscal 2012 was primarily due to lower consulting activities. Cost of maintenance and service revenue in the nine months ended July 31, 2013 compared to the same period in fiscal 2012 was relatively flat.

The increase in amortization of intangibles in the three and nine months ended July 31, 2013 compared to the same periods in fiscal 2012 was primarily due to higher intangibles acquired from acquisitions.

As a percentage of revenue, cost of revenue marginally increased for the three and nine months ended July 31, 2013 compared to the same periods in fiscal 2012 primarily due to increased amortization expense.

Operating Expenses

Research and Development

Table of Contents

	July 31,			
	2013	2012	\$ Change	% Change
	(dollars in millions)			
Three months ended	\$ 166.7	\$ 144.0	\$ 22.7	16%
Percentage of total revenue	35%	32%		
Nine months ended	\$ 494.1	\$ 428.1	\$ 66.0	15%
Percentage of total revenue	34%	33%		

The increase in research and development expenses in the three months ended July 31, 2013 compared to the same period in fiscal 2012 was primarily due to an increase of \$18.5 million in personnel-related costs as a result of headcount increases, primarily from our acquisitions, and functionally allocated expenses that were higher by \$2.0 million in fiscal 2013.

The increase in research and development expenses in the nine months ended July 31, 2013 compared to the same period in fiscal 2012 was primarily due to an increase of \$61.6 million in personnel-related costs primarily as a result of headcount increases, predominantly from our acquisitions, and functionally allocated expenses that were higher by \$8.3 million in fiscal 2013. Also contributing to the increase was a \$3.0 million reduction in contingent consideration liability in fiscal 2012. The increase in research and development expenses was partially offset by an additional week of expenses of approximately \$7.5 million in fiscal 2012 and a \$5.1 million reduction of acquisition-related costs compared to the same period in fiscal 2012.

Sales and Marketing

	July 31,			
	2013	2012	\$ Change	% Change
	(dollars in millions)			
Three months ended	\$ 105.4	\$ 100.0	\$ 5.4	5%
Percentage of total revenue	22%	23%		
Nine months ended	\$ 311.1	\$ 304.2	\$ 6.9	2%
Percentage of total revenue	21%	23%		

The increase in sales and marketing expenses in the three months ended July 31, 2013 compared to the same period in fiscal 2012 was primarily due to increases of \$1.9 million in variable compensation due to higher shipments, and \$2.2 million in personnel-related costs as a result of headcount increases, primarily from our acquisitions.

The increase in sales and marketing expenses in the nine months ended July 31, 2013 compared to the same period in fiscal 2012 was primarily due to increases of \$15.8 million in personnel-related costs driven by headcount increases, and \$1.8 million for contract termination fees. The increase in sales and marketing expenses was partially offset by the additional week of expenses of approximately \$4.9 million in fiscal 2012 and a \$4.5 million reduction of acquisition-related costs compared to the same period in fiscal 2012.

General and Administrative

	July 31,			
	2013	2012	\$ Change	% Change
	(dollars in millions)			
Three months ended	\$ 34.5	\$ 31.8	\$ 2.7	8%
Percentage of total revenue	7%	7%		
Nine months ended	\$ 104.7	\$ 115.6	\$ (10.9)	(9)%
Percentage of total revenue	7%	9%		

The increase in general and administrative expenses for the three months ended July 31, 2013 compared to the same period in fiscal 2012 was primarily due to an increase of \$7.5 million in professional service costs, which was partially offset by a \$3.7 million reduction of acquisition-related costs compared to the same period in fiscal 2012.

The decrease in general and administrative expenses for the nine months ended July 31, 2013 compared to the same period in fiscal 2012 was primarily due to \$20.9 million less in acquisition-related costs in fiscal 2013, higher allocation of \$5.2 million in expenses to other functions, resulting from increased expenses in the allocation pool, and the additional week of expenses of approximately \$1.6 million in fiscal 2012. The decrease in general and administrative expenses was partially offset by an increase of \$11.6 million in professional services costs, and \$4.4

million in facilities and depreciation expenses primarily due to our acquisitions.

Table of Contents**Amortization of Intangible Assets**

	July 31,			
	2013	2012	\$ Change	% Change
	(dollars in millions)			
Three months ended				
Included in cost of revenue	\$ 26.5	\$ 21.2	\$ 5.3	25%
Included in operating expenses	5.8	4.8	1.0	21%
Total	\$ 32.3	\$ 26.0	\$ 6.3	24%
Percentage of total revenue				
	7%	6%		
Nine months ended				
Included in cost of revenue	\$ 79.4	\$ 58.2	\$ 21.2	36%
Included in operating expenses	17.6	13.3	4.3	32%
Total	\$ 97.0	\$ 71.5	\$ 25.5	36%

Percentage of total revenue 7% 5%

The increase in amortization of intangible assets for the three and nine months ended July 31, 2013 compared to the same periods in fiscal 2012 was due to the amortization of intangible assets from our prior-year acquisitions. See Note 6 of the *Notes to Unaudited Condensed Consolidated Financial Statements* for a schedule of future amortization amounts.

Other Income (Expense), net

	July 31,			
	2013	2012	\$ Change	% Change
	(dollars in millions)			
Three months ended				
Interest income	\$ 0.3	\$ 0.3	\$ 0.0	0%
Interest expense	(0.4)	(0.7)	0.3	(43)%
Gain (loss) on assets related to executive deferred compensation plan assets	2.9	(1.4)	4.3	(307)%
Foreign currency exchange gain (loss)	0.2	(0.4)	0.6	(150)%
Other, net	0.2	(0.1)	0.3	(300)%
Total	\$ 3.2	\$ (2.3)	\$ 5.5	(239)%
Nine months ended				
Interest income	\$ 1.5	\$ 1.3	\$ 0.2	15%
Interest expense	(1.3)	(1.4)	0.1	(7)%
Gain on assets related to executive deferred compensation plan assets	12.5	5.0	7.5	150%
Foreign currency exchange gain	6.1	1.6	4.5	281%
Other, net	2.3	1.4	0.9	64%
Total	\$ 21.1	\$ 7.9	\$ 13.2	167%

The increase in other income (expense), net in the three and nine months ended July 31, 2013 compared to the same periods in fiscal 2012 was primarily due to gains in the value of investments within the executive deferred compensation plan. Additionally, other income (expense) increased for the nine months ended July 31, 2013 compared to the same period in fiscal 2012 due to gains in our foreign currency hedges.

Taxes

Edgar Filing: SYNOPSIS INC - Form 10-Q

Our effective tax rate for the three months ended July 31, 2013 as compared to the same period in fiscal 2012 was higher primarily due to the tax impact of an Internal Revenue Service (IRS) settlement for fiscal years 2010 and 2011 and a settlement with the Taiwan tax authorities for fiscal year 2008 recorded in the third quarter of fiscal 2012. Our effective tax rate for the nine months ended July 31, 2013 as compared to the same period in fiscal 2012 was higher principally due to the tax impact of IRS and Taiwan audit settlements recorded in fiscal 2012 offset by the benefit of the reinstatement of

Table of Contents

the U.S. federal research tax credit and the reversal of deferred taxes resulting from the merger of a foreign affiliate in the first quarter of fiscal 2013. The reinstatement of research tax credit resulted in an additional tax credit for ten months of fiscal 2012 as well as a full year credit for fiscal 2013, compared to only two months of credit in fiscal 2012 as a result of the expiration of the credit on December 31, 2011. For further discussion of the provision for income taxes, see Note 15 of the *Notes to Unaudited Condensed Consolidated Financial Statements*.

Liquidity and Capital Resources

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

As of July 31, 2013, we held an aggregate of \$383.4 million in cash and cash equivalents in the United States and an aggregate of \$509.0 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 unaudited, condensed balance sheets and statements of cash flow, and other commitments of our liquidity and capital resources during the nine months ended July 31, 2013.

Cash and Cash Equivalents

	July 31, 2013	October 31, 2012	\$ Change	% Change
	(dollars in millions)			
Cash and cash equivalents	\$ 892.4	\$ 700.4	\$ 192.0	27%

Our cash provided by operating activities was \$305.4 million in the nine months ended July 31, 2013.

Our cash used in investing and financing activities included: (1) purchases of property and equipment of \$47.6 million (2) proceeds from issuances of common stock of \$90.5 million for stock awards, (3) payment for the remaining non-controlling interest in SpringSoft of \$44.0 million (4) payment for the repurchase of shares of \$70.0 million, and (5) repayment for our Term Loan of \$22.5 million.

Cash Flows

	2013	July 31, 2012	\$ Change	% Change
	(dollars in millions)			
Nine months ended				
Cash provided by operating activities	\$ 305.4	\$ 383.1	\$ (77.7)	(20)%
Cash used in investing activities	(48.1)	(471.0)	422.9	(90)%
Cash provided by (used in) financing activities	(52.2)	204.7	(256.9)	(126)%

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 which the license fee is typically paid either quarterly or annually over the term of the license.

Cash provided by operating activities. Cash provided by operating activities for the nine months ended July 31, 2013 was lower compared to the same period in fiscal 2012 primarily due to lower deferred revenue and higher disbursements, offset partly by lower tax-related payments and higher collections from customers, which were all attributable to timing.

Edgar Filing: SYNOPSIS INC - Form 10-Q

Cash used in investing activities. Cash used in investing activities for the nine months ended July 31, 2013 was lower compared to the same period in fiscal 2012 driven by cash paid for acquisitions during the first half of fiscal 2012, but partly offset by proceeds from the sale of short-term investments in the first quarter of fiscal 2012.

Cash used in financing activities. Cash used in financing activities for the nine months ended July 31, 2013 was higher compared to the same period in fiscal 2012 primarily due to payment for acquiring the remaining non-controlling interest in SpringSoft, a decrease in proceeds from issuances of common stock, and proceeds from the drawdown from our credit facilities in fiscal 2012 that did not recur in the current period.

Table of Contents**Accounts Receivable, net**

July 31, 2013	October 31, 2012	\$ Change (dollars in millions)	% Change
\$ 278.9	\$ 292.7	\$ (13.8)	(5)%

Our accounts receivable and days sales outstanding (DSO) are primarily driven by our billing and collections activities. Our DSO was 53 days at July 31, 2013, and 59 days at October 31, 2012. DSO decreased primarily due to increased cash collections and the timing of billings to customers.

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

	July 31, 2013	October 31, 2012	\$ Change (dollars in millions)	% Change
Current assets	\$ 1,330.1	\$ 1,140.7	\$ 189.4	17%
Current liabilities	1,171.7	1,252.6	(80.9)	(6)%
Working capital	\$ 158.4	\$ (111.9)	\$ 270.3	(242)%

Changes in our working capital were primarily due to: (1) a \$192.0 million increase in cash and cash equivalents, (2) a \$62.0 million decrease in accounts payable and accrued liabilities, and (3) a \$30.5 million decrease in current deferred revenue due to the timing of our billings. These changes in working capital were partially offset by a \$13.8 million decrease in accounts receivable attributable to timing and an \$11.5 million increase in accrued income taxes.

Other Commitments Credit Facility

On February 17, 2012, we entered into an agreement with several lenders (the *Credit Agreement*) providing for (i) a \$350.0 million senior unsecured revolving credit facility (the *Revolver*) and (ii) a \$150.0 million senior unsecured term loan facility (the *Term Loan*). Principal payments on a portion of the Term Loan are due in equal quarterly installments of \$7.5 million, with the remainder due when the Credit Agreement expires in October 2016. Subject to obtaining additional commitments from lenders, the principal amount of the loans provided under the Credit Agreement may be increased by up to an additional \$150.0 million through October 13, 2015.

As of July 31, 2013, we had no outstanding balance under the Revolver and a \$112.5 million outstanding balance under the Term Loan, of which \$82.5 million is classified as long-term. The interest paid on borrowings under the Credit Agreement and commitment fees paid on the Revolver are variable rates tied to LIBOR plus a spread based on our leverage ratio.

Other

As of July 31, 2013, our cash equivalents consist of cash deposits, tax-exempt money market mutual funds and taxable money market mutual funds. We follow an established investment policy and set of guidelines to monitor, manage and limit our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer. During the three and nine months ended July 31, 2013 and 2012, we had no impairment charge associated with our 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.

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 portfolio invested in banks and securities with a weighted-average credit rating exceeding AA. The majority of our investments are classified as Level 1 or Level 2 investments, as measured under fair value guidance. See Notes 4 and 5 of the *Notes to*

Unaudited Condensed Consolidated Financial Statements.

Item 3. *Quantitative and Qualitative Disclosures about Market Risk*

As of July 31, 2013, our exposure to market risk has not changed materially since October 31, 2012. For more information on financial market risks related to changes in interest rates, reference is made to Item 7A. *Quantitative and Qualitative Disclosure About Market Risk* contained in Part II of our Annual Report on Form 10-K for the fiscal year ended October 31, 2012, filed with the SEC on December 20, 2012.

Table of Contents

Item 4. *Controls and Procedures*

- (a) *Evaluation of Disclosure Controls and Procedures.* As of July 31, 2013, Synopsisys carried out an evaluation under the supervision and with the participation of Synopsisys management, including the Co-Chief Executive Officers and Chief Financial Officer, of the effectiveness of the design and operation of Synopsisys disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable, not absolute, assurance of achieving their control objectives. Our Co-Chief Executive Officers and Chief Financial Officer have concluded that, as of July 31, 2013, (1) Synopsisys disclosure controls and procedures were designed to provide reasonable assurance of achieving their objectives, and (2) Synopsisys disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the reports Synopsisys 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 Synopsisys management, including the Co-Chief Executive Officers 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 Synopsisys internal control over financial reporting during the three months ended July 31, 2013, that have materially affected, or are reasonably likely to materially affect, Synopsisys internal control over financial reporting.

Table of Contents

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.

On December 5, 2011, plaintiff Dynetix Design Solutions, Inc. (Dynetix) filed a patent infringement lawsuit against Synopsys in federal district court in the Northern District of California. The lawsuit alleges, among other things, that our VCS functional verification tool, and more specifically our VCS multicore technology, infringes Dynetix's United States Patent No. 6,466,898, and that such infringement is willful. The lawsuit seeks, among other things, compensatory damages and a permanent injunction. Synopsys asserted patent infringement counterclaims against Dynetix based on Dynetix's verification products.

We acquired Emulation & Verification Engineering S.A. (EVE) on October 4, 2012. EVE and EVE-USA, Inc. (collectively, the EVE Parties) were defendants in three existing patent infringement lawsuits filed by Mentor Graphics Corporation (Mentor). Mentor filed suit against the EVE Parties in federal district court in the District of Oregon on August 16, 2010 alleging that EVE's ZeBu series of products infringes Mentor's United States Patent No. 6,876,962. Mentor filed an additional suit in federal district court in the District of Oregon on August 17, 2012 alleging that EVE's ZeBu series of products infringes Mentor's United States Patent No. 6,947,882. Both cases seek compensatory damages and a permanent injunction and have been consolidated, along with a case filed by Synopsys and the EVE Parties in September 2012 as described below, in federal district court in the District of Oregon (the Oregon Action). Mentor also filed a patent infringement lawsuit against Nihon EVE K.K. in Tokyo District Court in 2010 alleging that EVE's ZeBu series of products infringes Mentor's Japanese Patent No. P3,588,324. This case seeks compensatory damages, a permanent injunction and destruction of inventory.

On September 27, 2012, Synopsys and the EVE Parties filed an action for declaratory relief against Mentor in federal district court in the Northern District of California, seeking a determination that Mentor's United States Patents Nos. 6,009,531; 5,649,176 and 6,240,376, which were the subject of a patent infringement lawsuit filed by Mentor against EVE in 2006 and settled in the same year, are invalid and not infringed by EVE's products, and that Mentor is without right or authority to threaten or maintain suit against the plaintiffs on such patents. Mentor has asserted patent infringement counterclaims in this action based on the same three patents and is seeking compensatory damages and a permanent injunction. In April 2013, this action was transferred and consolidated with the Oregon Action.

In the consolidated Oregon Action, Synopsys and the EVE Parties have further asserted patent infringement counterclaims against Mentor based on Synopsys' United States Patents Nos. 6,132,109 and 7,069,526, seeking compensatory damages and a permanent injunction.

On September 26, 2012, Synopsys filed two *inter partes* review requests with the U.S. Patent and Trademark Office (the PTO) challenging the validity of Mentor's 376 and 882 patents. The PTO granted review of the 376 patent and denied review of the 882 patent.

On December 21, 2012, Synopsys filed an action for patent infringement against Mentor in federal district court in the Northern District of California, alleging that Mentor's Veloce family of products infringes Synopsys' United States Patents Nos. 5,748,488, 5,530,841, 5,680,318 and 6,836,420. This case seeks compensatory damages and a permanent injunction.

Item 1A. *Risk Factors*

We describe our risk factors below.

Table of Contents

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.

The global economy has 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 ongoing weakness in the global economy has adversely affected the semiconductor industry. Growth in the semiconductor industry has been relatively flat in the last two years and 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.

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 multi-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. If payment defaults by our customers significantly increase or we experience significant reductions in existing contractual commitments, our operating results would be harmed. Furthermore, future periods of decreased committed average annual revenue, customer bankruptcies, or consolidation among our customers, could adversely affect our year-over-year revenue growth.

Weakness in the global economy 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 deteriorate in the future, or, in particular, if the semiconductor industry does 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.

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 previously led and in the future could lead to a decrease in design starts and design activity in general, with some customers focusing more on one discrete phase of the design process. Demand for our products and services could decrease 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 increased 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.

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

Table of Contents

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

Acquisitions are an important part of our growth strategy. We have completed a significant number of acquisitions in recent years, including the recent acquisitions of SpringSoft, Inc. and Emulation & Verification Engineering S.A. (EVE).

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

- Potential negative impact on our earnings per share;
- Failure of acquired products to achieve projected sales;
- Problems in integrating the acquired products with our products;
- Difficulties entering into new market segments in which we are not experienced;
- Potential downward pressure on operating margins due to lower operating margins of acquired businesses, increased headcount costs and other expenses associated with adding and supporting new products;
- Difficulties in retaining and integrating key employees;
- Failure to realize expected synergies or cost savings;
- Dilution of our current stockholders through the issuance of common stock as part of the merger consideration, 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;
- Disruption of ongoing business operations, including diversion of management's attention;
- Potential negative impact on our relationships with customers, distributors and business partners; and
- Negative impact on our earnings resulting from the application of ASC 805, *Business Combinations*.

If we do not manage these risks, the acquisitions that we complete may have an adverse effect on our business and financial condition. If we are unable to successfully integrate acquired products and technology, we may not be able to achieve anticipated revenue growth from our acquisitions. In addition, expenses associated with supporting acquired products could result in less expense synergies than anticipated. The integration process may involve significant management time and create uncertainty for employees and customers, and delays in the process could have a material adverse effect on our revenues, expenses, operating results and financial condition. 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.

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

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

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

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

We prepare our consolidated financial statements in conformity with U.S. Generally Accepted Accounting Principles (GAAP). These principles are subject to interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles and guidance. A change in existing principles or guidance can have a significant effect on our reported results and may retroactively affect previously reported results. Additionally, proposed accounting standards could have a significant impact on our operational processes, revenues and expenses, and could cause unexpected financial reporting fluctuations.

Edgar Filing: SYNOPSIS INC - Form 10-Q

For example, the Financial Accounting Standards Board (FASB) is currently working together with the International Accounting Standards Board (IASB) to converge certain accounting principles and facilitate more comparable financial reporting between companies that are required to follow GAAP and those that are required to follow International

Table of Contents

Financial Reporting Standards (IFRS). These efforts may result in different accounting principles under GAAP, which may have a material impact on the way in which we report financial results in areas including, but not limited to, revenue recognition, lease accounting, and financial statement presentation. The SEC may make a determination in the future regarding the incorporation of IFRS into the financial reporting system for U.S. companies. A change in accounting principles from GAAP to IFRS or to converged accounting principles may have a material impact on our financial statements and may retroactively adversely affect previously reported transactions.

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

Our operating results are subject to quarterly and annual fluctuations, which may adversely affect our stock price. Our historical results should not be viewed as indicative of our future performance due to these periodic fluctuations. Many factors may cause our revenue or earnings to fluctuate, including:

- Changes in demand for our products due to fluctuations in demand for our customers' products and due to constraints in our customers' budgets for research and development and EDA products and services;
- Product competition in the EDA industry, which can change rapidly due to industry or customer consolidation and technological innovation;
- Our ability to innovate and introduce new products and services or effectively integrate products and technologies that we acquire;
- Failures or delays in completing sales due to our lengthy sales cycle, which often includes a substantial customer evaluation and approval process because of the complexity of our products and services;
- Cancellations or changes to levels of license orders or the mix between upfront license revenue 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 license 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;
- Expenses related to our acquisition and integration of businesses and technology;
- 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.

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

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

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

We compete principally on the basis of technology, product quality and features (including ease-of-use), license or usage terms, post-contract customer support, interoperability among products, and price and payment terms. Specifically, we believe the following competitive factors affect our success:

Edgar Filing: SYNOPSIS INC - Form 10-Q

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

Table of Contents

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.

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

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

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

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

Assert claims of infringement of our intellectual property;

Defend our products from piracy;

Protect our trade secrets or know-how; or

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

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

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.

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

Edgar Filing: SYNOPSIS INC - Form 10-Q

We have operations 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 impact our effective tax rate. Furthermore, we maintain significant deferred tax assets related to federal research credits and foreign tax credits and certain state tax credits. Our ability to use these

Table of Contents

credits is dependent upon having sufficient future taxable income, including 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.

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 periodic research and development expenses may be independent of our level of revenue which could negatively impact our financial results. Finally, there can be no guarantee that our research and development investments will result in products that create significant, or even any, revenue.

The global nature of our operations exposes us to increased risks and compliance obligations 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;

Government trade restrictions, including tariffs or other trade barriers;

Additional taxes and penalties; and

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

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

In addition, our global operations are subject to numerous U.S. and foreign laws and regulations, including those related to anti-corruption, tax, corporate governance, imports and exports, financial and other disclosures, privacy and labor relations. These laws and regulations are complex and may have differing or conflicting legal standards, making compliance difficult and costly. If we violate these laws and regulations we could be subject to fines, penalties or criminal sanctions, and may be prohibited from conducting business in one or more countries. Although we have implemented policies and procedures to ensure compliance with these laws and regulations, there can be no assurance that our employees,

Edgar Filing: SYNOPSYS INC - Form 10-Q

contractors or agents will not violate these laws and regulations. Any violation individually or in the aggregate could have a material adverse effect on our operations and financial condition.

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

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

As of July 31, 2013, we have outstanding debt of \$112.5 million under our term loan facility, primarily as a result of funding our acquisition of Magma Design Automation, Inc. in February 2012. Most of our worldwide cash and cash equivalents balance is held in subsidiary accounts outside the United States approximately 57% as of July 31, 2013. Most of our worldwide cash and cash equivalents are held by our international subsidiaries in their own accounts. Should

Table of Contents

our cash spending needs in the United States rise and exceed our existing U.S. balances, available credit under our revolving credit and term loan facilities, and future U.S. cash flows, we may be required to incur additional debt at higher than anticipated interest rates or access other funding sources, which could negatively affect our results of operations, capital structure and/or the market price of our common stock.

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

We are from time to time subject to claims alleging our infringement of third party intellectual property rights, including patent rights. For example, in December 2011, a patent infringement lawsuit was filed against us by Dynetix Design Solutions, Inc., which seeks, among other things, compensatory damages and a permanent injunction. We may also acquire companies that are party to existing infringement claims. For example, EVE, a company we acquired in October 2012, is a party to ongoing patent infringement lawsuits involving Mentor Graphics Corporation. Further information regarding the Dynetix and EVE lawsuits is contained in Part II, Item 1, *Legal Proceedings*. In addition, under our customer agreements and other license agreements, we agree in many cases to indemnify our customers if our products infringe a third party's intellectual property rights. Infringement claims can result in costly and time-consuming litigation, require us to enter into royalty arrangements, subject us to damages or injunctions restricting our sale of products, invalidate a patent or family of patents, require us to refund license fees to our customers or to forgo future payments or require us to redesign certain of our products, any one of which could harm our business and operating results.

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.

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. Further information regarding material pending lawsuits, other than ordinary routine litigation incidental to our business, is contained in Part II, Item 1, *Legal Proceedings*.

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

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

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

Table of Contents

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 Stock Market, and the FASB. These rules and regulations continue to evolve in scope and complexity and many new requirements have been created in response to laws enacted by Congress, making compliance more difficult and uncertain. For example, Congress recently passed the Dodd-Frank Wall Street Reform and Consumer 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 portfolio currently consists of 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, 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.

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

We store sensitive data, including intellectual property, our proprietary business information and that of our customers, and confidential employee information, in our data centers and on our networks. Despite our security measures, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions that could result in unauthorized disclosure or loss of sensitive information. Furthermore, in the operation of our business we also use third party vendors that store certain sensitive data, including confidential information about our employees, and these third parties are subject to their own cybersecurity threats. Any security breach of our own or a third party vendor's systems could cause us to be non-compliant with applicable laws or regulations, subject us to legal claims or proceedings, disrupt our operations, damage our reputation, and cause a loss of confidence in our products and services, any of which could adversely affect our business.

In preparing our financial statements we make certain assumptions, judgments and estimates that affect amounts reported in our consolidated financial statements, which, if not accurate, may significantly impact our financial results.

We make assumptions, judgments and estimates for a number of items, including the fair value of financial instruments, goodwill, long-lived assets and other intangible assets, the realizability of deferred tax assets, the recognition of revenue and the fair value of stock awards. We also make assumptions, judgments and estimates in determining the accruals for employee related liabilities, including commissions and variable compensation, and in determining the accruals for uncertain tax positions, allowances for doubtful accounts, and legal contingencies. These assumptions, judgments and estimates are drawn from historical experience and various other factors that we believe are reasonable under the circumstances as of the date of the consolidated financial statements. Actual results could differ materially from our estimates, and such differences could significantly impact our financial results.

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

Due to the global nature of our business, our operating results may be negatively impacted by catastrophic events throughout the world. We rely on a global network of infrastructure applications, enterprise applications and technology systems for our development, marketing, operational, support and sales activities. A disruption or failure of these systems in the event of a major earthquake, fire, telecommunications failure,

cybersecurity attack, terrorist attack, or other

Table of Contents

catastrophic event could cause system interruptions, delays in our product development and loss of critical data and could prevent us from fulfilling our customers' orders. Moreover, our corporate headquarters, a significant portion of our research and development activities, our data centers, and certain other critical business operations are located in California, near major earthquake faults. A catastrophic event that results in the destruction or disruption of our data centers or our critical business or information technology systems would severely affect our ability to conduct normal business operations and, as a result, our operating results would be adversely affected.

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

Our Board of Directors (Board) 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 replenished the stock repurchase program up to \$500.0 million on May 25, 2011. We repurchase shares to offset dilution caused by ongoing stock issuances from existing plans for equity compensation awards or issuances related to acquisitions, and when management believes it is a good use of cash. Repurchases are transacted in accordance with Rule 10b-18 of the Securities Exchange Act of 1934 (Exchange Act) and may be made through any means including, but not limited to, open market purchases, plans executed under Rule 10b5-1(c) of the Exchange Act and structured transactions. As of July 31, 2013, \$202.4 million remained available for further repurchases under the program.

The table below sets forth information regarding repurchases of Synopsys' common stock by Synopsys during the three months ended July 31, 2013.

Period(1)	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced programs	Maximum dollar value of shares that may yet be purchased under the programs
Month #1				
May 5, 2013 through June 8, 2013		\$		\$ 237,379,496
Month #2				
June 9, 2013 through July 6, 2013	969,800	\$ 36.09	969,800	\$ 202,379,612
Month #3				
July 7, 2013 through August 3, 2013		\$		\$ 202,379,612
Total	969,800	\$ 36.09	969,800	\$ 202,379,612

(1) All months shown are Synopsys' fiscal months.

See Note 10 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. *Mine Safety Disclosures*

Not applicable.

Item 5. *Other Information*

Not applicable.

Table of ContentsItem 6. *Exhibits*

Exhibit		Incorporated By Reference				Filed Herewith
Number	Exhibit Description	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	Amended and Restated Bylaws	8-K	000-19807	3.2	05/23/12	
4.1	Specimen Common Stock Certificate	S-1	33-45138	4.3	02/24/92 (effective date)	
31.1	Certification of Co-Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
31.2	Certification of Co-Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
31.3	Certification of Principal Financial Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
32.1	Certification of Co-Principal Executive Officers and Principal Financial Officer furnished pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					X

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: August 30, 2013

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	Amended and Restated Bylaws	8-K	000-19807	3.2	05/23/12	
4.1	Specimen Common Stock Certificate	S-1	33-45138	4.3	02/24/92 (effective date)	
31.1	Certification of Co-Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
31.2	Certification of Co-Principal Executive Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
31.3	Certification of Principal Financial Officer furnished pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Exchange Act					X
32.1	Certification of Co-Principal Executive Officers and Principal Financial Officer furnished pursuant to Rule 13a-14(b) or Rule 15d-14(b) of the Exchange Act and Section 1350 of Chapter 63 of Title 18 of the United States Code					X
101.INS	XBRL Instance Document					X
101.SCH	XBRL Taxonomy Extension Schema Document					X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document					X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document					X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document					X