CADENCE DESIGN SYSTEMS INC
Form 10-Q
April 25, 2008

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 29, 2008

OR

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

For the transition period from _____to _____

Commission file number 0-15867

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

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

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

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

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

Large accelerated filer [X] Accelerated filer [__] Non-accelerated filer [__] Smaller reporting company [__]
(Do not check if a 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 X

On March 29, 2008, 257,854,529 shares of the registrant s common stock, $0.01 par value, were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

ASSETS

	March 29, 2008	December 29, 2007
Current Assets:		
Cash and cash equivalents	$ 825,545	$ 1,062,920
Short-term investments	11,157	15,193
Receivables, net of allowances of $2,752 and $2,895, respectively	346,321	326,211
Inventories	29,771	31,003
Prepaid expenses and other	97,940	94,236
Total current assets	1,310,734	1,529,563
Property, plant and equipment, net of accumulated depreciation of $633,059 and $624,680, respectively	345,918	339,463
Goodwill	1,315,561	1,310,211
Acquired intangibles, net	124,196	127,072
Installment contract receivables	214,991	238,010
Other assets	326,003	326,831
Total Assets	$ 3,637,403	$ 3,871,150

LIABILITIES AND STOCKHOLDERS EQUITY

	March 29, 2008	December 29, 2007
Current Liabilities:		
Convertible notes	$ 230,385	$ 230,385
Accounts payable and accrued liabilities	220,906	289,934
Current portion of deferred revenue	298,956	265,168
Total current liabilities	750,247	785,487
Long-Term Liabilities:		
Long-term portion of deferred revenue	135,465	136,655
Convertible notes	500,000	500,000
Other long-term liabilities	357,986	368,942
Total long-term liabilities	993,451	1,005,597

Stockholders Equity:		
Common stock and capital in excess of par value	1,528,671	1,516,493
Treasury stock, at cost	(780,999)	(619,125)
Retained earnings	1,119,176	1,162,441
Accumulated other comprehensive income	26,857	20,257
Total stockholders equity	1,893,705	2,080,066
Total Liabilities and Stockholders Equity	$ 3,637,403	$ 3,871,150

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

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CADENCE DESIGN SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended	
	March 29, 2008	March 31, 2007
Revenue:		
Product	$ 156,193	$ 237,904
Services	32,196	31,922
Maintenance	98,800	95,359
Total revenue	287,189	365,185
Costs and Expenses:		
Cost of product	12,001	15,652
Cost of services	25,193	23,615
Cost of maintenance	14,540	15,123
Marketing and sales	93,034	102,698
Research and development	125,356	117,065
General and administrative	37,708	40,611
Amortization of acquired intangibles	5,760	4,509
Restructuring and other charges (credits)	----	(945)
Write-off of acquired in-process technology	600	----
Total costs and expenses	314,192	318,328
Income (loss) from operations	(27,003)	46,857
Interest expense	(2,995)	(3,460)
Other income, net	5,763	19,530
Income (loss) before provision (benefit) for income taxes	(24,235)	62,927
Provision (benefit) for income taxes	(5,488)	18,506
Net income (loss)	$ (18,747)	$ 44,421
Basic net income (loss) per share	$ (0.07)	$ 0.16
Diluted net income (loss) per share	$ (0.07)	$ 0.15
Weighted average common shares outstanding basic	262,825	269,660
Weighted average common shares outstanding diluted	262,825	293,603

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

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

	Three Months Ended	
	March 29, 2008	March 31, 2007
Cash and Cash Equivalents at Beginning of Period	$ 1,062,920	$ 934,342
Cash Flows from Operating Activities:		
Net income (loss)	(18,747)	44,421
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:		
Depreciation and amortization	32,982	31,920
Stock-based compensation	21,590	27,682
Equity in loss from investments, net	333	637
Gain on investments, net	(224)	(7,498)
Gain on sale and leaseback of land and buildings	(535)	(11,127)
Write-down of investment securities	5,401	----
Write-off of acquired in-process technology	600	----
Tax benefit of call options	----	1,906
Deferred income taxes	----	191
Proceeds from the sale of receivables, net	15,660	41,434
Provisions (recoveries) for losses (gains) on trade accounts receivable and sales returns	(142)	1,283
Other non-cash items	1,075	3,216
Changes in operating assets and liabilities, net of effect of acquired businesses:		
Receivables	(20,431)	18,156
Installment contract receivables	23,253	(87,504)
Inventories	1,281	(651)
Prepaid expenses and other	(3,546)	(9,832)
Other assets	(4,344)	(4,346)
Accounts payable and accrued liabilities	(80,931)	(37,729)
Deferred revenue	22,530	6,661
Other long-term liabilities	(14,886)	143
Net cash provided by (used for) operating activities	(19,081)	18,963
Cash Flows from Investing Activities:		
Proceeds from sale of short-term investments	----	197
Proceeds from the sale of long-term investments	3,250	4,787
Proceeds from the sale of property, plant and equipment	----	46,500
Purchases of property, plant and equipment	(24,595)	(20,394)
Purchases of software licenses	(375)	----

Investment in venture capital partnerships and equity investments	----	(1,499)
Cash paid in business combinations and asset acquisitions, net of cash acquired, and acquisition of intangibles	(5,560)	(1,547)
Net cash provided by (used for) investing activities	(27,280)	28,044
Cash Flows from Financing Activities:		
Principal payments on term loan	----	(28,000)
Tax benefit from employee stock transactions	95	8,642
Proceeds from issuance of common stock	25,485	111,616
Stock received for payment of employee taxes on vesting of restricted stock	(2,207)	(6,223)
Purchases of treasury stock	(216,236)	(121,455)
Net cash used for financing activities	(192,863)	(35,420)
Effect of exchange rate changes on cash and cash equivalents	1,849	825
Increase (decrease) in cash and cash equivalents	(237,375)	12,412
Cash and Cash Equivalents at End of Period	$ 825,545	$ 946,754

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

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

NOTE 1. BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q have been prepared by Cadence Design Systems, Inc., or Cadence, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, or the SEC. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, Cadence believes that the disclosures contained in this Quarterly Report comply with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, for a Quarterly Report on Form 10-Q and are adequate to make the information presented not misleading. These Condensed Consolidated Financial Statements are meant to be, and should be, read in conjunction with the Consolidated Financial Statements and the notes thereto included in Cadence s Annual Report on Form 10-K for the fiscal year ended December 29, 2007.

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

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

In September 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standard, or SFAS, No. 157, Fair Value Measurements, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position, or FSP, FAS No. 157-2, Effective Date of FASB Statement No. 157, which delayed the effective date of SFAS No. 157 to fiscal years beginning after November 15, 2008 and interim periods within those fiscal years for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Cadence adopted SFAS No. 157 for fiscal 2008, except as it applies to those non-financial assets and non-financial liabilities as described in FSP FAS No. 157-2, and it did not have a material impact on its consolidated financial position, results of operations or cash flows. See Note 3 for information and related disclosures regarding Cadence s fair value measurements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. Under SFAS No. 159, companies may elect to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Cadence adopted SFAS No. 159 for fiscal 2008. However Cadence did not elect to apply the fair value option to any financial instruments or other items upon adoption of SFAS No. 159 or during the three months ended March 29, 2008. Therefore, the adoption of SFAS No. 159 did not impact Cadence s consolidated financial position, results of operations or cash flows.

NOTE 2. STOCK-BASED COMPENSATION

Cadence has equity incentive plans that provide for the grant to employees of stock-based awards, including stock options, restricted stock awards and restricted stock units. Restricted stock awards and restricted stock units are referred to in this Form 10-Q as restricted stock. In addition, the 1995 Directors Stock Option Plan, or

1995 Directors Plan, provides for the automatic grant of stock options to non-employee members of Cadence s Board of Directors. Cadence also has an employee stock purchase plan, or ESPP, which enables employees to purchase shares of Cadence common stock.

Stock-based compensation expense and the related income tax benefit recognized under SFAS No. 123R, Share-Based Payment in the Condensed Consolidated Statements of Operations in connection with stock options, restricted stock and the ESPP for the three months ended March 29, 2008 and March 31, 2007 were as follows:

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands)	
Stock options	$ 7,519	$ 10,430
Restricted stock and stock bonuses	11,164	15,184
ESPP	2,907	2,068
Total stock-based compensation expense	$ 21,590	$ 27,682
Income tax benefit	$ 6,060	$ 10,011

Stock Options

The exercise price of each stock option granted under Cadence s employee equity incentive plans is equal to or greater than the market price of Cadence s common stock on the date of grant. Generally, option grants vest over four years, expire no later than ten years from the grant date and are subject to the employee s continuing service to Cadence. The options granted under the 1995 Directors Plan vest one year from the date of grant. Options assumed in connection with acquisitions generally have exercise prices that differ from the fair value of Cadence s common stock on the date of acquisition and such options generally continue to vest under their original vesting schedules and expire on the original dates stated in the acquired company s option agreements. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The weighted average grant date fair value of options granted and the weighted average assumptions used in the model for the three months ended March 29, 2008 and March 31, 2007 were as follows:

	Three Months Ended	
	March 29, 2008	March 31, 2007
Dividend yield	None	None
Expected volatility	45.0%	23.0%
Risk-free interest rate	2.51%	4.54%
Expected life (in years)	4.5	4.4
Weighted average fair value of options granted	$ 4.29	$ 4.75

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

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Restricted Stock and Stock Bonuses

The cost of restricted stock is determined using the fair value of Cadence s common stock on the date of the grant, and compensation expense is recognized over the vesting period. The weighted average grant date fair values of restricted stock granted during the three months ended March 29, 2008 and March 31, 2007 were as follows:

	Three Months Ended	
	March 29, 2008	March 31, 2007
Weighted average fair value of restricted stock granted	$ 10.66	$ 20.26

Generally, restricted stock vests over four years and is subject to the employee s continuing service to Cadence. Cadence issues some of its restricted stock with performance-based vesting. The terms of these restricted stock grants are consistent with grants of restricted stock described above, with the exception that the shares vest not upon the mere passage of time, but upon the attainment of certain predetermined performance goals. Each period, Cadence estimates the most likely outcome of such performance goals and recognizes the related stock-based compensation expense. The amount of stock-based compensation expense recognized in any one period can vary based on the attainment or estimated attainment of the various performance goals. If such performance goals are not met, no compensation expense is recognized and any previously recognized compensation expense is reversed. Stock-based compensation expense related to these performance-based restricted stock grants for the three months ended March 29, 2008 and March 31, 2007 was as follows:

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands)	
Stock-based compensation expense related to performance-based grants	$ 2,016	$ 1,764

Liability-based Awards

Cadence maintains a performance-based bonus plan under which payments may be made in Cadence s common stock. Each period, Cadence estimates the most likely outcome of predetermined performance goals and recognizes any related stock-based compensation expense. The amount of stock-based compensation expense recognized in any one period can vary based on the attainment or estimated attainment of the various performance goals. If such performance goals are not met, no compensation expense is recognized and any previously recognized compensation expense is reversed. The dollar amount earned under this bonus plan is based on the achievement of the performance goals, and the number of shares to be issued under the plan is based on the average stock price for three days preceding the grant date. Stock issued under the performance-based bonus plan vests immediately. During the three months ended March 29, 2008, Cadence agreed to make the period s payment of $2.7 million in cash. Under the terms of this performance-based bonus plan, future payments are to be made in stock. Stock-based compensation expense related to these performance-based bonus plans and the shares issued for the three months ended March 29, 2008 and March 31, 2007 were as follows:

Three Months Ended

	March 29, 2008	March 31, 2007
	(In thousands)	
Stock-based compensation expense related to performance-based bonus plan	$ 1,425	$ 3,932
Shares issued for performance-based bonus plan	----	252

Employee Stock Purchase Plan

Under the ESPP, substantially all employees may purchase Cadence s common stock at a price equal to 85% of the lower of the fair market value at the beginning of the applicable offering period or at the end of each applicable purchase period, in an amount up to 12% of their annual base earnings plus bonuses, subject to a limit in any calendar year of $25,000 worth of common stock. The duration of each offering period under the ESPP is six months. New offerings begin on each February 1st and August 1st of each year and the purchase dates under the ESPP are January 31st and July 31st of each year.

Shares of Cadence s common stock issued under the ESPP for the three months ended March 29, 2008 and March 31, 2007 were as follows:

	Three Months Ended March 29, 2008	Three Months Ended March 31, 2007
	(In thousands, except per share amounts)	
Cadence shares issued under the ESPP	2,719	1,921
Cash received from the exercise of purchase rights under the ESPP	$ 23,455	$ 22,581
Weighted average purchase price per share	$ 8.63	$ 11.76

Compensation expense is calculated using the fair value of the employees purchase rights under the Black-Scholes option pricing model. The weighted average grant date fair value of purchase rights granted under the ESPP and the weighted average assumptions used in the model for the three months ended March 29, 2008 and March 31, 2007 were as follows:

	Three Months Ended March 29, 2008	Three Months Ended March 31, 2007
Dividend yield	None	None
Expected volatility	45.0%	23.0%
Risk-free interest rate	2.15%	5.16%
Expected life (in years)	0.5	0.5
Weighted average fair value of purchase rights granted	$ 2.97	$ 4.49

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

NOTE 3. FINANCIAL INSTRUMENTS

Fair Value of Financial Instruments

On a quarterly basis, Cadence measures at fair value certain financial assets and liabilities, including cash equivalents, available-for-sale securities, trading securities held in Cadence s Nonqualified Deferred Compensation Plans, or NQDCs, and foreign exchange contracts. SFAS No. 157 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect Cadence s market assumptions. These two types of inputs have created the following fair-value hierarchy:

Level 1 Quoted prices for identical instruments in active markets;

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

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

This hierarchy requires Cadence to minimize the use of unobservable inputs and to use observable market data, if available, when determining fair value. The fair value of these financial assets and liabilities was determined using the following levels of inputs as of March 29, 2008.

	Fair Value Measurements as of March 29, 2008:			
	Total	Level 1	Level 2	Level 3
	(In thousands)			
Assets:				
Cash equivalents Money market mutual funds	$ 706,080	$ 706,080	$ ----	$ ----
Available-for-sale securities	10,887	10,799	----	88
Trading securities held in NQDCs	51,451	51,451	----	----
Foreign currency exchange contracts	82	----	82	----
Total	$ 768,500	$ 768,330	$ 82	$ 88

Marketable Securities

Cadence considers all of its investments in marketable securities as available-for-sale. Available-for-sale securities are stated at fair value, with the unrealized gains and losses presented net of tax and reported as a separate component of Stockholders equity. Realized gains and losses are determined using the specific identification method. Gains are recognized when realized and are recorded in the Condensed Consolidated Statements of Operations as Other income, net. Losses are recognized as realized or when Cadence has determined that an other-than-temporary decline in fair value has occurred.

It is Cadence s policy to review the fair value of these marketable securities on a regular basis to determine whether its investments in these companies are other-than-temporarily impaired. This evaluation includes, but is not limited to, reviewing each company s cash position, financing needs, earnings or revenue outlook, operational performance, management or ownership changes and competition. If Cadence believes the carrying value of an investment is in excess of its fair value, and this difference is other-than-temporary, it is Cadence s policy to write down the investment to reduce its carrying value to fair value.

During the three months ended March 29, 2008, Cadence determined that one of its available-for-sale securities was other-than-temporarily impaired based on the severity and the duration of the impairment and Cadence wrote down the investment by $5.4 million. This impairment is included in Other income, net in the Condensed Consolidated Statement of Operations for the three month ended March 29, 2008.

NOTE 4. GOODWILL AND ACQUIRED INTANGIBLES

Goodwill

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

The changes in the carrying amount of goodwill for the three months ended March 29, 2008 were as follows:

	(In thousands)
Balance as of December 29, 2007	$ 1,310,211
Goodwill resulting from acquisition during the period	3,074
Foreign currency translation	2,276
Balance as of March 29, 2008	$ 1,315,561

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Acquired Intangibles, net

Acquired intangibles with finite lives as of March 29, 2008 were as follows:

	Gross Carrying Amount	Accumulated Amortization (In thousands)	Acquired Intangibles, net
Existing technology and backlog	$ 655,467	$ (608,352)	$ 47,115
Agreements and relationships	101,480	(55,943)	45,537
Distribution rights	30,100	(14,297)	15,803
Tradenames, trademarks and patents	29,867	(14,126)	15,741
Total acquired intangibles	$ 816,914	$ (692,718)	$ 124,196

During the three months ended March 29, 2008, Cadence acquired intangible assets of $8.6 million, including $0.6 million allocated to acquired in-process technology related to Cadence s acquisition of Chip Estimate Corporation. The acquired in-process technology was immediately expensed because technological feasibility had not been established and no future alternative use existed.

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

	Gross Carrying Amount	Accumulated Amortization (In thousands)	Acquired Intangibles, net
Existing technology and backlog	$ 651,427	$ (602,161)	$ 49,266
Agreements and relationships	96,585	(51,791)	44,794
Distribution rights	30,100	(13,545)	16,555
Tradenames, trademarks and patents	29,367	(12,910)	16,457
Total acquired intangibles	$ 807,479	$ (680,407)	$ 127,072

Amortization of acquired intangibles for the three months ended March 29, 2008 and March 31, 2007 was as follows:

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands)	
Cost of product	$ 4,683	$ 5,552
Cost of services	3	3

Cost of maintenance	1,045	1,227
Amortization of acquired intangibles	5,760	4,509
Total acquired intangibles	$ 11,491	$ 11,291

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

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

	(In thousands)
2008 remaining period	$ 32,827
2009	35,243
2010	22,924
2011	17,620
2012	12,129
Thereafter	3,453
Total estimated amortization expense	$ 124,196

NOTE 5. CONTINGENCIES

Legal Proceedings

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

On May 30, 2007, Ahmed Higazi, a former Cadence employee, filed suit against Cadence in the United States District Court for the Northern District of California alleging that Cadence improperly classified him and a class of other Cadence information technology employees as exempt from overtime pay. The suit alleges claims for unpaid overtime under the federal Fair Labor Standards Act and California law, waiting-time penalties under the California Labor Code, failure to provide proper earnings statements under California law, failure to provide meal periods and rest breaks as required by California law, unfair business practices under California Business & Professions Code section 17200, and unpaid 401(k) Plan contributions in violation of the Employee Retirement Income Security Act, or ERISA. On June 20, 2007, Cadence answered plaintiff s complaint, denying its material allegations and raising a number of affirmative defenses, and on December 19, 2007, Cadence filed an amended answer. A period of discovery conducted by both sides then ensued, followed, in January 2008, by a private mediation of the case. At the mediation, the parties were successful in resolving their respective differences, and have entered into a settlement agreement without contesting the merits of the claims or admitting liability. The parties are in the process of obtaining court approval of the settlement, which is not expected to occur before the third quarter of 2008. Cadence has accrued for the expected settlement in its Condensed Consolidated Balance Sheets.

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

Income Taxes

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

Cadence believes that the proposed IRS adjustments are inconsistent with applicable tax laws and Cadence is vigorously challenging these proposed adjustments. The RAR is not a final Statutory Notice of Deficiency, but the IRS imposes interest on the proposed deficiencies until the matters are resolved. Interest is compounded daily at rates that are published and adjusted quarterly by the IRS and have been between 4% and 10% since 2001. The IRS is currently examining Cadence s federal income tax returns for the tax years 2003 through 2005.

Other Contingencies

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

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

NOTE 6. NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed by dividing net income (loss), the numerator, by the weighted average number of shares of common stock outstanding, less unvested restricted stock grants, the denominator, during the period. Diluted net income per share gives effect to equity instruments considered to be potential common shares, if dilutive, computed using the treasury stock method of accounting. In periods in which a net loss is recorded, potentially dilutive equity instruments would decrease the loss per share and therefore are not added to the weighted average shares outstanding.

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

Emerging Issues Task Force, or EITF, No. 04-08, Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share, requires Cadence to include in diluted earnings per share the shares of Cadence s common stock into which the 1.375% Convertible Senior Notes Due 2011 and the 1.500% Convertible Senior Notes Due 2013, together, the Convertible Senior Notes, may be converted. However, since the Convertible Senior Notes meet the qualification of an Instrument C under EITF No. 90-19, Convertible Bonds with Issuer Option to Settle for Cash Upon Conversion, and because cash will be paid for the principal amount of the obligation upon conversion, the only shares that will be considered for inclusion in diluted net income per share are those relating to the excess of the conversion premium over the principal amount, using the if-converted method of accounting.

The calculations for basic and diluted net income (loss) per share for the three months ended March 29, 2008 and March 31, 2007 were as follows:

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands, except per share amounts)	
Basic:		
Net income (loss)	$ (18,747)	$ 44,421
Weighted average common shares outstanding	262,825	269,660
Basic net income (loss) per share	$ (0.07)	$ 0.16
Diluted:		
Net income (loss)	$ (18,747)	$ 44,421
Effect of dilutive securities:		
Amortization of 2023 Notes transaction fees, net of tax	----	219
Net income (loss) as adjusted	$ (18,747)	$ 44,640
Weighted average common and potential common shares used to calculate basic net income (loss) per share	262,825	269,660
2023 Notes	----	14,721
Options	----	7,336
Restricted stock and ESPP shares	----	1,886
Weighted average common and potential common shares used to calculate diluted net income (loss) per share	262,825	293,603
Diluted net income (loss) per share	$ (0.07)	$ 0.15

The following table presents the potential shares of Cadence s common stock outstanding for the three months ended March 29, 2008 and March 31, 2007 that were not included in the computation of diluted net income per share because the effect of including these shares would have been anti-dilutive:

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands)	
Options to purchase shares of common stock (various expiration dates through 2017)	41,532	18,168
Non-vested shares of restricted stock	5,415	----
	23,640	23,640

Warrants to purchase shares of common stock related to the Convertible Senior Notes (various expiration dates through 2014)		
Warrants to purchase shares of common stock related to the 2023 Notes (various expiration dates through May 2008)	8,340	14,717
Total potential common shares excluded	78,927	56,525

NOTE 7. STOCK REPURCHASE PROGRAMS

In December 2006, Cadence s Board of Directors authorized a program to repurchase shares of Cadence s common stock in the open market with a value of up to $500.0 million in the aggregate that was completed during the three months ended March 29, 2008. In February 2008, Cadence s Board of Directors authorized a new program

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to repurchase shares of Cadence s common stock in the open market with a value of up to $500.0 million in the aggregate.

The shares repurchased under Cadence s stock repurchase programs during the three months ended March 29, 2008 and March 31, 2007 were as follows:

	Three Months Ended March 29, 2008	Three Months Ended March 31, 2007
	(In thousands)	
Shares repurchased	19,774	5,900
Total cost of repurchased shares	$ 216,236	$ 121,455

As of March 29, 2008, the repurchase authorization remaining under Cadence s repurchase program totaled $412.1 million.

NOTE 8. RETAINED EARNINGS

The changes in retained earnings for the three months ended March 29, 2008 were as follows:

	(In thousands)
Balance as of December 29, 2007	$ 1,162,441
Net loss	(18,747)
Re-issuance of treasury stock	(24,518)
Balance as of March 29, 2008	$ 1,119,176

Cadence records a gain or loss on re-issuance of treasury stock based on the total proceeds received in the transaction. Gains on the re-issuance of treasury stock are recorded as a component of Capital in excess of par in Stockholders Equity. Losses on the re-issuance of treasury stock are recorded as a component of Capital in excess of par to the extent that there are gains to offset the losses. If there are no treasury stock gains in Capital in excess of par, the losses upon re-issuance of treasury stock are recorded as a component of Retained earnings in Stockholders Equity. During the three months ended March 29, 2008, Cadence recorded losses on the re-issuance of treasury stock of $24.5 million as a component of Retained earnings.

NOTE 9. OTHER COMPREHENSIVE INCOME (LOSS)

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

Cadence s comprehensive income (loss) for the three months ended March 29, 2008 and March 31, 2007 was as follows:

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands)	
Net income (loss)	$ (18,747)	$ 44,421
Foreign currency translation gain	5,707	2,580
Changes in unrealized holding gains (losses) on available-for-sale securities, net of reclassification adjustment for realized gains and losses, net of related tax effects	893	(835)
Comprehensive income (loss)	$ (12,147)	$ 46,166

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NOTE 10. OTHER INCOME, NET

Cadence s Other income, net, for the three months ended March 29, 2008 and March 31, 2007 was as follows: