SYNOPSYS INC
Form 10-Q/A
July 09, 2003

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

AMENDMENT NO. 1 TO
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 JANUARY 31, 2003

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	56-1546236
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

700 EAST MIDDLEFIELD ROAD
MOUNTAIN VIEW, CA 94043
(Address of principal executive offices)

TELEPHONE: (650) 584-5000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (l) 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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes [X] No [ ]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

77,253,625 shares of Common Stock as of July 7, 2003

DOCUMENTS INCORPORATED BY REFERENCE

EXPLANATORY NOTE

This Amendment No. 1 to the Registrant's Form 10-Q for the fiscal quarter ended January 31, 2003 is being filed in order to revise the pro forma disclosure information that is required by Statement of Financial Accounting Standards No. 123, 'Accounting for Stock-Based Compensation'for the fiscal quarters ended January 31, 2002 and 2003. For ease of reference, the Registrant has filed this document in its entirety. Except as so indicated, the Registrant has made no other changes to the quarterly report on Form 10-Q for the fiscal quarter ended January 31, 2003.

SYNOPSYS, INC.
QUARTERLY REPORT ON FORM 10-Q
January 31, 2003

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SYNOPSYS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value data)

	JANUARY 31, 2003	OCTOBER 31, 2002
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 347,339	$ 312,580
Short-term investments	122,921	102,153
Total cash and short-term investments	470,260	414,733
Accounts receivable, net of allowances of $11,325 and $11,565, respectively	220,573	207,206
Deferred taxes	288,920	282,867
Prepaid expenses and other	27,795	24,509
Total current assets	1,007,548	929,315
Property and equipment, net	182,454	185,040
Long-term investments	30,368	39,386
Goodwill, net	435,767	434,554
Intangible assets, net	327,652	355,334
Other assets	34,226	35,085
Total assets	$ 2,018,015	$ 1,978,714
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 194,641	$ 246,789
Current portion of long-term debt	78	1,423
Accrued income taxes	164,136	169,912
Deferred revenue	383,558	359,245
Total current liabilities	742,413	777,369
Deferred compensation and other liabilities	45,153	36,387
Long-term deferred revenue	41,562	51,477
Stockholders' equity:		
Preferred stock, $0.01 par value; 2,000 shares authorized; no shares outstanding	--	--
Common stock, $0.01 par value; 400,000 shares authorized; 74,330 and 73,562 shares outstanding, respectively	743	735
Additional paid-in capital	1,042,483	1,039,386
Retained earnings	225,842	198,863
Treasury stock, at cost	(83,999)	(116,499)
Deferred stock compensation	(7,351)	(8,858)
Accumulated other comprehensive income (loss)	11,169	(146)
Total stockholders' equity	1,188,887	1,113,481
Total liabilities and stockholders' equity	$ 2,018,015	$ 1,978,714

See accompanying notes to unaudited condensed consolidated financial statements.

SYNOPSYS, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(in thousands, except per share data)

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
Revenue:		
Product	$ 54,520	$ 39,555
Service	72,387	69,093
Ratable license	141,229	66,897
Total revenue	268,136	175,545
Cost of revenue:		
Product	3,753	4,066
Service	22,020	20,684
Ratable license	12,786	10,440
Amortization of intangible assets and deferred stock compensation	19,903	--
Total cost of revenue	58,462	35,190
Gross margin	209,674	140,355
Operating expenses:		
Research and development	67,269	48,706
Sales and marketing	71,238	59,799
General and administrative	22,551	18,708
Amortization of goodwill, intangible assets and deferred stock compensation	8,880	4,044
Total operating expenses	169,938	131,257
Operating income	39,736	9,098
Other income, net	9,210	11,081
Income before provision for income taxes	48,946	20,179
Provision for income taxes	14,561	6,127
Net income	$ 34,385	$ 14,052
Basic earnings per share:		
Net income per share	$ 0.46	$ 0.23
Weighted-average common shares	74,065	60,136

Diluted earnings per share:		
Net income per share	$ 0.45	$ 0.22
Weighted-average common shares and dilutive stock options outstanding	76,639	65,011

See accompanying notes to unaudited condensed consolidated financial statements.

SYNOPSYS, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 34,385	$ 14,052
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Amortization and depreciation	43,902	16,674
Provision for doubtful accounts and sales returns	--	1,231
Write-down of long-term investments	1,000	--
Gain on sale of long-term investments	(8,142)	(5,865)
Net change in unrecognized gains and losses on foreign exchange contracts	18,710	4,110
Deferred taxes	(4,650)	(2,903)
Deferred rent	1,006	--
Tax benefit associated with stock options	3,226	8,061
Net changes in operating assets and liabilities:		
Accounts receivable	(14,550)	(1,268)
Prepaid expenses and other current assets	1,842	(11,530)
Other assets	88	(5,781)
Accounts payable and accrued liabilities	(58,309)	(29,407)
Accrued income taxes	(5,776)	(55,095)
Deferred revenue	14,398	(9,487)
Deferred compensation	4,332	5,250
Net cash (used in) provided by operating activities	31,462	(71,958)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and maturities of short-term investments	76,559	346,627
Purchases of short-term investments	(97,767)	(349,996)
Proceeds from sale of long-term investments	12,466	11,057
Purchases of long-term investments	(300)	(2,733)

Purchases of property and equipment	(11,564)	(17,824)
Capitalization of software development costs	(654)	(398)
Net cash used in investing activities	(21,260)	(13,267)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from sale of common stock	25,153	42,791
Net cash provided by financing activities	25,153	42,791
Effect of exchange rate changes on cash	(596)	2,707
Net increase (decrease) in cash and cash equivalents	34,759	(39,727)
Cash and cash equivalents, beginning of period	312,580	271,696
Cash and cash equivalents, end of period	$ 347,339	$ 231,969

See accompanying notes to unaudited condensed consolidated financial statements.

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SYNOPSYS, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF COMPANY

Synopsys, Inc. (Synopsys or the Company) is a leading supplier of electronic design automation (EDA) software to the global electronics industry. The Company develops, markets, and supports a wide range of integrated circuit (IC) design products that are used by designers of advanced ICs and the electronic systems (such as computers, cell phones, and internet routers) that use such ICs, to automate significant portions of their design process. ICs are distinguished by the speed at which they run, their area, the amount of power they consume and their cost of production. Synopsys' products offer its customers the opportunity to design ICs that are optimized for speed, area, power consumption and production cost, while reducing overall design time. The Company also provides consulting services to help its customers improve their IC design and, where requested, to assist them with their IC designs, as well as training and support services.

2. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Fiscal Period End. The Company has a fiscal year and first quarter that ends on the Saturday nearest October 31 and January 31, respectively. Fiscal year 2003 and fiscal year 2002 are both 52-week years. For presentation purposes, the unaudited condensed consolidated financial statements and notes refer to the calendar month end.

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. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the financial position, results of operations and cash flows of the Company have been made. Operating results for the interim periods are not necessarily indicative of the results that may be expected for any future period or the full fiscal year. The

unaudited condensed consolidated financial statements and notes included herein should be read in conjunction with the consolidated financial statements and notes thereto for the fiscal year ended October 31, 2002, included in the Company's 2002 Annual Report on Form 10-K, as amended.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts recorded in the unaudited condensed consolidated financial statements and accompanying notes. Actual amounts could differ from these estimates.

Revenue Recognition and Cost of Revenue. Revenue consists of fees for perpetual and time-based licenses for the Company's software products, post-contract customer support (PCS), customer training and consulting. The Company classifies its revenues as product, service or ratable license. Product revenue consists primarily of sales of perpetual licenses.

Service revenue consists of fees for consulting services, training, and PCS associated with non-ratable time-based licenses or perpetual licenses. PCS sold with perpetual licenses is generally renewable, after any bundled PCS period expires, in one-year increments for a fixed percentage of the perpetual list price or, for certain perpetual license arrangements in excess of $2 million, as a percentage of the net license fee.

Ratable license revenue is all fees related to time-based licenses bundled with PCS and sold as a single package (commonly referred to by the Company as a Technology Subscription License or TSL), and time-based licenses in which the Company did not bundle PCS but has granted extended payment terms or under which the customer has a right to receive unspecified future products.

Cost of product revenue includes cost of production personnel, product packaging, documentation, amortization of capitalized software development costs, and costs of the Company's systems products. Cost of service revenue includes personnel and the related costs associated with providing training, consulting and PCS. Cost of ratable license revenue includes the cost of products and services related to time-based licenses bundled with PCS and sold as a single package and to time-based licenses that include extended payment terms or unspecified future products. Cost of revenue also includes the amortization of contract rights intangible, core technology and deferred stock compensation. The contract rights intangible arose in connection with certain acquisitions and represents amounts due after the date of acquisition on certain signed ratable license agreements under which the acquired companies had delivered the initial configuration of licensed technologies and were obligated to meet reconfiguration obligations and to provide PCS over a one to three year period. On these arrangements, the customer had been granted extended payment terms and, therefore, the fees were not considered to be fixed and determinable at the outset of the arrangement. As the amounts represented by the contract rights intangible were due after the date of acquisition, there were no receivables or deferred revenues representing these amounts recorded on the historical financial statements of the acquired companies at the respective closing dates. As deliveries are scheduled to occur over the terms of the arrangements, these ratable licenses and PCS arrangements require future performance by both parties and, as such, represent executory contracts.

The Company recognizes revenue in accordance with SOP 97-2, Software Revenue Recognition, as amended by SOP 98-9 and SOP 98-4 and generally

recognizes revenue when all of the following criteria are met as set forth in paragraph 8 of SOP 97-2:

- Persuasive evidence of an arrangement exists,
- Delivery has occurred,
- The vendor's fee is fixed or determinable, and
- Collectibility is probable.

The Company defines each of the four criteria above as follows:

Persuasive Evidence of an Arrangement Exists. It is the Company's customary practice to have a written contract, which is signed by both the customer and Synopsys, or a purchase order from those customers that have previously negotiated a standard end-user license arrangement or volume purchase agreement, prior to recognizing revenue on an arrangement.

Delivery Has Occurred. The Company's software may be either physically or electronically delivered to its customers. For those products that are delivered physically, the Company's standard transfer terms are FOB shipping point. For an electronic delivery of software, delivery is considered to have occurred when the customer has been provided with the access codes that allow the customer to take immediate possession of the software on its hardware.

If an arrangement includes undelivered products or services that are essential to the functionality of the delivered product, delivery is not considered to have occurred.

The Vendor's Fee is Fixed or Determinable. The fee the Company's customers pay for its products is negotiated at the outset of an arrangement, and is generally based on the specific volume of product to be delivered. The Company's license fees are not a function of variable-pricing mechanisms such as the number of units distributed or copied by the customer, or the expected number of users in an arrangement. Therefore, except in cases where the Company grants extended payment terms to a specific customer, the Company's fees are considered to be fixed or determinable at the inception of the arrangements.

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The Company's typical payment terms are such that a minimum of 75% of the arrangement revenue is due within one year or less. Arrangements with payment terms extending beyond the typical payment terms are not considered to be fixed or determinable. Revenue from such arrangements is recognized at the lesser of the aggregate of amounts due and payable or the amount of the arrangement fee that would have been recognized if the fees had been fixed or determinable.

Collectibility is Probable. Collectibility is assessed on a customer-by-customer basis. The Company typically sells to customers for which there is a history of successful collection. New customers are subjected to a credit review process that evaluates the customers' financial positions and ultimately their ability to pay. New customers are typically assigned a credit limit based on a formulated review of their financial position. Such credit limits are only increased after a successful collection history with the customer has been established. If it is determined from the outset of an arrangement that collectibility is not probable based upon the Company's credit review process, revenue is recognized on a cash-collected basis.

Multiple Element Arrangements. The Company allocates revenue on software arrangements involving multiple elements to each element based on the relative fair values of the elements. The Company's determination of fair value of each element in multiple element arrangements is based on vendor-specific objective evidence (VSOE). The Company limits its assessment of VSOE for each element to the price charged when the same element is sold separately.

The Company has analyzed all of the elements included in its multiple-element arrangements and determined that it has sufficient VSOE to allocate revenue to the PCS components of its perpetual license products and consulting. Accordingly, assuming all other revenue recognition criteria are met, revenue from perpetual licenses is recognized upon delivery using the residual method in accordance with SOP 98-9 and revenue from PCS is recognized ratably over the PCS term. The Company recognizes revenue from TSLs over the term of the ratable license period, as the license and PCS portions of a TSL are bundled and not sold separately and the Company has not established VSOE on TSLs. Revenue from contracts with extended payment terms is recognized as the lesser of amounts due and payable or the amount of the arrangement fee that would have been recognized if the fee were fixed or determinable.

Certain of the Company's time-based licenses include the rights to unspecified additional products. Revenue from contracts with the rights to unspecified additional software products is recognized ratably over the contract term. The Company recognizes revenue from time-based licenses that include both unspecified additional software products and extended payment terms that are not considered to be fixed or determinable in an amount that is the lesser of amounts due and payable or the ratable portion of the entire fee.

Consulting Services. The Company provides design methodology assistance, specialized services relating to telecommunication systems design and generalized turnkey design services. The Company's consulting services generally are not essential to the functionality of the software. The Company's software products are fully functional upon delivery and implementation does not require any significant modification or alteration. The Company's services to its customers often include assistance with product adoption and integration and specialized design methodology assistance. Customers typically purchase these professional services to facilitate the adoption of the Company's technology and dedicate personnel to participate in the services being performed, but they may also decide to use their own resources or appoint other professional service organizations to provide these services. Software products are generally billed separately and independently from consulting services, which are mostly billed on a time-and-materials or milestone-achieved basis. The Company generally recognizes revenue from consulting services as the services are performed.

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Exceptions to the general rule above involve arrangements where the Company has committed to significantly alter the features and functionality of its software or build complex interfaces necessary for the Company's software to function in the customer's environment. These types of services are considered to be essential to the functionality of the software. Accordingly, contract accounting is applied to both the software and service elements included in these arrangements.

Accounting For Stock-Based Compensation. In accordance with APB 25, the Company applies the intrinsic value method in accounting for employee stock

options. Accordingly, the Company generally recognizes no compensation expense with respect to stock-based awards to employees. The Company has determined pro forma information regarding net income and earnings per share as if the Company had accounted for employee stock options under the fair value method as required by SFAS No. 123. The Company has revised its SFAS No. 123 pro forma stock option disclosure presented below for the three month periods ended January 31, 2002 and 2003 to incorporate the tax benefits associated with equity instruments. The fair value of these stock-based awards to employees was estimated using the Black-Scholes option pricing model, assuming no expected dividends and using the following weighted-average assumptions:

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
	Stock Option Plans	
Expected life (in years)	5.1	4.9
Risk-free interest rate	3.0%	4.0%
Volatility	59.1%	59.0%
	ESPP	
Expected life (in years)	1.25	1.25
Risk-free interest rate	1.4%	2.1%
Volatility	59.1%	59.0%

For unaudited pro forma purposes, the estimated fair value of the Company's stock-based awards to employees is amortized over the options' vesting period (generally over four years) and the ESPP's look-back period (six-months to two years). The weighted-average estimated fair value of stock options issued for the three months ended January 31, 2003 and 2002 was $23.39 and $29.17 per share, respectively. The weighted-average estimated fair value of share purchase rights under the ESPP for the three months ended January 31, 2003 and 2002 was $16.17 and $17.67 per share, respectively. The Company's unaudited pro forma net income and earnings per share data under SFAS No. 123 is as follows:

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
	(in thousands, except per share amounts)	
Net income, as reported	$ 34,385	$ 14,052
Add: Stock-based employee compensation included in net income	1,327	--
Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	31,263	22,165
Pro forma net (loss) under SFAS 123	$ 4,449	$ (8,113)
Earnings (loss) per share-- basic		
As reported under APB 25	$ 0.46	$ 0.23
Pro forma under SFAS 123	$ 0.06	$ (0.13)
Earnings (loss) per share-- diluted		

As reported under APB 25	$ 0.45	$ 0.22
Pro forma under SFAS 123	$ 0.06	$ (0.13)

NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 141 (SFAS 141), Business Combinations, and Financial Accounting Standards No. 142 (SFAS 142), Goodwill and Other Intangible Assets. SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and specifies criteria intangible assets acquired in a purchase method business combination must meet to be recognized apart from goodwill. SFAS 141 is effective for all business combinations completed after June 30, 2001.

The Company adopted SFAS 142 on November 1, 2002. Upon adoption of SFAS 142, amortization of goodwill recorded for business combinations consummated prior to July 1, 2001 ceased. Intangible assets acquired prior to July 1, 2001 that do not meet the criteria for recognition under SFAS 141 are required to be reclassified to goodwill; no such reclassifications to goodwill were required. In addition, upon adoption of SFAS 142, the Company assessed useful lives and residual values of all intangible assets acquired. The Company also tested goodwill for impairment in accordance with the provisions of SFAS 142. In completing its impairment analysis, the Company determined that it has one reporting unit. In conjunction with the implementation of SFAS No. 142, the Company has completed a goodwill impairment review as of the beginning of fiscal 2003 and found no indicators of impairment. This impairment review was based on the fair value of the Company as determined by its market capitalization on the date of adoption. As of January 31, 2003, unamortized goodwill was $435.8 million, which will no longer be amortized in accordance with SFAS 142.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 143 (SFAS 143), Accounting for Asset Retirement Obligations. SFAS 143 requires that asset retirement obligations that are identifiable upon acquisition, construction or development and during the operating life of a long-lived asset be recorded as a liability using the present value of the

estimated cash flows. A corresponding amount would be capitalized as part of the asset's carrying amount and amortized to expense over the asset's useful life. The Company adopted the provisions of SFAS 143 effective November 1, 2002. The adoption of SFAS 143 did not have a significant impact on the Company's financial position and results of operations for the three months ended January 31, 2003.

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144 (SFAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, Reporting the Results of Operations for a Disposal of a Segment of a Business. The Company adopted the provisions of SFAS 144 effective November 1, 2002. The adoption of SFAS 144 did not have a significant impact on the Company's financial position and results of operations for the three months ended January 31, 2003.

In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146 (SFAS 146), Accounting for Exit or Disposal Activities. SFAS 146 addresses the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including costs related to

terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS 146 supersedes Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) and requires liabilities associated with exit and disposal activities to be expensed as incurred. SFAS 146 is effective for exit or disposal activities of the Company that are initiated after December 31, 2002. The adoption of SFAS 146 did not have a significant impact on the Company's financial position and results of operations for the three months ended January 31, 2003.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148 (SFAS 148), Accounting for Stock-Based Compensation - Transition and Disclosure. SFAS 148 amends FASB Statement No. 123 (SFAS 123), Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The Company adopted the disclosure provisions of SFAS 148 beginning in the first quarter of fiscal 2003.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, which clarifies disclosure and recognition/measurement requirements related to certain guarantees. The disclosure requirements are effective for financial statements issued after December 15, 2002 and the recognition/measurement requirements are effective on a prospective basis for guarantees issued or modified after December 31, 2002. We typically warrant our products to be free from defects in media and to substantially conform to material specifications for a period of 90 days. We also indemnify our customers from third party claims of intellectual property infringement relating to the use of our products. Historically, costs related to these guarantees have not been significant and we are unable estimate the potential impact of these guarantees on our future results of operations.

3. BUSINESS COMBINATIONS

Acquisition of Avant! Corporation. On June 6, 2002, the Company completed its merger with Avant! Corporation (Avant!). Avant! was a leader in the development of software used in the physical design and physical verification phases of chip design. As a result of the merger, the Company is now able to offer a comprehensive array of products for the design and verification of chips. Under the terms of the merger agreement between Synopsys and Avant!, Avant! merged with and into a wholly-owned subsidiary of Synopsys. The aggregate merger consideration, including the fair value of stock issued, was approximately $1.0 billion, and was determined primarily as a result of competitive bidding with other potential acquirers. As a result of the merger, the Company recorded goodwill of $370.5 million which includes an increase to

the value of goodwill as a result of an increase in the value of the contract termination liabilities of $1.0 million since October 31, 2002. The results of operations of Avant! are included in the accompanying unaudited condensed consolidated statement of income for the period from November 1, 2002 through January 31, 2003.

The following table presents the components of acquisition-related costs recorded, along with amounts paid through the period ended January 31, 2003.

(in thousands)	Balance at October 31, 2002	Payments	Balance at January 31, 2003
Acquisition related costs	$ 3,840	$ 466	$ 3,374
Facilities closure costs	57,261	8,454	48,807
Employee severance costs	290	155	135
Total	$ 61,391	$ 9,075	$ 52,316

The remaining acquisition related costs of $3.4 million consist primarily of legal and accounting fees.

Facilities closure costs at January 31, 2003 include $46.8 million related to Avant!'s corporate headquarters. After the merger, the functions performed in the buildings were consolidated into Synopsys' corporate facilities. The lessors have brought a claim against Avant! for the future amounts payable under the lease agreements. Synopsys settled certain of the claims of the landlord of two of these buildings for $7.4 million during the three months ended January 31, 2003. The amount accrued at January 31, 2003 includes an amount equal to the future amounts payable under the related lease agreements, without taking into consideration in the accrual any defenses the Company may have to the claim. Resolution of this contingency at an amount different from that accrued will result in an increase or decrease in the purchase consideration and the amount will be allocated to goodwill. The remaining facilities closure costs at the closing date totaling $2.0 million represents the present value of the future obligations under certain of Avant!'s lease agreements which the Company has or intends to terminate under an approved facilities exit plan plus additional costs expected to be incurred directly related to vacating such facilities.

Acquisition of Co-Design. On September 6, 2002, the Company completed its acquisition of Co-Design Automation, Inc. (Co-Design), a private company which was developing simulation software used in the high level verification stage of the chip design process, and a new design language that permits designers to describe the behavior of their chips more efficiently than current standard languages. The aggregate purchase price for Co-Design was $34.3 million, which was determined principally by competitive bidding with another potential acquirer. As a result of the merger the Company recorded goodwill of $27.7 million. The results of operations of Co-Design are included in the accompanying unaudited condensed consolidated statement of income for the period from November 1, 2002 through January 31, 2003.

Acquisition of inSilicon. On September 20, 2002, the Company completed its acquisition of inSilicon Corporation (inSilicon), a company that developed, marketed and licensed an extensive portfolio of complex "intellectual property blocks", or pre-designed, pre-verified subportions of a chip that can be used as building blocks for complex systems-on-a-chip, and therefore accelerate the

development of such chips. The aggregate purchase price for inSilicon was $74.6

million. As a result of the merger, the Company recorded goodwill of $22.2 million. The results of operations of inSilicon are included in the accompanying unaudited condensed consolidated statement of income for the period from the November 1, 2002 through January 31, 2003.

In connection with the acquisition of inSilicon, the Company incurred acquisition related costs of $6.2 million, consisting primarily of legal and accounting fees of $1.8 million, and other directly related charges including contract termination costs of $3.3 million, and restructuring costs of approximately $0.8 million. As of January 31, 2003, remaining accrued and unpaid acquisition related costs of $1.2 million consist primarily of outstanding contract termination costs.

Unaudited Pro Forma Results of Operations. The following table presents unaudited pro forma results of operations and gives effect to the Avant! and inSilicon mergers as if the mergers were consummated on November 1, 2001. Amounts shown for the three-month period ended January 31, 2003 are the combined Company's actual results of operations. The 2002 unaudited pro forma results of operations do not include the effect of the Co-Design merger as such effect is not material. The unaudited pro forma results of operations are not necessarily indicative of the results of operations had the Avant! and inSilicon mergers actually occurred at the beginning of fiscal 2002, nor is it necessarily indicative of future operating results:

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
	(in thousands, except per share amounts)	
Revenue	$ 268,136	$ 288,508
Net income	$ 34,385	$ 28,056
Basic earnings per share	$ 0.46	$ 0.38
Weighted average common shares outstanding	74,065	74,666
Diluted earnings per share	$ 0.45	$ 0.35
Weighted average common shares and dilutive stock options outstanding	76,639	79,376

The unaudited pro forma results of operations for each of the periods presented exclude non-recurring merger costs of $21.0 million for Avant!'s pre-merger litigation settlement and other related costs incurred by Avant! for the three months ended January 31, 2002. These expenses are included in the historical unaudited condensed consolidated statement of income. In addition, the unaudited pro forma results of operations for 2002, do not reflect the reduction in Avant!'s reported deferred revenue as required under the purchase method of accounting. This reduction results in lower revenue in periods subsequent to the merger than would have been achieved if the two companies had not been combined.

4. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

The following table presents a rollforward of the carrying value of goodwill and other intangibles, net from October 31, 2002 to January 31, 2003:

(in thousands)	Amortization Period (Years)	Balance at October 31, 2002	Additions(1)	Amortization
Goodwill		$ 434,554	$ 1,213	$ --
Intangibles:				
Contract rights intangible	3	$ 44,519	$ --	$ 4,308
Core/developed technology	3-10	186,766	--	17,226
Covenant not-to-compete	4	8,152	--	569
Customer backlog	3	3,267	--	158
Customer relationship	6	95,782	--	4,276
Trademark and tradename	3	15,242	--	1,475
Capitalized research and development costs	2	1,606	654	324
Total intangible assets		$ 355,334	$ 654	$ 28,336

(1) - Additions include amounts related to foreign currency fluctuations for goodwill which is not denominated in US dollars and $1.0 million of contract termination costs.

Total amortization expense related to goodwill and other intangible assets is set forth in the table below:

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
	(in thousands)	
Goodwill	$ --	$ 3,892
Intangibles:		
Contract rights intangible	$ 4,308	$ --
Core/developed technology	17,226	152
Covenant not-to-compete	569	--
Customer backlog	158	--
Customer relationship	4,276	--
Trademark and tradename	1,475	--
Capitalized research and development costs	324	305
Total intangible assets	$ 28,336	$ 457

The following table presents the estimated future amortization of the other intangibles (in thousands):

Fiscal Year	
2003 - remainder of fiscal year	$ 87,274

2004	112,874
2005	77,122
2006	19,727
2007 and thereafter	30,655
Total estimated future amortization of other intangibles	$ 327,652

The adjusted net loss per share excluding amortization of goodwill, as if SFAS 142 was adopted as of July 1, 2001, is included in the table below. Amounts shown for the three month period ended January 31, 2003 are the Company's actual results of operations.

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
	(in thousands, except per share amounts)	
Net income	$ 34,385	$ 14,052
Add: Amortization of goodwill	--	3,892
Adjusted net income	$ 34,385	$ 17,944
Basic earnings per share	$ 0.46	$ 0.30
Weighted average common shares outstanding	74,065	60,136
Diluted earnings per share	$ 0.45	$ 0.28
Weighted average common shares and dilutive stock options outstanding	76,639	65,011

5. STOCK REPURCHASE PROGRAM

In December 2002, the Company's Board of Directors renewed its stock repurchase program originally approved in July 2001. Under the renewed program, Synopsys common stock with a market value up to $500 million may be acquired in the open market. This renewed stock repurchase program replaced all prior repurchase programs authorized by the Board. Common shares repurchased are intended to be used for ongoing stock issuances such as existing employee stock option and stock purchase plans and acquisitions. During the three months ended January 31, 2003 and 2002, the Company did not repurchase any common shares.

6. COMPREHENSIVE INCOME

The following table sets forth the components of comprehensive income, net

of income tax expense:

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
	(in thousands)	
Net income	$ 34,385	$ 14,052
Foreign currency translation adjustment	(778)	2,595
Unrealized gain on foreign exchange contracts	13,786	--
Unrealized (loss) gain on investments	(3,991)	5,644
Reclassification adjustment for realized gains (losses) on investments	2,298	(2,969)
Total comprehensive income	$ 45,700	$ 19,322

7. EARNINGS PER SHARE

Basic earnings per share is computed using the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed using the weighted-average number of common shares and dilutive stock options outstanding during the period. The weighted-average dilutive stock options outstanding is computed using the treasury stock method.

The following is a reconciliation of the weighted-average common shares used to calculate basic net income per share to the weighted-average common shares used to calculate diluted net income per share:

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
	(in thousands)	
Weighted-average common shares for basic net income per share	74,065	60,136
Weighted-average dilutive stock options outstanding under the treasury stock method	2,574	4,875
Weighted-average common shares for diluted net income per share	76,639	65,011

The effect of dilutive stock options outstanding excludes approximately 9.9 million and 3.3 million stock options for the three months ended January 31, 2003 and 2002, respectively, which were anti-dilutive for net income per share

calculations.

8. SEGMENT DISCLOSURE

Statement of Financial Accounting Standards No. 131 (SFAS 131), Disclosures about Segments of an Enterprise and Related Information, requires disclosures of certain information regarding operating segments, products and services, geographic areas of operation and major customers. The method for determining what information to report under SFAS 131 is based upon the "management approach," or the way that management organizes the operating segments within a Company for which separate financial information is available that is evaluated regularly by the Chief Operating Decision Maker (CODM) in deciding how to allocate resources and in assessing performance. Synopsys' CODM is the Chief Executive Officer and Chief Operating Officer.

The Company provides comprehensive design software products and consulting services in the electronic design automation software industry. The CODM evaluates the performance of the Company based on profit or loss from operations before income taxes not including merger-related costs, in-process research and development and amortization of intangible assets. For the purpose of making operating decisions, the CODM primarily considers financial information presented on a consolidated basis accompanied by disaggregated information about revenues by geographic region. Revenue is defined as revenues from external customers.

Revenue and long-lived assets related to operations in the United States and other geographic areas are as follows:

	THREE MONTHS ENDED JANUARY 31, 2003	THREE MONTHS ENDED JANUARY 31, 2002
	(in thousands)	
Revenue:		
United States	$ 166,122	$ 108,709
Europe	42,289	34,068
Japan	32,896	17,018
Other	26,829	15,750
Consolidated	$ 268,136	$ 175,545

	JANUARY 31, 2003	OCTOBER 31, 2002
	(in thousands)	
Long-lived assets:		
United States	$ 158,820	$ 162,360
Other	23,634	22,680
Consolidated	$ 182,454	$ 185,040

Geographic revenue data for multi-region, multi-product transactions reflect internal allocations and is therefore subject to certain assumptions and to the Company's methodology. Beginning in fiscal 2003, geographic revenue reflects reconfiguration. The Company had one customer, Intel Corporation, that accounted for more than ten percent of the Company's total revenue for the three months ended January 31, 2003. Intel's Chief Financial and Enterprise Services Officer serves on the Synopsys Board of Directors. Company management believes the transactions between the two parties were carried out under the Company's normal terms and conditions. No one customer accounted for more than ten percent of the Company's total revenue for the same period in the prior year.

The Company segregates revenue into five categories for purposes of internal management reporting: Design Implementation, Verification and Test, Design Analysis, Intellectual Property (IP) and Professional Services. The following table summarizes the revenue attributable to each of the various categories. Revenue attributable to products acquired from Avant!, inSilicon and Co-Design that was recognized by the acquired companies prior to the respective acquisition date is not reflected in the three months ended January 31, 2002. Revenue attributable to such acquired products is included in the three months ended January 31, 2003. Due to a business unit reorganization in the first quarter of fiscal 2003, products were realigned with the majority of the shift occurring between IP and Verification and Test. Prior period amounts have been reclassified to conform to the new presentation.

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
	(in thousands)	
Revenue:		
Design Implementation	$ 116,385	$ 70,523
Verification and Test	70,680	65,765
Design Analysis	53,664	10,618
IP	15,772	14,797
Professional Services	11,635	13,842
Consolidated	$ 268,136	$ 175,545

Beginning in fiscal 2003, product revenue reflects reconfiguration.

9. DEFERRED STOCK COMPENSATION

In connection with the mergers which occurred in fiscal 2002, the Company also assumed unvested stock options held by Avant!, inSilicon and Co-Design employees. The Company recorded deferred stock compensation totaling $8.1 million, $1.7 million and $0.7 million based on the intrinsic value of these assumed unvested stock options for Avant!, inSilicon and Co-Design, respectively. The deferred stock compensation is amortized over the options' remaining vesting period of one to three years. During the three months ended January 31, 2003, the Company recorded amortization of deferred stock compensation of $1.3 million. Had the Company allocated the amortization, such

allocation would have been recorded in the following expense classifications:

(in thousands)	
Cost of revenue	$ 136
Research and development	847
Sales and marketing	283
General and administrative	61
Subtotal	1,191
Total	$ 1,327

There was no deferred stock compensation recorded during the three months ended January 31, 2002.

10. ACQUISITION OF NUMERICAL TECHNOLOGIES, INC.

On January 13, 2003, the Company entered into an Agreement and Plan of Merger with Numerical Technologies, Inc. (Numerical) under which the Company commenced a cash tender offer to acquire all of the outstanding shares of Numerical common stock at $7.00 per share, followed by a second-step merger in which the Company would acquire any untendered Numerical shares at the same price per share. Following the consummation of the cash tender offer on February 28, 2003, Numerical merged with and into a wholly owned subsidiary of Synopsys, effective March 1, 2003. The cash consideration value is approximately $240 million. The Company acquired Numerical in order to expand its offerings of design for manufacturing products.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. For example, statements including terms such as "projects," "expects," "believes," "anticipates" or "targets" are forward-looking statements. Actual results could differ materially from those anticipated in such forward-looking statements as a result of certain factors, including those set forth under "Factors That May Affect Future Results."

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of our financial condition and results of operations is based upon our unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, bad debts, investments, intangible assets and income taxes. Our estimates are based on historical experience and on various other assumptions we believe are reasonable under the circumstances. Actual results may differ from these estimates.

The accounting policies described below are those that most frequently require us to make estimates and judgments, and are therefore critical to understanding our results of operations.

Revenue Recognition. Our revenue recognition policy is detailed in Note 2 of the Notes to Unaudited Condensed Consolidated Financial Statements. Management has made significant judgments related to revenue recognition; specifically, in connection with each transaction involving our products (referred to as an "arrangement" in the accounting literature), we must evaluate whether our fee is "fixed or determinable" and we must assess whether "collectibility is probable". These judgments are discussed below.

The Fee is Fixed or Determinable. With respect to each arrangement, we must make a judgment as to whether the arrangement fee is fixed or determinable. If the fee is fixed or determinable, then revenue is recognized upon delivery of software (assuming other revenue recognition criteria are met). If the fee is not fixed or determinable, then the revenue recognized in each quarter (subject to application of other revenue recognition criteria) will be the lesser of the aggregate of amounts due and payable or the amount of the arrangement fee that would have been recognized if the fees had been fixed or determinable.

Except in cases where we grant extended payment terms to a specific customer, we have determined that our fees are fixed or determinable at the inception of our arrangements based on the following:

- The fee our customers pay for our products is negotiated at the outset of an arrangement and is generally based on the specific volume of products to be delivered.

- Our license fees are not a function of variable-pricing mechanisms such as the number of units distributed or copied by the customer or the expected number of users of the product delivered.

A determination that an arrangement fee is fixed or determinable also depends upon the payment terms relating to such an arrangement. Our customary payment terms - supported by historical practice - require that a minimum of 75% of the arrangement fee is due within one year or less. Arrangements with payment terms extending beyond the customary payment terms are considered not to be fixed or determinable. A determination of whether the arrangement fee is fixed or determinable is particularly relevant to revenue recognition on perpetual licenses.

Collectibility is Probable. In order to recognize revenue, we must make a judgment of the collectibility of the arrangement fee. Our judgment of the collectibility is applied on a customer-by-customer basis pursuant to our credit review policy. We typically sell to customers for which there is a history of

successful collection. New customers are subjected to a credit review process, which evaluates the customers' financial positions and ability to pay. New customers are typically assigned a credit limit based on a formulated review of their financial position. Such credit limits are only increased after a successful collection history with the customer has been established. If it is determined from the outset of an arrangement that collectibility is not probable based upon our credit review process, revenue is recognized on a cash-collected basis.

Valuation of Strategic Investments. As of January 31, 2003, the adjusted

cost of our strategic investments, excluding $10.3 million of net unrealized gains and amortization of equity forwards, totaled $20.1 million. We review our investments in non-public companies on a quarterly basis and estimate the amount of any impairment incurred during the current period based on specific analysis of each investment, considering the activities of and events occurring at each of the underlying portfolio companies during the quarter. Our portfolio companies operate in industries that are rapidly evolving and extremely competitive. For equity investments in non-public companies where there is not a market in which their value is readily determinable, we assess each investment for indicators of impairment at each quarter end based primarily on achievement of business plan objectives and current market conditions, among other factors, and information available to us at the time of this quarterly assessment. The primary business plan objectives we consider include achievement of planned financial results, completion of capital raising activities, the launching of technology, the hiring of key employees and overall progress on the portfolio company's business plan. If it is determined that an impairment has occurred with respect to an investment in a portfolio company, in the absence of quantitative valuation metrics, management estimates the impairment and/or the net realizable value of the portfolio investment based on public- and private-company market comparable information and valuations completed for companies similar to our portfolio companies. Based on these measurements, impairment losses aggregating $1.0 million were recorded during the three months ended January 31, 2003. No impairment losses were recorded during the same period in the prior fiscal year. Future adverse changes in market conditions, poor operating results of underlying investments and other information obtained after our quarterly assessment could result in additional losses or an inability to recover the current carrying value of the investments thereby requiring a further impairment charge in the future.

Valuation of Intangible Assets. Intangible assets, net of accumulated amortization, totaled $327.7 million as of January 31, 2003. We periodically evaluate our intangible assets for indications of impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Intangible assets consist of purchased technology, contract rights intangible (as defined under Note 2 of the Notes to Unaudited Condensed Consolidated Financial Statements), customer installed base/relationship, trademarks and tradenames, covenants not to compete, customer backlog and capitalized software. Factors we consider important which could trigger an impairment review include significant under-performance relative to expected historical or projected future operating results, significant changes in the manner of our use of the acquired assets or the strategy for our overall business or significant negative industry or economic trends. If this evaluation indicates that the value of the intangible asset may be impaired, an assessment of the recoverability of the net carrying value of the asset over its remaining useful life is made. If this assessment indicates that the intangible asset is not recoverable, based on the estimated undiscounted future cash flows of the acquired entity or technology over the remaining amortization period, the net carrying value of the related intangible asset will be reduced to fair value and the remaining amortization period may be adjusted. Any such impairment charge could be significant and could have a material adverse effect on our reported financial statements. Based on these measurements, no impairment losses were recorded during the three months ended January 31, 2003 and 2002.

Allowance For Doubtful Accounts. As of January 31, 2003, our allowance for doubtful accounts totaled $11.3 million. Management estimates the collectibility of our accounts receivable on an account-by-account basis. In addition, we provide for a general reserve on all accounts receivable, using a specified percentage of the outstanding balance in each aged group. Management specifically analyzes accounts receivable and historical bad debt experience, customer creditworthiness, current economic trends, international exposures (such as currency devaluation), and changes in our customer payment terms when

evaluating the adequacy of the allowance for doubtful accounts. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. During each of the three month periods ended January 31, 2003 and 2002, write-offs (net of recoveries) totaled $0.5 million.

Income Taxes. Our effective tax rate is directly affected by the relative proportions of our domestic and foreign revenue and income. We are also subject to changing tax laws in the multiple jurisdictions in which we operate. As of January 31, 2003, current net deferred tax assets and long-term liabilities totaled $288.9 million and $10.7 million, respectively. We believe that it is more likely than not that the results of future operations will generate sufficient taxable income to utilize these net deferred tax assets. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for any valuation allowance, should we determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets would be charged to income in the period such determination was made. A change in the deferred tax liabilities may result in an adjustment to goodwill in the period such determination is made.

RESULTS OF OPERATIONS

Mergers and Acquisitions. On June 6, 2002, we completed our merger with Avant!, a leader in the development of software used in the physical design and physical verification phases of chip design. As a result of the merger, we are now able to offer a comprehensive array of products for the design and verification of chips. The aggregate merger consideration, including the fair value of stock issued, was approximately $1.0 billion, and was determined primarily as a result of competitive bidding with other potential acquirers. As a result of the merger, we recorded goodwill of $370.5 million. The results of operations of Avant! are included in the accompanying unaudited condensed consolidated statement of income for the period from November 1, 2002 through January 31, 2003.

On September 6, 2002, we completed our acquisition of Co-Design, a private company which was developing simulation software used in the high level verification stage of the chip design process, and a new design language that permits designers to describe the behavior of their chips more efficiently than current standard languages. The aggregate purchase price for Co-Design was $34.3 million, which was determined principally by competitive bidding with another potential acquirer. As a result of the merger we recorded goodwill of $27.7 million. The results of operations of Co-Design are included in the accompanying unaudited condensed consolidated statement of income for the period from November 1, 2002 through January 31, 2003.

On September 20, 2002, we completed our acquisition of inSilicon, a company that developed, marketed and licensed an extensive portfolio of complex "intellectual property blocks", or pre-designed, pre-verified subportions of a chip that can be used as building blocks for complex systems-on-a-chip, and therefore accelerate the development of such chips. The aggregate purchase price for inSilicon was $74.6 million. As a result of the merger, we recorded goodwill of $22.2 million. The results of operations of inSilicon are included in the accompanying unaudited condensed consolidated statement of income for the period from the November 1, 2002 through January 31, 2003.

Revenue. Revenue consists of fees for perpetual and ratable licenses of our

software products, post-contract customer support (PCS), customer training and consulting. We classify revenues as product, service or ratable license. Product revenue consists primarily of perpetual software licenses. Service revenue consists of PCS under perpetual licenses and fees for consulting services and training. Ratable license revenue consists of all revenue from our TSLs and from time-based licenses sold prior to the adoption of TSLs in August 2000 that include extended payment terms or unspecified additional products.

Adoption of Subscription Licenses; Impact on Revenue. In the fourth quarter of fiscal 2000 we introduced a new type of license called a technology subscription license. A TSL is a license to use one or more of our software products, and to receive support services (such as hotline support and updates) for a limited period of time. Since TSLs include bundled products and services, both product and service revenue is generally recognized ratably over the term of the license, or, if later, as payments become due. The terms of TSLs, and the payments due thereon, may be structured flexibly to meet the needs of the customer.

In certain situations, customers have limited rights to new technology through reconfiguration clauses under their agreements.

Prior to the adoption of TSLs, we sold perpetual licenses and "term" licenses (a type of time-based license). Under these types of licenses, software support is purchased separately. Revenue from the license sale is generally recognized in the quarter that the product is shipped (or "upfront") and revenue from software support is recognized ratably over the support period. Term licenses were discontinued when TSLs were introduced.

Due to the different treatment of TSLs and perpetual/term licenses under applicable accounting rules, each type of license has a different impact on our financial statements. When a customer buys a TSL, relatively little revenue is recognized during the quarter the product is initially delivered. The remaining amount not recognized will either be recorded as deferred revenue on our balance sheet or considered operational or financial backlog by us and not recorded on the balance sheet. The amount recorded as deferred revenue is equal to the portion of the license fee that has been invoiced or paid but not recognized. The amount considered backlog moves out of backlog and is recorded as deferred revenue or recognized as invoiced or as additional payments are made. Deferred revenue is reduced as revenue is recognized. Under perpetual licenses (and term licenses), a high proportion of all license revenue is recognized in the quarter that the product is delivered, with relatively little recorded as deferred revenue or as backlog. Therefore, an order for a TSL will result in significantly lower current-period revenue than an equal-sized order under the prior form of time-based licenses. Conversely, an order for a TSL will result in higher revenues recognized in future periods than an equal-sized order for a perpetual or term license. For example, a $120,000 order for a perpetual license will result in $120,000 of revenue recognized in the quarter the product is shipped and no revenue in future quarters. The same order for a 3-year TSL shipped at the beginning of the quarter will result in $10,000 of revenue recognized in the quarter the product is shipped and in each of the 11 succeeding quarters.

On an aggregate basis, the introduction of TSLs has had, and will continue to have, a significant impact on our reported revenue and on our balance sheet. In the quarter immediately following the adoption of TSLs, reported revenue dropped significantly. In each quarter since adoption, ratable revenue has grown, as TSL orders received in each quarter contribute revenue that is

"layered" over the revenue recognized from TSL orders received in prior quarters. This effect will repeat itself each quarter in varying degrees until the TSL model is fully phased in; during this transition period ratable revenue will continue to grow even if the overall level of TSL orders does not grow, and could grow even if the overall level of TSL orders declines. The phase in period of the TSL model is difficult to predict. Since our introduction of TSLs, the average TSL duration has been approximately 13 quarters. Therefore, absent any acquisitions, the model would be substantially phased in approximately 3.25 years following the adoption of the model. The phase in period has been extended by the acquisition of Avant! and will be extended to some extent by any future acquisitions we make of companies whose license mix is more heavily weighted toward perpetual licenses than ours. Over the long term, as the TSL model becomes more fully phased in, average revenue growth will closely track average orders growth.

Synopsys' license revenue in any given quarter is dependent upon the volume of perpetual orders shipped during the quarter, the amount of TSL revenue amortized from deferred revenue, or recognized out of backlog from TSL licenses shipped during a prior quarter and, to a small degree, the amount of revenue recognized on TSL orders received during the quarter. We set our revenue targets for any given period based, in part, upon an assumption that we will achieve a certain level of orders and a certain license mix of perpetual licenses and TSLs. The precise mix of orders is subject to substantial fluctuation in any given quarter or multiple quarter periods, and the actual mix of licenses sold affects the revenue we recognize in the period. If we achieve the target level of total orders but are unable to achieve our target license mix, we may not meet our revenue targets (if we deliver more than expected TSLs) or may exceed them (if we deliver more than expected perpetuals). If we achieve the target license mix but the overall level of orders is below the target level, then we will not meet our revenue targets.

The precise mix of orders is subject to substantial fluctuation in any given quarter or multiple quarter periods. Our historical license order mix from August 2000 to the present (i.e., since our adoption of TSLs), has been 22%

perpetual licenses and 78% ratable licenses. In the first quarter of fiscal 2003, the license mix was approximately 13% perpetual licenses and 87% TSLs, in comparison to 28% perpetual licenses and 72% TSLs in the first quarter of fiscal 2002. Our target license mix for new software orders for the second quarter of fiscal year 2003 is 22% to 27% perpetual licenses and 73% to 78% ratable licenses. Our target license mix for new software orders for fiscal year 2003 is 20% to 25% perpetual licenses and 75% to 80% ratable licenses.

Revenue. Total revenue for the three months ended January 31, 2003 increased 53% to $268.1 million as compared to $175.5 million for the same period in the prior fiscal year. The increase in total revenue is primarily due to the Avant! acquisition in June 2002 and to the additional quarters that the TSL license model has been in effect.

Product revenue for the three months ended January 31, 2003 increased 38% to $54.5 million as compared to $39.6 million for the same period in the prior fiscal year. The increase in product revenue is primarily due to an increase in perpetual licenses delivered during the period as compared to the same period last year reflecting the increased volume of perpetual licenses resulting from the Avant! merger. During the second quarter of 2002, we began offering variable maintenance arrangements to certain customers that entered into perpetual license technology arrangements in excess of $2.0 million. Under these

arrangements, the annual fee for post-contract customer support (PCS) is calculated as a percentage of the net license fee rather than a fixed percentage of the list price, which results in a lower cost for PCS for our customers.

Service revenue for the three months ended January 31, 2003 increased 5% to $72.4 million as compared to $69.1 million for the same period in the prior fiscal year. The increase in service revenue is primarily due to the recognition of PCS revenue acquired in the merger with Avant! in June 2002. Notwithstanding the positive impact of the Avant! PCS contracts on the first quarter, service revenue has been and will continue to be negatively affected by a number of factors which the Company believes will lead to a decline in service revenue in fiscal 2003 as compared to fiscal 2002. First, our new licenses are predominately TSLs rather than perpetual licenses. Time-based licenses formerly sold by the Company are expiring and being renewed as TSLs, and in some cases, customers with existing perpetual licenses are entering into new TSLs rather than renewing the PCS on the existing perpetual licenses. In each case, revenue attributable to PCS that otherwise would have been reflected in service revenue is now reflected in ratable license revenue. Third, the rate charged for PCS on perpetual licenses with technology commitments in excess of $2.0 million is lower than the rate charged for PCS under a perpetual license with fixed maintenance rates resulting in relatively less PCS revenue on an order for a perpetual with a variable maintenance charge. Service revenue has also been and will continue to be negatively affected by economic conditions. Some customers have sought to reduce their costs by curtailing their use of outside consultants or by discontinuing maintenance on their perpetual licenses. As a result, we have received a lower volume of new consulting orders and maintenance renewal orders than expected. Customer expenditures on training have also been reduced, which has accordingly reduced revenue from training. These conditions are expected to continue at least until research and development spending by the semiconductor industry returns to historic levels of growth.

Ratable license revenue for the three months ended January 31, 2003 increased 111% to $141.2 million as compared to $66.9 million for the same period in the prior fiscal year. The increase in ratable license revenue is due to the additional quarters that the TSL license model has been used and the increased volume of ratable licenses resulting from the Avant! merger.

Revenue Seasonality. Our revenue is seasonal. In general, revenue in the first quarter of our fiscal year is the lowest of any quarter, and revenue in the fourth quarter is the largest of any quarter, with revenue in the second and third quarters roughly in the middle of the first and fourth quarters. This seasonal pattern may be attributed to a variety of factors, including customer buying patterns, the timing of major contract renewals and sales compensation incentives.

Revenue - Product Groups. For management reporting purposes, our products have been organized into four distinct product groups - Design Implementation, Verification and Test, Design Analysis, Intellectual Property (IP) - and a services group - Professional Services. The following table summarizes the

revenue attributable to the various groups as a percentage of total Company revenue for the last eight quarters. Revenue attributable to products acquired from Avant! that was recognized by Avant! prior to June 6, 2002 is not reflected in the following tables. Revenue attributable to such products on or after June 6, 2002 is included in the table. As a result of the Avant! merger, we redefined our product groups, effective in the third quarter of fiscal 2002. Prior period amounts have been reclassified to conform to the new presentation.

	Q1-2003	Q4-2002	Q3-2002	Q2-2002	Q1-2002	Q4-2001	Q3-2001
Revenue							
Design Implementation	44%	46%	44%	42%	40%	42%	39%
Verification and Test	26	26	27	34	38	34	34
Design Analysis	20	19	17	6	6	6	6
IP	6	5	5	9	8	9	10
Professional Services	4	4	7	9	8	9	11
Total Company	100%	100%	100%	100%	100%	100%	100%

Design Implementation. Design Implementation includes products used to design a chip from a high level functional description to a complete description of the transistors and connections that implement such functions that can be delivered to a semiconductor company for manufacturing. Design Implementation technologies include logic synthesis, physical synthesis, floor planning and place-and-route products and technologies. The principal products in this category at January 31, 2003 are Design Compiler, Physical Compiler, Chip Architect, Floorplan Compiler, Jupiter, Apollo and Astro. As a percentage of total revenue, Design Implementation fluctuated between 39% and 46% in the period from the second quarter of fiscal 2001 through the first quarter of fiscal 2003, and exhibited a generally increasing trend from the first quarter of fiscal 2001 through the fourth quarter of fiscal 2002. This trend reflects the Company's growing portfolio of Design Implementation products during the period, most notably the introduction of Physical Compiler and, with the Avant! merger, the addition of Apollo and Astro. We believe that the decrease in contribution between the fourth quarter of fiscal 2002 and the first quarter of fiscal 2003 represents a normal fluctuation based on the configuration of perpetual orders received during the quarter.

Verification and Test. Verification and Test includes products used for verification and analysis performed at the system level, register transfer level and gate level of design, including simulation, system level design and verification, timing analysis, formal verification, test and related products. The principal products in this category are VCS, Polaris, Vera, PathMill, CoCentric System Studio, PrimeTime, Formality, Design Verifyer, DFT Compiler and TetraMax, which are used in several different phases of chip design. As a percentage of total revenue, revenue from this product family fluctuated between 32% and 38% in the period from the second quarter of fiscal 2001 through the second quarter of fiscal 2002, principally attributable to the mix of perpetual versus TSL orders received for Verification and Test products during any given quarter. Beginning in the third quarter of fiscal 2002, Verification and Test revenues as a percent of total Company revenue were lower, principally because the Verification and Test product group does not include many products acquired from Avant!.

Design Analysis. Design Analysis includes products used for verification and analysis performed principally during the physical verification phase of chip design, including analog and mixed signal circuit simulation, design rule checking, power analysis, customer design, semiconductor process modeling and reliability analysis. The principal products in this category are NanoSim, StarSim, HSPICE, StarRC, Arcadia, TCAD, Hercules, Venus, Proteus, Optical Proximity Correction, PrimePower and Cosmos. During the third quarter of fiscal 2002, revenue from this product group as a percentage of total revenue increased

from a steady level of 6% to 17% primarily due to the Avant! acquisition, as the second largest portion of Avant!'s revenue was derived from products that were added to the Design Analysis category. The continued increase in contribution from these products since that quarter reflects the growing importance of design analysis technologies in addressing customers' design challenges and the emphasis of additional sales of these products by Synopsys after the merger with Avant!

Intellectual Property. Our IP products include the DesignWare library of design components and verification models and the products acquired in the merger with inSilicon in September 2002. As a percentage of total revenue, revenue from this product group was relatively stable from the second quarter of fiscal 2001 through the second quarter of fiscal 2002 reflecting growth consistent with our average. Beginning in the third quarter of fiscal 2002, IP revenue as a percentage of total revenue decreased principally because the IP product group does not include many products acquired from Avant!

Professional Services. The Professional Services group includes consulting and training activities. This group provides consulting services, including design methodology assistance, specialized telecommunications systems design services and turnkey design. As a percentage of total revenue, revenue from this product group has declined from 15% in the second quarter of fiscal 2001 to 4% in the first quarter of fiscal 2003, reflecting the fact that Avant! did not have a significant professional services business and, as described above under "Revenue", the impact of the economic environment.

Cost of Revenue. Cost of revenue consists of the cost of product revenue, cost of service revenue, cost of ratable license revenue and amortization of intangible assets and deferred stock compensation. Cost of product revenue includes personnel and related costs, production costs, product packaging, documentation, and amortization of capitalized software development costs and purchased technology. The cost of internally developed capitalized software is amortized on a straight-line basis over the software's estimated economic life of approximately two years. Cost of service revenue includes consulting services, personnel and related costs associated with providing training and PCS on perpetual licenses. Cost of ratable license revenue includes the costs of product and services related to our TSLs (TSLs include bundled product and services). Cost of product revenue, cost of service revenue and cost of ratable license revenue during any period are heavily dependent on the mix of software orders received during such period.

Cost of revenue amortization of intangible assets and deferred stock compensation includes the amortization of the contract rights intangible associated with certain executory contracts related to the acquisitions of Avant! Corporation and inSilicon Corporation, and the amortization of core/developed technology acquired in the Avant!, inSilicon and Co-Design mergers. Total amortization of intangible assets included in cost of revenues for the first quarter of fiscal 2003 was $19.9 million which includes $15.5 million and $4.4 million for core developed technology and contract rights intangible, respectively.

Total cost of revenue as a percentage of total revenue for the three months ended January 31, 2003 was 22% as compared to 20% for the same period in fiscal 2002. Excluding amortization of intangible assets and deferred stock compensation, cost of revenue as a percentage of total revenue decreased due to the increase in quarterly amortization of deferred revenue and backlog, which is an inherent result of the use of the ratable license model and due to the fact

that other cost of goods sold components remained relatively stable. Our total product costs are relatively fixed and do not fluctuate significantly with changes in revenue or changes in revenue recognition methods. The dollar increase in total cost of revenue to $58.5 million for the three months ended January 31, 2003 as compared to $35.2 million for the same period in the prior fiscal year is due to increases of $19.9 million in amortization of contract rights intangible and core/developed technology recorded as a result of the mergers occurring in fiscal 2002, $1.5 million in additional royalties and $1.2 million in other special termination benefits, as discussed below.

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Work Force Reduction. In the first quarter of fiscal 2003, the Company implemented a workforce reduction. The purpose was to reduce expenses by decreasing the number of employees in all departments in domestic and foreign locations. As a result, our workforce was decreased by approximately 200 employees and a charge of approximately $4.4 million is included in operating expenses for the three months ended January 31, 2003. The charge consists of severance and other special termination benefits and is reflected in the unaudited condensed consolidated statement of income as follows:

(in thousands)	
Cost of revenue	$ 1,167
Research and development	1,388
Sales and marketing	1,239
General and administrative	630
Total	$ 4,424

Research and Development. Research and development expenses for the three months ended January 31, 2003 increased 38% to $67.3 million as compared to $48.7 million for the same period in the prior fiscal year. The increase in expenses is due to increases of $9.1 million in personnel and related costs as a result of an increase in research and development headcount due to the Avant! acquisition in June 2002, $7.5 million in human resources, technology and facilities costs as a result of increased research and development staffing and $1.4 million in restructuring costs as a result of the workforce reduction in January 2003.

Sales and Marketing. Sales and marketing expenses for the three months ended January 31, 2003 increased 19% to $71.2 million as compared to $59.8 million for the same period in the prior fiscal year. The increase in expenses is due to increases of $11.1 million in personnel and related costs as a result of an increase in sales and marketing headcount due to the Avant! acquisition in June 2002 and $1.2 million in restructuring costs as a result of the workforce reduction in January 2003. These increases were offset by decreases of $1.3 million in human resources, technology and facilities costs as a result of a decrease in sales and marketing headcount as a percentage of total headcount

General and Administrative. General and administrative expenses for the three months ended January 31, 2003 increased 21% to $22.6 million as compared to $18.7 million for the same period in the prior fiscal year. The increase in expenses is due to increases of $2.3 million in personnel and related costs as a result of an increase in general and administrative headcount due to the Avant! acquisition in June 2002, $2.2 million in depreciation as a result of the

upgrade to our information technology infrastructure, $1.2 million in maintenance agreements covering more software and equipment due to the mergers occurring in fiscal 2002 and an increase in litigation expenses relating to certain legal actions. These increases were offset by decreases of $4.4 million in human resources, technology and facilities costs as a result of a decrease in general and administrative headcount as a percentage of total headcount.

Amortization of Goodwill, Intangible Assets and Deferred Stock Compensation. Goodwill represents the excess of the aggregate purchase price over the fair value of the tangible and identifiable intangible assets we have acquired. On November 1, 2002, we adopted SFAS 142 which requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually. As of January 31, 2003, unamortized goodwill was $435.8 million, which will no longer be amortized in accordance with SFAS 142. During the three months ended January 31, 2002, goodwill for our pre-fiscal 2002 acquisitions and intangible assets were amortized over their estimated useful lives of three to ten years. Total amortization of goodwill and intangible assets was $4.0 million for the three months ended January 31, 2002.

Amortization of intangible assets and deferred stock compensation includes the amortization of trademarks, trade names, customer relationships and covenants not-to-compete. Total amortization of intangible assets included in operating expenses for the first quarter of fiscal 2003 was $8.9 million including $1.2 million for deferred stock compensation.

In connection with the mergers occurring in fiscal 2002, we also assumed unvested stock options held by Avant!, inSilicon and Co-Design employees. We have recorded deferred stock compensation totaling $8.1 million, $1.7 million and $0.7 million based on the intrinsic value of these assumed unvested stock options for Avant!, inSilicon and Co-Design, respectively. The deferred stock compensation is amortized over the options' remaining vesting period of one to three years. During the three months ended January 31, 2003, we recorded amortization of deferred stock compensation of $1.3 million. Had we allocated the amortization, such allocation would have been recorded in the following expense classifications:

(in thousands)	
Cost of revenue	$ 136
Research and development	847
Sales and marketing	283
General and administrative	61
Subtotal	1,191
Total	$ 1,327

No deferred stock compensation was recorded during the three months ended January 31, 2002.

Other Income, Net. Other income, net for the three months ended January 31, 2003 was $9.2 million. The balance consists primarily of the following: (i) realized gain on investments of $7.6 million, (ii) rental income of $2.6

million, (iii) interest income of $1.2 million, (iv) amortization of premium forwards and foreign currency forwards of $1.1 million, (v) impairment charges related to certain assets in our venture portfolio of $1.0 million and (vi) other miscellaneous expenses including foreign exchange gains and losses recognized during the quarter of $2.3 million.

Other income, net for the three months ended January 31, 2002 was $11.1 million. The balance consists primarily of the following: (i) realized gain on investments of $6.6 million, (ii) rental income of $2.4 million, (iii) interest income of $2.2 million, (iv) amortization of premium forwards and foreign currency forwards of $0.4 million and (v) other miscellaneous expenses including foreign exchange gains and losses recognized during the quarter of $0.5 million.

Unaudited Pro Forma Results of Operations. The following table presents unaudited pro forma results of operations and gives effect to the Avant! and inSilicon mergers as if the mergers were consummated on November 1, 2001. Amounts shown for the three-month period ended January 31, 2003 are the combined Company's actual results of operations. The 2002 unaudited pro forma results of operations do not include the effect of the Co-Design merger as such effect is not material. The unaudited pro forma results of operations are not necessarily indicative of the results of operations had the Avant! and inSilicon mergers actually occurred at the beginning of fiscal 2002, nor is it necessarily indicative of future operating results:

	THREE MONTHS ENDED JANUARY 31,	
	2003	2002
	(in thousands, except per share amounts)	
Revenue	$ 268,136	$ 288,508
Net income	$ 34,385	$ 28,056
Basic earnings per share	$ 0.46	$ 0.38
Weighted average common shares outstanding	74,065	74,666
Diluted earnings per share	$ 0.45	$ 0.35
Weighted average common shares and dilutive stock options outstanding	76,639	79,376

The unaudited pro forma results of operations for each of the periods presented exclude non-recurring merger costs of $21.0 million for Avant!'s pre-merger litigation settlement and other related costs incurred by Avant! for the three months ended January 31, 2002. These expenses are included in the historical unaudited condensed consolidated statement of income. In addition, the unaudited pro forma results of operations for 2002, do not reflect the reduction in Avant!'s reported deferred revenue as required under the purchase method of accounting. This reduction results in lower revenue in periods subsequent to the merger than would have been achieved if the two companies had not been combined.

Interest Rate Risk. Our exposure to market risk for changes in interest rates relates primarily to our short-term investment portfolio. We place our investments in a mix of tax-exempt and taxable instruments that meet high credit quality standards, as specified in our investment policy. The policy also limits the amount of credit exposure to any one issue, issuer and type of instrument. We do not anticipate any material losses due to this risk with respect to our investment portfolio.

The following table presents the carrying value and related weighted-average total return for our investment portfolio. The carrying value approximates fair value at January 31, 2003. In accordance with our investment policy, the weighted-average maturities of our total invested funds does not exceed one year.

	Carrying Amount	Weighted-Average After Tax Return
	(in thousands)	
Short-term investments--fixed rate	$ 122,921	4.12%
Cash-equivalent investments (restricted)-- variable rate	5,275	0.91%
Money market funds-- variable rate	224,030	0.76%
Total interest bearing instruments	$ 352,226	1.94%

Foreign Currency Risk. At the present time, we hedge only (i) those currency exposures associated with certain assets and liabilities denominated in non-functional currencies and (ii) forecasted accounts receivable and accounts payable denominated in non-functional currencies. Our hedging activities are intended to offset the impact of currency fluctuations on the value, as measured

in the relevant non-functional currency, of these balances. We do not hedge anticipated expenses in non-functional currencies. The success of our hedging activity depends upon the accuracy of our estimates of balances denominated in various currencies. Our greatest exposure to a foreign currency is to the Euro, which is the currency in which we hold the bulk of our accounts receivable relating to products sold outside of North America. We also have exposures, in varying degrees, to the Japanese yen, Taiwan dollar, British pound sterling, Canadian dollar, Singapore dollar, Korean won and Israeli shekel. If a non-functional currency increases in value relative to the dollar, then expenses denominated in that currency, assets, liabilities and forecasted accounts receivable increase. If a non-functional currency declines in value relative to the dollar, then expenses denominated in that currency, assets, liabilities and forecasted accounts receivable decrease. Looking forward, we do not anticipate any material adverse effect on our consolidated financial position or results of operations resulting from the use of hedging instruments. There can be no assurance that our hedging transactions will be effective in the future, however.

These foreign currency contracts contain credit risk in that the counterparty may be unable to meet the terms of the agreements. We have limited these agreements to major financial institutions to reduce such credit risk. Furthermore, we monitor the potential risk of loss with any one financial

institution. We do not enter into forward contracts for speculative purposes.

The following table provides information about our foreign currency contracts at January 31, 2003. Due to the short-term nature of these contracts, the contract rates approximate the weighted-average currency exchange rates at January 31, 2003. These forward contracts mature in approximately thirty days and contracts are rolled-forward on a monthly basis to match firmly committed transactions.

	USD Amount	Contract Rate
	(in thousands)	
Forward Net Contract Values:		
Euro	$ 313,495	0.9245
Japanese yen	44,330	118.2119
Canadian dollar	5,512	1.5362
British pound sterling	3,079	0.6118
Israeli shekel	2,180	4.9000
Korean won	3,344	1176.0000
Singapore dollar	3,039	1.7319
Taiwan dollar	4,641	34.7100
	$ 379,620	

Net unrealized gains of approximately $20.3 million, net of tax on the outstanding forward contracts as of January 31, 2003 are included in other comprehensive income on the unaudited condensed consolidated balance sheet as of January 31, 2003. Net cash inflows on maturing forward contracts during the quarter were $25.9 million.

Acquisition of Numerical Technologies, Inc. On January 13, 2003, we entered into an Agreement and Plan of Merger with Numerical Technologies, Inc. (Numerical) under which we commenced a cash tender offer to acquire all of the outstanding shares of Numerical common stock at $7.00 per share, followed by a second-step merger in which we would acquire any untendered Numerical shares at the same price per share. Following the consummation of the cash tender offer on February 28, 2003, Numerical merged with and into a wholly owned subsidiary of Synopsys, effective March 1, 2003. The total cash consideration is expected to be approximately $240 million. The Company acquired Numerical in order to expand its offerings of design for manufacturing products.

Effect of New Accounting Standards. In July 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 141 (SFAS 141), Business Combinations, and Financial Accounting Standards No. 142 (SFAS 142), Goodwill and Other Intangible Assets. SFAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001 and specifies criteria intangible assets acquired in a

purchase method business combination must meet to be recognized apart from goodwill. SFAS 141 is effective for all business combinations completed after June 30, 2001.

We adopted SFAS 142 on November 1, 2002. Upon adoption of SFAS 142, amortization of goodwill recorded for business combinations consummated prior to July 1, 2001 ceased. Intangible assets acquired prior to July 1, 2001 that do

not meet the criteria for recognition under SFAS 141 are required to be reclassified to goodwill; no such reclassifications to goodwill were required. In addition, upon adoption of SFAS 142, we assessed useful lives and residual values of all intangible assets acquired. We also tested goodwill for impairment in accordance with the provisions of SFAS 142. In completing our impairment analysis, we determined that we have one reporting unit. In conjunction with the implementation of SFAS No. 142, we completed a goodwill impairment review as of the beginning of fiscal 2003 and found no indicators of impairment. This impairment review was based on the fair value of the Company as determined by its market capitalization. As of January 31, 2003, unamortized goodwill was $435.8 million, which will no longer be amortized in accordance with SFAS 142.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 143 (SFAS 143), Accounting for Asset Retirement Obligations. SFAS 143 requires that asset retirement obligations that are identifiable upon acquisition, construction or development and during the operating life of a long-lived asset be recorded as a liability using the present value of the estimated cash flows. A corresponding amount would be capitalized as part of the asset's carrying amount and amortized to expense over the asset's useful life. We adopted the provisions of SFAS 143 effective November 1, 2002. The adoption of SFAS 143 did not have a significant impact on our financial position and results of operations for the three months ended January 31, 2003.

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144 (SFAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of, and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, Reporting the Results of Operations for a Disposal of a Segment of a Business. We adopted the provisions of SFAS 144 effective November 1, 2002. The adoption of SFAS 144 did not have a significant impact on our financial position and results of operations for the three months ended January 31, 2003.

In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146 (SFAS 146), Accounting for Exit or Disposal Activities. SFAS 146 addresses the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including costs related to terminating a contract that is not a capital lease and termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract. SFAS 146 supersedes Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring) and requires liabilities associated with exit and disposal activities to be expensed as incurred. SFAS 146 is effective for exit or disposal activities of the Company that are initiated after December 31, 2002. The adoption of SFAS 146 did not have a significant impact on our financial position and results of operations for the three months ended January 31, 2003.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148 (SFAS 148), Accounting for Stock-Based Compensation - Transition and Disclosure. SFAS 148 amends FASB Statement No. 123 (SFAS 123), Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of SFAS 148

are effective for fiscal years ending after December 15, 2002. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. We have adopted the disclosure provisions of SFAS 148 beginning in the first quarter of fiscal 2003.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, which clarifies disclosure and recognition/measurement requirements related to certain guarantees. The disclosure requirements are effective for financial statements issued after December 15, 2002 and the recognition/measurement requirements are effective on a prospective basis for guarantees issued or modified after December 31, 2002. We typically warrant our products to be free from defects in media and to substantially conform to material specifications for a period of 90 days. We also indemnify our customers from third party claims of intellectual property infringement relating to the use of our products. Historically, costs related to these guarantees have not been significant and we are unable estimate the potential impact of these guarantees on our future results of operations.

LIQUIDITY AND CAPITAL RESOURCES

Cash, cash equivalents and short-term investments increased $55.5 million, or 13%, to $470.3 million at January 31, 2003 from $414.7 million at October 31, 2002. For the first three months of fiscal 2003, cash provided by operations was $31.5 million. Cash was provided by net income adjusted for non-cash related items and for cash flows related to hedging activities, partially offset by cash used for changes in working capital balances, including increases in receivables and deferred revenue and decreases in accounts payables and accrued liabilities. Accounts receivable and deferred revenue increased due to the timing of installment billings to customers on long-term arrangements. Accounts payable and accrued liabilities decreased as a result of payments of merger-related accruals, commissions and year-end bonuses, partially offset by year-to-date accruals.

Cash used in investing activities was $21.3 million for the three months ended January 31, 2003 as compared to cash used in investing activities of $13.3 million for the same period in the prior fiscal year. The increase of $8.0 million in cash used in investing activities is primarily due to net purchases of short- and long-term investments of $9.0 million for the three months ended January 31, 2003 as compared to net proceeds from sales of short- and long-term investments of $5.0 million for the same period in the prior fiscal year. Capital expenditures totaled $11.6 million during the three months ended January 31, 2003 as compared to $17.8 million for the same period in the prior fiscal year. The decrease in capital expenditures is primarily due to the completion of construction of our Oregon facilities and investment in computing equipment to upgrade our infrastructure systems that was in progress during the three months ended January