SYNOPSYS INC
Form 10-Q/A
September 20, 2002

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 JULY 31, 2002

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 (1) has filed all reports required to be filed by Section 13, or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

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

75,639,019 shares of Common Stock as of September 6, 2002

Explanatory Note

This Amendment No.1 to the Registrant's Report on Form 10-Q for the quarterly period ended July 31, 2002 is being filed in order to amend the weighted average common shares and dilutive stock options outstanding included in the "unaudited pro forma results of operations" in note 3 to the unaudited condensed consolidated financial statements on page 12 and "Management's Discussion and Analysis of Financial condition and results of operations" on page 30.

SYNOPSYS, INC.
QUARTERLY REPORT ON FORM 10-Q
JULY 31, 2002

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PART I

ITEM 1. FINANCIAL STATEMENTS

SYNOPSYS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)

	JULY 31, 2002 (UNAUDITED)	O
ASSETS		
Current assets:		
Cash and cash equivalents	$ 347,661	$
Short-term investments	98,547	
Total cash and short-term investments	446,208	
Accounts receivable, net of allowances of $22,985 and $11,027, respectively	233,157	
Deferred tax assets	169,208	
Prepaid expenses and other	54,973	
Total current assets	903,546	
Property and equipment, net	185,872	
Long-term investments	48,767	
Goodwill, net	368,068	
Intangible assets, net	351,249	
Restricted asset	240,000	
Other assets	61,503	
Total assets	$ 2,159,005	$
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 233,756	$
Current portion of long-term debt	178	
Accrued income taxes	123,338	
Deferred revenue	379,897	
Total current liabilities	737,169	
Deferred compensation and other long-term liabilities	50,400	
Long-term deferred revenue	63,167	
Stockholders' equity:		
Preferred stock, $.01 par value; 2,000 shares authorized; no shares outstanding	--	
Common stock, $.01 par value; 400,000 shares authorized; 76,105 and 59,428 shares outstanding, respectively	761	
Additional paid-in capital	1,031,183	
Retained earnings	303,755	

Treasury stock, at cost	(9,875)
Deferred stock compensation	(7,592)
Accumulated other comprehensive income	(9,963)
Total stockholders' equity	1,308,269
Total liabilities and stockholders' equity	$ 2,159,005

The accompanying notes are an integral part of these financial statements.

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

	THREE MONTHS ENDED JULY 31,	
	2002	2001
Revenue:		
Product	$ 60,096	$ 44,858
Service	73,924	81,430
Ratable license	102,075	49,822
Total revenue	236,095	176,110
Cost of revenue:		
Product	4,400	6,086
Service	19,819	19,158
Ratable license	10,101	7,476
Amortization of intangible assets and deferred stock compensation	13,366	-
Total cost of revenue	47,686	32,720
Gross margin	188,409	143,390
Operating expenses:		
Research and development	61,581	49,382
Sales and marketing	69,122	68,954
General and administrative	21,908	19,140
Integration	117,266	-
In-process research and development	82,500	-
Amortization of intangible assets and deferred stock compensation	8,820	4,163
Total operating expenses	361,197	141,639
Operating (loss) income	(172,788)	1,751
Other income, net	11,408	19,499

(Loss) income before (benefit) provision for income taxes	(161,380)	21,250	
(Benefit) provision for income taxes	(23,791)	6,800	
Net (loss) income	$ (137,589)	$ 14,450	$
Basic (loss) earnings per share	$ (1.93)	$ 0.24	$
Weighted average common shares outstanding	71,157	60,048	
Diluted (loss) earnings per share	$ (1.93)	$ 0.22	$
Weighted average common shares and dilutive stock options outstanding	71,157	64,887	

The accompanying notes are an integral part of these financial statements.

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

	NINE MONTHS E JULY 31,	
	2002	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) income	$ (102,157)	$
Adjustments to reconcile net (loss) income to net cash flows (used in) provided by operating activities:		
In-process research and development	82,500	
Depreciation and amortization	69,835	
Tax benefit associated with stock options	18,001	
Impairment of land and buildings	14,712	
Impairment of long-term investments	7,539	
Provision for doubtful accounts and sales returns	3,065	
Deferred taxes	(3,967)	
Gain on sale of long-term investments	(21,393)	
Gain on sale of silicon libraries business	--	
Other	2,538	
Net changes in operating assets and liabilities:		
Accounts receivable	(22,774)	
Prepaid expenses and other current assets	1,079	
Other assets	(7,323)	

Accounts payable and accrued liabilities	(75,978)	
Accrued income taxes	(81,799)	
Deferred revenue	33,225	
Deferred compensation	4,748	
Net cash (used in) provided by operating activities	(78,149)	
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of contingently refundable insurance policy	(240,000)	
Cash acquired in the Avant! acquisition	234,963	
Purchases of property and equipment	(35,902)	
Purchases of short-term investments	(667,430)	
Proceeds from sales and maturities of short-term investments	778,501	
Purchases of long-term investments	(5,205)	
Proceeds from sale of long-term investments	30,533	
Proceeds from the sale of silicon libraries business	--	
Purchase of intangible assets, net	--	
Capitalization of software development costs	(1,194)	
Net cash provided by investing activities	94,266	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments of debt obligations	--	
Issuances of common stock	103,595	
Purchases of treasury stock	(41,773)	
Net cash provided by (used in) financing activities	61,822	
Effect of exchange rate changes on cash	(1,974)	
Net increase (decrease) in cash and cash equivalents	75,965	
Cash and cash equivalents, beginning of period	271,696	
Cash and cash equivalents, end of period	$ 347,661	$
SUPPLEMENTAL NONCASH DISCLOSURES:		
Issuance of stock and options in exchange for net assets of Avant!	$ 858,421	$

The accompanying notes are an integral part of these financial statements.

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SYNOPSYS, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF COMPANY AND BASIS OF PRESENTATION

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 IC 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 processes and

to assist them with their IC designs, as well as training and support services.

The Company's fiscal year ends on the Saturday nearest October 31. Fiscal year 2001 was a 53-week year, with the extra week added to the first quarter, and fiscal year 2002 will be a 52-week year. For presentation purposes, the unaudited condensed consolidated financial statements and notes refer to the calendar month end.

On June 6, 2002 (the "closing date"), the Company completed its merger with Avant! Corporation (Avant!), a company that develops, markets, licenses and supports electronic design automation software products that assist design engineers in the physical layout, design, verification, simulation, timing and analysis of advanced integrated circuits. Under the terms of the merger agreement between the Company and Avant!, Avant! merged with and into a wholly owned subsidiary of Synopsys. The merger is accounted for under the purchase method of accounting. The results of operations of Avant! are included in the accompanying condensed consolidated financial statements for the period from the closing date through July 31, 2002.

The unaudited condensed consolidated financial statements include the accounts of Synopsys and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the financial position and results of operations 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, 2001 included in the Company's 2001 Annual Report on Form 10-K.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the unaudited condensed consolidated financial statements and accompanying notes. A change in the facts and circumstances surrounding these estimates and assumptions could result in a change to the estimates and assumptions and impact future operating results.

2. SIGNIFICANT ACCOUNTING POLICIES

REVENUE RECOGNITION AND COST OF REVENUE

Revenue consists of fees for perpetual and time-based licenses for the Company's software products, sales of hardware system 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 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 on which the Company 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 additional products. Cost of revenue also includes the amortization of the contract rights intangible, core technology and deferred compensation.

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 products 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 its arrangements.

The Company's customary payment terms are such 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. 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, which 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.

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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. 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 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 billed separately and independently from consulting services, which are generally billed on a time-and-materials or milestone-achieved basis. The Company generally recognizes revenue from consulting services as the services are performed.

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.

NEW ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 141, BUSINESS COMBINATIONS (SFAS 141), and No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS (SFAS 142). 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 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually in accordance with the provisions of SFAS 142.

The Company adopted the provisions of SFAS 141 on July 1, 2001. Under SFAS 141, goodwill and intangible assets with indefinite useful lives acquired in a purchase business combination completed after June 30, 2001, but before SFAS 142 is adopted, will not be amortized but will continue to be evaluated for impairment in accordance with SFAS 121. Goodwill and intangible assets acquired in business combinations completed before July 1, 2001 will continue to be amortized and tested for impairment in accordance with current accounting guidance until the date of adoption of SFAS 142.

Upon adoption of SFAS 142, the Company must evaluate its existing intangible assets and goodwill acquired in purchase business combinations prior to July 1, 2001, and make any necessary reclassifications in order to conform with the new criteria in SFAS 141 for recognition apart from goodwill. Upon adoption of SFAS 142, the Company will be required to reassess the useful lives and residual values of all intangible assets acquired, and make any necessary amortization period adjustments. The Company will also be required to test goodwill for impairment in accordance with the provisions of SFAS 142 within the six-month period following adoption. Any impairment loss will be measured as of the date of adoption and recognized immediately as the cumulative effect of a change in accounting principle. Any subsequent impairment losses will be included in operating activities.

The Company expects to adopt SFAS 142 on November 1, 2002. As of July 31, 2002, unamortized goodwill of $23.1 million will continue to be amortized until the date of adoption of SFAS 142, in accordance with the Statements.

Amortization of goodwill and other intangible assets for the nine-month period ended July 31, 2002 is $12.1 million. Goodwill totaling $344.9 relates to acquisitions subsequent to July 1, 2001 and is therefore not amortized in accordance with SFAS 142. The Company does not have any intangible assets with an indefinite useful life. The Company is currently evaluating the impact of the adoption of this statement on its financial position and results of operations.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS (SFAS 143). 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 is required to adopt the provisions of SFAS 143 effective November 1, 2002. The adoption of SFAS 143 will not have a significant impact on the Company's financial position and results of operations.

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS (SFAS 144), 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 APB Opinion No. 30, REPORTING THE RESULTS OF OPERATIONS FOR A DISPOSAL OF A SEGMENT OF A BUSINESS. The Company is required to adopt the provisions of SFAS 144 no later than November 1, 2002. The Company does not expect that the adoption of SFAS 144 will have a significant impact on its financial position and results of operations.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145, RESCISSION OF FASB STATEMENTS NO. 4, 44, AND 64, AMENDMENT OF FASB STATEMENT NO. 13, AND TECHNICAL CORRECTIONS (SFAS 145). SFAS 145 eliminates the requirement that gains and losses from the extinguishments of debt be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. However, an entity would not be prohibited from classifying such gains and losses as extraordinary items so long as they are both unusual in nature and infrequent in occurrence. The Company is required to adopt the provisions of SFAS 145 effective November 1, 2002. SFAS 145 also amends SFAS 13, ACCOUNTING FOR LEASES and certain other authoritative pronouncements to make technical corrections or clarifications. SFAS 145 is effective related to the amendment of SFAS 13 for all transactions occurring after May 15, 2002. The Company does not expect that the adoption of SFAS 145 will have a significant impact on its financial position and results of operations.

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 will be effective for exit or disposal activities of the Company that are initiated after December 31, 2002. The Company is evaluating the effect of adopting SFAS 146 on its financial position and results of operations.

RECLASSIFICATION

Certain prior year amounts have been reclassified to conform to current year presentation.

3. ACQUISITION OF AVANT! CORPORATION

On June 6, 2002 (the "closing date"), the Company completed the merger with Avant! Corporation (Avant!).

REASONS FOR THE ACQUISITION. The Company's Board of Directors unanimously approved the Company's merger with Avant! at its December 1, 2001 meeting. In approving the merger agreement, the Board of Directors consulted with legal and financial advisors as well as with management and considered a number of factors. Management is willing to pay a premium over the fair value of the tangible and identifiable intangible assets as the merger is expected to enable

Synopsys to offer its customers a complete end-to-end solution for IC design that combines Synopsys' logic synthesis and design verification tools with Avant!'s advanced place and route, physical verification and design integrity products, thus increasing customers' design efficiencies. By increasing customer

design efficiencies, Synopsys expects to be able to better compete for customers designing the next generation of semiconductors. Further, by gaining access to Avant!'s physical design and verification products, as well as its broad customer base and relationships, Synopsys will gain new opportunities to market its existing products. The foregoing discussion of the information and factors considered by the Company's Board of Directors is not intended to be exhaustive but includes the material factors considered by the Company's Board.

PURCHASE PRICE. Holders of Avant! common stock received 0.371 of a share of Synopsys common stock (including the associated preferred stock rights) in exchange for each share of Avant! common stock owned as of the closing date, aggregating 14.5 million shares of Synopsys common stock. The fair value of the Synopsys shares issued was based on a per share value of $54.74, which is equal to Synopsys' average last sale price per share as reported on the Nasdaq National Market for the trading-day period two days before and after December 3, 2001, the date of the merger agreement.

The total purchase consideration consists of the following:

(IN THOUSANDS)	
Fair value of Synopsys common stock issued	$ 795,388
Estimated acquisition related costs	37,342
Estimated facilities closure costs	62,638
Estimated employee severance costs	50,367
Estimated fair value of options to purchase Synopsys common stock to be issued, less $8.1 million representing the portion of the intrinsic value of Avant!'s unvested options applicable to the remaining vesting period	63,033
	$ 1,008,768

The estimated acquisition-related costs of $37.3 million consist primarily of banking, legal and accounting fees, printing costs, and other directly related charges including contract termination costs of $6.7 million. The Company is currently reviewing all outstanding Avant! contracts to determine the additional cost, if any, to exit existing contracts which may result in additional accruals for contract termination costs in accordance with Emerging Issues Task Force (EITF) Issue No. 95-3. Any such accruals would increase the purchase consideration and the allocation of the purchase consideration to goodwill.

Estimated facilities closure costs includes $54.2 million related to Avant!'s corporate headquarters. The lessor has brought a claim against the Company for the future amounts payable under the lease agreements. The amount accrued at the closing date is equal to the future amounts payable under the related lease agreements, without taking into consideration in the accrual any defenses we 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 allocated to goodwill. The remaining

estimated facilities closure costs totaling $8.4 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.

Estimated employee severance costs include (i) $39.6 million in cash paid to Avant!'s Chairman of the Board, consisting of severance plus a cash payment equal to the intrinsic value of his in-the-money stock options at the closing date, (ii) $4.5 million in cash severance payments paid to redundant employees (primarily sales and corporate infrastructure personnel) terminated on or subsequent to the consummation of the merger under an approved plan of termination and (iii) $6.3 million in termination payments to certain executives in accordance with their respective pre-merger employment agreements. The total number of Avant! employees expected to be terminated as a result of the merger is approximately 250.

As of July 31, 2002, $73.3 million of costs described in the three preceding paragraphs have been paid and $77.1 million of these costs have not yet been paid. The following table presents the components of acquisition-related costs recorded, along with amounts paid through the third quarter of 2002.

(IN THOUSANDS)	Total Cost	Payments through July 31, 2002	Balance at July 31, 2002
Estimated acquisition related costs	$ 37,342	$23,967	$13,375
Estimated facilities closure costs	62,638	262	62,376
Estimated employee severance costs	50,367	49,031	1,336
Total	$150,347	$73,260	$77,087

The total purchase consideration has been allocated on a preliminary basis to the assets and liabilities acquired, including identifiable intangible assets, based on their respective fair value at the acquisition date and resulted in excess purchase consideration over the net tangible and identifiable intangible assets acquired of $344.9 million. The following unaudited condensed balance sheet data presents the preliminary fair value of the assets and liabilities acquired and recorded at June 6, 2002.

(IN THOUSANDS)	
Assets acquired	
Cash, cash equivalents and short-term investments	$ 241,313
Accounts receivable	67,154
Prepaid expenses and other current assets	19,483
Assets held for sale	33,220
Intangible assets	365,000
Goodwill	344,949
Other assets	3,876

Total assets acquired	$ 1,074,995
Liabilities acquired	
Accounts payable and accrued liabilities	$ 172,528
Deferred revenue	30,080
Income taxes payable	94,576
Other liabilities	4,651
Total liabilities acquired	$ 301,835

Other current assets acquired includes an investment in a venture-capital fund valued at $12.8 million. Management intends to dispose of this investment; however, the Company has been unable to obtain certain financial records and information required to effectively market the investment. The fair value of the asset recorded does not include any adjustment of this investment due to this contingency. Any adjustment to the fair-value of this investment which is ultimately made will increase or decrease the purchase consideration and the allocation of the purchase consideration to goodwill.

UNAUDITED PRO FORMA RESULTS OF OPERATIONS. The following table presents pro forma results of operations and gives effect to the proposed merger as if the merger had been consummated on November 1, 2000. The unaudited pro forma results of operations are not necessarily indicative of the results of operations had the acquisition actually occurred at the beginning of fiscal 2001, nor is it necessarily indicative of future operating results:

(IN THOUSANDS, EXCEPT PER SHARE DATA)	THREE MONTHS ENDED JULY 31, 2002	2001	NINE MONTHS JULY 31 2002	
Revenues	$ 278,217	$ 276,922	$ 861,822	$
Net income (loss)	16,099	18,434	71,697	
Basic earnings (loss) per share	$ 0.23	$ 0.25	$ 1.12	$
Weighted average common shares outstanding	71,157	74,578	64,157	
Diluted earnings (loss) per share	$ 0.21	$ 0.23	$ 1.04	$
Weighted average common shares and dilutive stock options outstanding	74,955	80,351	68,698	

The unaudited pro forma results of operations for each of the periods presented exclude non-recurring merger costs of $95,000 and $82,500 for the contingently refundable insurance policy and IPRD recorded by Synopsys in the third quarter of 2002 and included in the historical condensed consolidated statement of operations.

GOODWILL AND INTANGIBLE ASSETS. Goodwill, representing the excess of the

purchase price over the fair value of tangible and identifiable intangible assets acquired in the merger will not be amortized consistent with the guidance with SFAS 142. The goodwill associated with the Avant! acquisition is not deductible for tax purposes. In addition, a portion of the purchase price was allocated to the following identifiable intangible assets:

Intangible Asset	(IN THOUSANDS)	Estimated Useful Life
Core/developed technology	$184,000	3 years
Contract rights intangible	51,700	3 years
Customer installed base/relationship	102,500	6 years
Trademarks and tradenames	17,700	3 years
Covenants not to compete	9,100	The life of the related agreement (2 to 4 years)
Total	$365,000	

CONTRACT RIGHTS INTANGIBLE. Avant! had executed signed license agreements, had delivered the initial configuration of licensed technologies under ratable license arrangements and had executed signed contracts to provide PCS over a one to three year period, for which Avant! did not consider the fees to be fixed and determinable at the outset of the arrangement. There were no receivables or deferred revenues recorded on Avant!'s historical financial statements at the closing date as the related payments were not yet due under extended payment terms and deliveries are scheduled to occur over the term of the arrangements. These ratable licenses and PCS arrangements require future performance by both parties and, as such, represent executory contracts. The contract rights intangible asset associated with these arrangements is amortized to cost of revenues over the related contract lives.

The amortization of intangible assets, with the exception of the contract rights intangible and the core/developed technology, is included in operating expenses in the statement of operations for the three- and nine-month periods ended July 31, 2002. Amortization of the core/developed technology and contract rights intangible is included in cost of revenue.

ASSET HELD FOR SALE. In January 2001, Synopsys sold the assets of its silicon libraries business to Artisan Components, Inc. ("Artisan") and entered into an agreement not to engage, directly or indirectly, in the physical libraries business before January 3, 2003. Synopsys also agreed that if it acquired a physical libraries business as part of a larger acquisition, then Artisan would have certain preferential rights to negotiate and bid for such business. Prior to the merger, Avant! engaged in the physical libraries business. As a result of the merger, Synopsys acquired Avant!'s physical libraries business, and Synopsys is obligated to offer and sell such business to Artisan under the terms of the January 2001 agreement. The value allocated to the acquired libraries business was recorded as net assets held for sale and is based on the estimated future net cash flows from the libraries business in accordance with EITF 87-11, ALLOCATION OF PURCHASE PRICE TO ASSETS TO BE SOLD. The carrying value of the libraries business as of July 31, 2002 is approximately $33.1 million and losses for the period from June 6, 2002 through July 31, 2002 that have been excluded from the consolidated income statement were approximately $0.5 million.

CONTINGENTLY REFUNDABLE INSURANCE POLICY. Avant!, which upon completion of the Synopsys-Avant! merger became a wholly-owned subsidiary of Synopsys is a

party to a number of material civil litigation matters, including civil litigation (the Avant!/Cadence litigation) brought by Cadence Design Systems, Inc. (Cadence) as discussed in Footnote 12. Synopsys obtained an insurance policy from a subsidiary of American International Group, Inc., a AAA-rated insurance company, whereby insurance was obtained for certain compensatory, exemplary and punitive damages, penalties and fines and attorneys' fees arising out of the Avant!/Cadence litigation. The policy does not provide coverage for litigation other than the Avant!/Cadence litigation.

The Company paid a total premium of $335 million for the policy, of which $240 million is contingently refundable. Under the policy the insurer is obligated to pay covered loss up to a limit of liability equaling (a) $500 million plus (b) interest accruing at the fixed rate of 2%, compounded semi-annually, on $250 million (the "interest component"), as reduced by previous covered losses. The policy will expire following a final judgment or settlement of the Avant!/Cadence litigation or any earlier date upon Synopsys' election. Upon such expiration, Synopsys will be entitled to a payment equal to $240 million plus the interest component less any covered loss (which, for this purpose, shall include legal fees only to the extent that the aggregate amount of such fees exceeds $10 million).

The contingently refundable portion of the insurance premium ($240 million) is included in the July 31, 2002 balance sheet as a long-term restricted asset. Interest earned on $250 million will be included in other income, net in the post-merger statement of operations. The balance of the premium paid to the insurer ($95 million) is included in integration expense for the three- and nine-month periods ended July 31, 2002.

At the closing date, the Avant!/Cadence litigation was accounted for as a pre-merger contingency because a litigation judgment or settlement amount, if any, is not probable or estimable. If a litigation loss becomes probable and estimable, such loss will be included in net income.

VALUATION OF IPRD. The amounts allocated to purchased research and development, totaling $82.5 million, were determined through established valuation techniques in the high-technology industry and were expensed upon acquisition because technological feasibility had not been established and no future alternative uses existed. Research and development costs to bring the products to technological feasibility are expected to total approximately $17.5 million.

4. STOCK REPURCHASE PROGRAM

In July 2001, the Company's Board of Directors authorized a stock repurchase program under which Synopsys common stock with a market value up to $500 million may be acquired in the open market. This stock repurchase program replaced all prior repurchase programs authorized by the Board. Common shares repurchased are intended to be used for ongoing stock issuances under the Company's employee stock plans, for acquisitions and for other corporate purposes. The July 2001 stock repurchase program expires on October 31, 2002. During the three-month and nine-month periods ended July 31, 2001, the Company purchased 2.4 million and 6.6 million shares, respectively, of Synopsys common stock in the open market under a prior stock repurchase program, at average prices of $53 per share and $50 per share, respectively. The Company repurchased 0.8 million shares during the three-month and nine-month periods ended July 31, 2002 at an average price of $50 per share. At July 31, 2002, approximately $440.1 million remained available for repurchases under the July 2001 program.

5. COMPREHENSIVE (LOSS) INCOME

The following table sets forth the components of comprehensive (loss) income, net of income tax expense:

	THREE MONTHS ENDED JULY 31,		NI
	2002	2001	2002
	(IN THOUSANDS)		
Net (loss) income	$(137,589)	$ 14,450	$ (102,
Foreign currency translation adjustment	(4,672)	(936)	(4,
Unrealized (loss) gain on investments	(10,720)	1,803	(4,
Reclassification adjustment for realized gains on investments	--	(7,967)	(5,
Total comprehensive (loss) income	$(152,981)	$ 7,350	$ (116,

6. 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 employee stock options outstanding during the period. The weighted-average dilutive stock options outstanding is computed using the treasury stock method. For the three- and nine-month periods ended July 31, 2002, due to the net loss incurred for such periods, the effect of employee stock options is anti-dilutive.

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

	THREE MONTHS ENDED JULY 31,		N
	2002	2001	200
	(IN THOUSANDS, EXCEPT PER SHA		
NUMERATOR			
Net (loss) income	$ (137,589)	$ 14,450	$ (102
DENOMINATOR:			
Weighted-average common shares outstanding	71,157	60,048	64
Effect of dilutive employee stock options	-	4,839	
Diluted common shares	71,157	64,887	64
Basic (loss) earnings per share	$ (1.93)	$ 0.24	$ (
Diluted (loss) earnings per share	$ (1.93)	$ 0.22	$ (

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The effect of dilutive employee stock options excludes approximately 7,445,643 and 3,577,000 stock options for the three-month periods ended July 31, 2002 and 2001, respectively, and 5,339,772 and 3,513,000 for the nine-month periods ended July 31, 2002 and 2001, respectively, which were anti-dilutive for earnings per share calculations.

7. SEGMENT DISCLOSURE

Statement of Financial Accounting Standards No. 131, DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION (SFAS 131), 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 technology products and consulting services in the EDA software industry. The CODM evaluates the performance of the Company based on profit or loss from operations before income taxes not including integration costs, in-process research and development and amortization of intangible assets and deferred stock compensation. 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. There are no differences between the accounting policies used to measure profit and loss for the Company segment and those used on a consolidated basis. Revenue is defined as revenues from external customers.

The disaggregated financial information reviewed by the CODM is as follows:

	THREE MONTHS ENDED JULY 31,		NINE
	2002	2001	2002
		(IN THOUSANDS)	
Revenue:			
Product	$ 60,096	$ 44,858	$ 151,9
Service	73,924	81,430	208,7
Ratable license	102,075	49,822	236,5
Total revenue	$ 236,095	$ 176,110	$ 597,2

Gross margin before amortization of intangible assets and deferred stock compensation	$ 201,775	$ 143,390	$ 493,3
Operating income (loss) before integration costs, in-process research and development and amortization of intangible assets and deferred stock compensation	$ 49,164	$ 5,914	$ 86,1

There were no integration, in-process research and development or amortization of deferred stock compensation costs during the three- and nine-month periods ended July 31, 2001.

A reconciliation of the Company's segment gross margin to the Company's gross margin is as follows:

	THREE MONTHS ENDED JULY 31,		NINE
	2002	2001	2002
		(IN THOUSANDS)	
Gross margin before amortization of intangible assets and deferred stock compensation	$ 201,775	$ 143,390	$ 493,3
Amortization of intangible assets and deferred stock compensation	(13,366)	--	(13,36
Gross margin	$ 188,409	$ 143,390	$ 480,0

Reconciliation of the Company's segment profit and loss to the Company's operating (loss) income before (benefit) provision for income taxes is as follows:

	THREE MONTHS ENDED JULY 31,		NI
	2002	2001	2002
		(IN THOUSANDS)	
Operating income (loss) before integration costs, in-process research and development and amortization of intangible assets and deferred stock compensation	$ 49,164	$ 5,914	$ 86,
Integration costs	(117,266)	--	(117,
In-process research and development	(82,500)	--	(82,
Amortization of intangible assets and deferred stock compensation	(22,186)	(4,163)	(30,
Operating (loss) income	$ (172,788)	$ 1,751	$ (144,

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

	THREE MONTHS ENDED JULY 31,		NINE MONTHS ENDED JULY 31,	
	2002	2001	2002	2001
	(IN THOUSANDS)			
Revenue:				
United States	$ 154,501	$ 110,770	$ 390,529	$ 306,650
Europe	34,992	33,460	98,584	91,214
Japan	25,758	18,405	59,783	53,060
Other	20,844	13,475	48,382	45,864
Consolidated	$ 236,095	$ 176,110	$ 597,278	$ 496,788

	JULY 31, 2002	OCTOBER 31, 2001
	(IN THOUSANDS)	
Long-lived assets:		
United States	$ 160,270	$ 176,330
Other	25,602	15,974
Consolidated	$ 185,872	$ 192,304

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. Revenue is not reallocated among geographic regions to reflect any re-mixing of licenses between different regions following the initial product shipment. One customer accounted for approximately 15% and 10% of the Company's consolidated revenue during the three- and nine-months ended July 31, 2002, respectively. No one customer accounted for more than ten percent of the Company's consolidated revenue during the three- and nine-months ended July 31, 2001.

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! that was recognized by Avant! prior to June 6, 2002 is not reflected in the following tables. Revenue attributable to such products from June 6, 2002 through July 31, 2002 is included in the three- and nine- months ended July 31, 2002. As a result of the Avant! merger, the Company has redefined its product groups. Prior period amounts have been reclassified to conform to the new presentation.

	THREE MONTHS ENDED JULY 31,		NINE MONTHS ENDED JULY 31,	
	2002	2001	2002	2001
	(IN THOUSANDS)			
Revenue				
Design Implementation	$ 105,041	$ 68,726	$ 253,946	$ 192,817
Verification and Test	62,216	59,037	191,471	161,301
Design Analysis	40,616	11,300	61,745	30,216
IP	13,359	18,101	45,150	47,402
Professional Services	14,863	18,946	44,966	65,052
Consolidated	$ 236,095	$ 176,110	$ 597,278	$ 496,788

8. DERIVATIVE FINANCIAL INSTRUMENTS

Available-for-sale equity investments accounted for under Statement of Financial Accounting Standards No. 115, ACCOUNTING FOR CERTAIN INVESTMENTS IN DEBT AND EQUITY SECURITIES (SFAS 115), are subject to market price risk. From time to time, the Company enters into and designates forward contracts to hedge variable cash flows from anticipated sales of these investments. The Company recorded a net realized gain on the sale of the available-for-sale investments including the settlement of forward contracts of $10.3 million and $13.1 million (net of premium amortization), respectively, during the three-month periods ended July 31, 2002 and 2001 and $22.8 million and $41.9 million (net of premium

amortization), respectively, during the nine-month periods ended July 31, 2002 and 2001. As of July 31, 2002, the Company has recorded $7.6 million in long-term investments due to locked-in unrealized gains on the available-for-sale investments. As of July 31, 2002, the maximum length of time over which the Company is hedging its exposure to the variability in future cash flows associated with the forward sale contracts is 6 months.

9. TERMINATION OF AGREEMENT TO ACQUIRE IKOS SYSTEMS, INC.

On July 2, 2001, the Company entered into an Agreement and Plan of Merger with IKOS Systems, Inc. (IKOS). The Agreement provided for the acquisition of all outstanding shares of IKOS common stock by Synopsys.

On December 7, 2001, Mentor Graphics Corporation (Mentor) commenced a cash tender offer to acquire all of the outstanding shares of IKOS common stock at $11.00 per share, subject to certain conditions. On March 12, 2002, Synopsys and IKOS executed a termination agreement by which the parties terminated the Synopsys-IKOS merger agreement and pursuant to which IKOS paid Synopsys the $5.5 million termination fee required under the Synopsys-IKOS merger agreement. This termination fee and $2.4 million of expenses incurred in conjunction with the acquisition are included in other income, net on the unaudited condensed consolidated statement of income for the nine-month period ended July 31, 2002. Synopsys subsequently executed a revised termination agreement with Mentor and IKOS in order to add Mentor as a party thereto.

10. WORKFORCE REDUCTION

In March 2002, the Company implemented a workforce reduction. The purpose was to reduce expenses by decreasing the number of employees in all departments, both domestically and internationally. As a result, the Company's workforce was decreased by approximately 175 employees and a charge of approximately $3.9 million is included in operating expenses during the nine-month period ended July 31, 2002. This charge consists of severance and other special termination benefits.

11. DEFERRED STOCK COMPENSATION

In connection with the Avant! acquisition, the Company assumed unvested stock options held by former Avant! employees. The Company has recorded deferred stock compensation totaling $8.1 million based on the intrinsic value of the assumed unvested stock options. The deferred stock compensation is amortized over the options' remaining vesting period of one to three years. During the three- and nine-months ended, July 31, 2002, the Company recorded amortization of deferred stock compensation in each of the following expense classifications on the statement of operations:

(IN THOUSANDS)	
Cost of revenues	$ 58
Research and development	309
Sales and marketing	105
General and administrative	38
Total	$510

12. CADENCE LITIGATION

Avant! and its subsidiaries are engaged in the Avant!/Cadence litigation, a material civil litigation matter. The Avant!/Cadence litigation generally arises out of the same set of facts that were the subject of a criminal action brought against Avant! and several individuals by the District Attorney of Santa Clara County, California (the "Santa Clara criminal action"). Avant!, Gerald C. Hsu, Chairman of Avant! and five former Avant! employees pled no contest to certain of the charges in the Santa Clara criminal action. As part of that plea, Avant! paid approximately $35.3 million in fines and a hearing was held on the amount of restitution owed to Cadence. During the hearing, Cadence claimed losses of $683.3 million. Ultimately, the court in the Santa Clara criminal action required Avant! to pay Cadence restitution in the amount of $195.4 million. That amount has been fully paid.

Cadence seeks compensatory damages and treble or other exemplary damages from Avant! in the Avant!/Cadence litigation under theories of copyright infringement, misappropriation of trade secrets, inducing breach of contract and false advertising. Synopsys believes Avant! has defenses to all of Cadence's claims in the Avant!/Cadence litigation. Cadence has not fully quantified the amount of damages it seeks in the Avant!/Cadence litigation. Should Cadence

ultimately succeed in the prosecution of its claims, however, Avant! could be required to pay substantial monetary damages to Cadence. Some or all of these damages may be offset by the $195.4 million restitution paid to Cadence in the Santa Clara criminal action. Approximately $500 million in additional damages would be covered by the insurance policy Synopsys has obtained with respect to

the Avant!/Cadence litigation.

Injunctions entered in 1997 and 1998 enjoined Avant! from marketing its early place and route products, ArcCell and Aquarius, based on a judicial determination that they incorporated portions of Cadence's Design Framework II source code (DFII). The injunctions also prohibit Avant! from possessing, using, selling or licensing any product or work copied or derived from DFII and directly or indirectly marketing, selling leasing, licensing, copying or transferring any of the ArcCell or Aquarius products. Avant! ceased marketing, selling, leasing, licensing or supporting all of the ArcCell or Aquarius products in 1996 and 1999, respectively. The DFII code is not incorporated in any current Avant! product. Although Cadence has not made a claim in the Avant!/Cadence litigation against any current Avant! product, including its Apollo and Astro place and route products, and has not introduced any evidence that any such product infringes Cadence's intellectual property rights, Cadence has publicly implied that it intends to assert such claims. Synopsys believes it would have defenses to any such claims. Nonetheless, should Cadence be successful at proving that any past or then-current Avant! product incorporated intellectual property misappropriated from Cadence, Synopsys could be permanently enjoined from further use of such intellectual property, which might require modification to existing products and/or suspension of the sale of such products until such Cadence intellectual property was removed.

13. SUBSEQUENT EVENT - ACQUISITION OF INSILICON CORPORATION

On July 23, 2002, Synopsys entered into an Agreement and Plan of Merger with inSilicon Corporation (inSilicon) under which Synopsys commenced a cash tender offer to acquire all of the outstanding shares of inSilicon common stock at $4.05 per share or approximately $64.9 million, subject to certain conditions. Following the consummation of the tender offer, inSilicon will merge with and into a wholly owned subsidiary of Synopsys. Synopsys will account for the merger under the purchase method of accounting. The merger is subject to certain conditions, including approval of the merger and the Agreement and Plan of Merger by the inSilicon stockholders, compliance with regulatory requirements and customary closing conditions.

14. SUBSEQUENT EVENT - ACQUISITION OF CO-DESIGN

On September 6, 2002, Synopsys acquired all of the outstanding shares of capital stock of Co-Design Automation, Inc. (Co-Design) for consideration consisting of cash and notes of $29.7 million and $4.8 million, respectively, and assumed options with an aggregate value of approximately $1.3 million. The Company will account for the merger under the purchase method of accounting. Synopsys purchased Co-Design for a number of reasons, including (i) the combination of Co-Design's technology with Synopsys' verification tools is expected to speed the delivery of next-generation hardware description language solutions; (ii) the acquisition will help promote the use of the Superlog language, which Synopsys believes will be important in developing next generation verification tools and increasing designer productivity; and (iii) the acquisition gives Synopsys access to Co-Design's industry experts. As of the date of filing this Form 10-Q, the valuation of Co-Design's assets and liabilities, including identifiable intangible assets, as of the closing date has not been completed.

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. Such forward-looking statements include the statements concerning the effect of Technology Subscription Licenses on our revenue, expectations for revenue and costs of revenue, expectations about gains from the sale of investments, effects

of foreign currency hedging, adequacy of our cash as well as statements including the words "projects," "expects," "believes," "anticipates", "will" or similar expressions. 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 are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. 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 the ones that most frequently require us to make estimates and judgments, and are therefore critical to understanding our results of operations.

REVENUE RECOGNITION AND COST OF REVENUE. 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, evaluating whether our fee relating to an arrangement is fixed or determinable and assessing whether collectibility is probable. These judgments are discussed below.

THE VENDOR'S FEE IS FIXED OR DETERMINABLE. In order to recognize revenue, we must make a judgment as to whether the arrangement fee is 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.

Our customary payment terms are such that a minimum of 75% of the arrangement fee is due within one year or less. These customary payment terms are supported by historical practice and concessions have not been granted to customers under this policy. Arrangements with payment terms extending beyond the customary payment terms are considered not 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. 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 July 31, 2002, the adjusted cost of our strategic investments totaled $41.4 million. We review our investments in non-public companies 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, among others, those related to financial performance such as achievement of planned financial results or completion of capital raising activities, and those that are not primarily financial in nature such as the launching of technology or the hiring of key employees. 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

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public- and private-company market comparable information and valuations completed for companies similar to our portfolio companies. Future adverse changes in market conditions, poor operating results of underlying investments and other information obtained after our quarterly assessment could result in losses or an inability to recover the current carrying value of the investments thereby possibly requiring an impairment charge in the future. Based on these measurements, an impairment loss of $4.0 million and $7.5 million was recorded during the three- and nine-month periods ended July 31, 2002.

VALUATION OF INTANGIBLE ASSETS. Intangible assets, net of accumulated amortization, totaled $351.2 million as of July 31, 2002. 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 include goodwill, purchased technology 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 evaluation of the recoverability of the net carrying value of the asset over its remaining useful life is made. If this evaluation indicates that the intangible asset is not recoverable, based on the estimated undiscounted future cash flows of the entity or technology acquired 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 if and when an impairment charge is recorded. If an impairment charge is recognized, the amortization related to goodwill and other intangible assets would decrease during the remainder of the fiscal year. No impairment losses were recorded during the current quarter based on these measurements.

ALLOWANCE FOR DOUBTFUL ACCOUNTS. As of July 31, 2002, the allowance for doubtful accounts totaled $23.0 million. Management estimates the collectibility of our accounts receivable on an account-by-account basis. We record an increase in the allowance for doubtful accounts when the prospect of collecting a specific account receivable becomes doubtful. 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.

INCOME TAXES. Our effective tax rate is directly affected by the relative proportions of domestic and international revenue and income before taxes. We are also subject to changing tax laws in the multiple jurisdictions in which we operate. As of July 31, 2002, deferred tax assets and liabilities totaled $169.2 million and $23.3 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 asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

RESULTS OF OPERATIONS

On June 6, 2002 (the "closing date"), the Company completed the merger with Avant! Corporation (Avant!), a company which develops, markets, licenses and supports electronic design automation software products that assist design engineers in the physical layout, design, verification, simulation, timing and analysis of advanced integrated circuits. Under the terms of the merger agreement between the Company and Avant!, Avant! merged with and into a wholly-owned subsidiary of Synopsys. The merger is accounted for under the purchase method of accounting. The results of operations of Avant! are included in the accompanying condensed consolidated financial statements for the period from the closing date through July 31, 2002.

REVENUE. Revenue consists of fees for perpetual and ratable licenses of our software products, sales of hardware system 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 license product revenue. Service revenue consists of PCS under perpetual licenses and fees for consulting services and training. Ratable

license revenue consists of all revenue from our technology subscription licenses (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.

TSLs are time-limited rights to use our software. Since TSLs include bundled product 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.

We introduced TSLs in the fourth quarter of fiscal 2000. The replacement of the prior form of time-based licenses by TSLs has impacted and will continue to impact our reported revenue. When a customer buys a TSL, relatively little revenue is recognized during the quarter the product is initially delivered. The remaining amount will either be recorded as deferred revenue on our balance sheet or considered backlog by the Company 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 as invoiced or as additional payments are made. Deferred revenue is reduced as revenue is recognized. Under the prior form of time-based licenses, a high proportion of all license revenue was recognized in the quarter that the product was 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.

Since our introduction of TSLs, the average TSL duration has been approximately 3.25 years. This means that, absent the Avant! merger, the transition of our license base to TSLs would continue to impact our reported revenue until at least the first quarter of fiscal year 2004. This transition period will be extended as a result of our merger with Avant!. Avant!'s historical license order mix had a higher proportion of perpetual licenses and a lower proportion of ratable licenses than the Synopsys license order mix from August 2000 to the present (i.e., since our adoption of TSLs), which has been 22% perpetual licenses and 78% ratable licenses. We expect that the future license order mix of the combined company will approach, over time, the Synopsys license mix, though it is likely to fluctuate from quarter to quarter.

We set revenue targets for any given quarter based, in part, upon an assumption that we will achieve a certain license mix of perpetual licenses and TSLs. The actual mix of licenses sold affects the revenue we recognize in the period. If we are unable to achieve our target license mix, we may not meet our revenue targets. Our target license mix for total new software license orders for the fourth quarter of fiscal year 2002 is 20% to 25% perpetual licenses and 75% to 80% ratable licenses. For fiscal year 2003, our preliminary target license mix for total new software license orders is 22% to 27% perpetual licenses and 73% to 78% ratable licenses. These ranges are preliminary and are subject to revision based on developments in our business. In addition, the precise mix of orders is subject to substantial fluctuation in any given quarter or multiple quarter period. In the third quarter of fiscal 2002, the license mix was approximately 32% perpetual licenses and 68% TSLs, in comparison to 29% perpetual licenses and 71% TSLs in the third quarter of fiscal 2001.

As expected, total revenue for the third quarter of fiscal 2002 increased 34% to $236.1 million compared to $176.1 million for the third quarter of fiscal 2001. Revenue for the nine months ended July 31, 2002 increased 20% to $597.3 million compared to $496.8 million for the nine months ended July 31, 2001. The increase in total revenue for the three- and nine months ended July 31, 2002 compared to the same periods in 2001 is due primarily to the Avant! acquisition, and to the additional quarters that the TSL license model has been used and the related increase in revenue due to the timing of revenue recognition under this model.

Product revenue increased 34% to $60.1 million for the third quarter of fiscal 2002, compared to $44.9 million for the third quarter of fiscal 2001 and 30% to $151.9 million for the nine months ended July 31, 2002 compared to $117.2 million for the same period in fiscal 2001. The increase in product revenue is directly related to the increase in orders for perpetual licenses during the periods, since, in most cases, product revenue is recognized in the same quarter that an order for a perpetual license is received and to the increased volume as a result of 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 PCS is calculated as a percentage of the net license fee rather than a fixed percentage of the list price.

Service revenue decreased 9% to $73.9 million for the third quarter of fiscal 2002, compared to $81.4 million for the third quarters of fiscal 2001, and decreased 20% to $208.8 million for the nine months ended July 31, 2002

compared to $259.9 million for the same period in fiscal 2001. The decreases in both periods are due in part to economic factors and in part to the impact of our adoption of TSLs on our overall license mix. Economic conditions have led our customers to reduce their costs by curtailing their use of outside consultants and, in some cases, discontinuing maintenance on their perpetual license. As a result, we received a lower volume of new consulting orders than expected, and certain projects in the consulting backlog were deferred or cancelled. Customer expenditures on training have also been reduced, which has reduced our revenue from training. These conditions are expected to continue at least until the semiconductor industry recovers. The shift to TSLs has impacted service revenue in two ways. First, new licenses structured as TSLs include bundled PCS, which means that revenue attributable to PCS is recognized as ratable revenue. If such licenses were perpetual licenses or time-based licenses similar to the type that we used to offer, the PCS revenue relating to such licenses would be recognized as service revenue. Second, 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.

REVENUE EXPECTATIONS. For the fourth quarter of fiscal year 2002, we expect revenue to consist of 25% to 30% product revenue, 45% to 50% TSLs and 25% to 30% services revenue. For the full fiscal year 2003, we expect revenue to consist of 15% to 20% product revenue, 50% to 55% TSLs and 25% to 30%services revenue.

INTERNATIONAL REVENUE. The following table summarizes the performance of the various geographic regions as a percent of total Company revenue:

	THREE MONTHS ENDED JULY 31,		NINE MONTHS ENDED JULY 31,	
	2002	2001	2002	2001
North America	65%	63%	65%	62%
Europe	15%	19%	17%	18%
Japan	11%	10%	10%	11%
Asia Pacific and Other	9%	8%	8%	9%
Total	100%	100%	100%	100%

International revenue as a percentage of total revenue for the quarter ended

July 31, 2002 decreased to 35% from 37% for the quarter ended July 31, 2001 and to 35% from 38% for the nine-month periods ended July 31, 2002 and 2001, respectively. In any given period, the geographic mix of revenue is influenced by the particular contracts signed during the quarter and in prior quarters. International sales are vulnerable to regional or worldwide economic or political conditions. In particular, a number of our largest European customers are in the telecommunications equipment business, which has weakened considerably, resulting in a quarterly decline in revenues from Europe as a percentage of total Company revenue during fiscal 2002. The majority of our international sales are denominated in the U.S. dollar. There were no foreign exchange gains or losses that were material to our financial results during the three- and nine-month periods ended July 31, 2002 and 2001.

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 4, 2002 is not reflected in the following tables. Revenue attributable to such products from June 6, 2002 through July 31, 2002 is included in the third quarter fiscal 2002 revenue. As a result of the Avant! merger, we have redefined our product groups. Prior period amounts have been reclassified to conform to the new presentation.

	Q3-2002	Q2-2002	Q1-2002	Q4-2001	Q3-2001	Q
Revenue						
Design Implementation	45%	42%	40%	42%	39%	
Verification and Test	26	34	37	33	34	
Design Analysis	17	6	6	6	6	
IP	6	9	9	10	10	
Professional Services	6	9	8	9	11	
Total Company	100%	100%	100%	100%	100%	

DESIGN IMPLEMENTATION. Design Implementation includes products used for the design of a chip from a high level functional description to a complete description of the transistors and wires that implement such functions that can be delivered to a semiconductor company for manufacturing (a process often referred to as "RTL to GDSII"), including synthesis, physical synthesis, floor planning and place-and-route products and technologies. The principal products in this category are Design Compiler, FPGA Compiler, Physical Compiler, Chip Architect, Floorplan Compiler, Jupiter, Apollo, Astro and related products. Design Implementation, as a percent of revenue, fluctuated between 38% and 42% in the period from the fourth quarter of fiscal 2000 through the second quarter of fiscal 2002, and exhibited a generally increasing trend from the first quarter of fiscal 2001 through the second 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 the growing importance of design implementation products in solving customers design problems. The 3% increase from the second quarter of fiscal 2002 to the third

quarter of fiscal 2002 is due principally to the addition of Avant! products to this category, since the largest portion of Avant!'s revenue was derived from products (including its principal place and route products) that were added to the Design Implementation category.

VERIFICATION AND TEST. Verification and Test includes products used for verification and analysis performed at the system level, register transfer level (RTL) 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. As a percent of revenue, revenue from this product family fluctuated between 30% and 34% in the period from the fourth quarter of fiscal 2000 through the second quarter of fiscal 2002, principally attributable to the mix of perpetual versus time-based license orders received for Verification and Test products during any given quarter. Revenue as a percent of total revenue increased through the second quarter of fiscal 2002 as a result of the quarterly amortization of deferred revenue related to the ratable license model. From the second quarter of fiscal 2002 to the third quarter of fiscal 2002, Verification and Test revenues as a percent of total Company revenue decreased, principally because the Verification and Test product group does not include many products acquired from Avant!. In terms of absolute dollars, revenues from this product group remained relatively flat.

DESIGN ANALYSIS. Design Analysis includes products used for verification and analysis performed at the transistor level and physical level of 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, OPC, PrimePower and Cosmos. Revenue from this product group as a percentage of total revenues has ranged between 5% and 7% since the introduction of TSLs as a result of the mix of perpetual versus time-based license orders received during a particular quarter. During the third quarter of fiscal 2002, revenue from this product group as a percentage of total revenues increased to 17%, due primarily 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.

INTELLECTUAL PROPERTY. Our IP products include the DesignWare library of design components and verification models. Revenue as a percent of total revenue decreased from the fourth quarter of fiscal 2000 to the third quarter of fiscal 2002 from 11% to 6%, respectively, due in part to the fact that the term of many of these licenses has increased from one to three years and the revenue is recognized over a longer period of time. From the second quarter of fiscal 2002 to the third quarter of fiscal 2002, IP revenues as a percent of total Company 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. Revenue from professional services as a percentage of total revenues has declined from 14% in the fourth quarter of fiscal 2000 to 6% in the third quarter of fiscal 2002, reflecting, 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 and 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, amortization of capitalized software development costs and purchased technology, and costs of the components of our hardware system

products. The cost of internally developed capitalized software is amortized based on the greater of the ratio of current product revenue to the total of current and anticipated product revenue or the straight-line method 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, since TSLs include bundled product and services. Cost of product revenue, cost of service revenue and cost of ratable license revenue are heavily dependent on an on the mix of software orders received during the period.

Cost of product revenue decreased to 7% of total product revenue for the three months ended July 31, 2002 compared to 14% for the same period during 2001. Cost of product revenue was 8% and 15% for the nine months ended July 31, 2002 and 2001, respectively. This decrease in cost of product revenue as a percentage of total product revenue for the three- and nine-month periods ended July 31, 2002 as compared to 2001 is due in part to the wind-down of our internet business unit during the third quarter of fiscal 2001, and in part to certain direct costs related to commitments that were incurred during the third quarter of fiscal 2001 resulting from the sale of our silicon libraries business.

Cost of service revenue as a percentage of total service revenue was 27% and 24% for the third quarters of fiscal 2002 and 2001, respectively, and increased to 28% from 22% for the nine months ended July 31, 2002 and 2001, respectively. The increase in cost of service revenue as a percentage of total service revenue is due primarily to the decline in total service revenue and to decreased utilization of our professional services personnel, both as a result of the economic environment.

Cost of ratable license revenue was 10% in the third quarter of fiscal 2002 compared to 15% for the third quarter of 2001 and was 15% and 16% for the nine months ended July 31, 2002 and 2001, respectively. The cost of ratable license revenue as a percent of ratable revenue is impacted by the mix of orders between product, service and ratable revenue during the particular quarter as well as an increase in quarterly amortization of deferred revenue and backlog, which is an inherent result of the use of the ratable license model.

Amortization of intangible assets and deferred stock compensation includes the amortization of the contract rights intangible asset associated with certain executory contracts, as discussed under "ACQUISITION OF AVANT! CORPORATION" below, and the amortization of core/developed technology acquired in the Avant! merger. Total amortization of these intangible assets for the three- and nine-month periods ended July 31, 2002 was \$2.7 million and \$10.2 million, respectively. In connection with the Avant! acquisition, the Company also assumed unvested stock options held by Avant! employees. The Company has recorded deferred stock compensation totaling \$8.1 million based on the intrinsic value of these assumed unvested stock options. The deferred stock compensation is amortized over the options' remaining vesting period of one to three years. During the three- and nine-months ended July 31, 2002, we recorded amortization of deferred stock compensation in each of the following expense classifications on the statement of operations:

(IN THOUSANDS)	
Cost of revenues	$ 58
Research and development	309
Sales and marketing	105
General and administrative	38

Total	$510

COST REDUCTION PROGRAM. During the first quarter of fiscal 2002, as part of an overall cost reduction program, the Company implemented a workforce reduction affecting all departments, both domestically and internationally. As a result, the Company's workforce was reduced by approximately 175 employees and a charge of approximately $3.9 million was included in operating expenses during the second quarter of fiscal 2002. This charge consists of severance and other special termination benefits. These costs are reflected in the statement of operations as follows:

(IN THOUSANDS)	
Cost of revenues	$ 678
Research and development	1,081
Sales and marketing	1,078
General and administrative	1,033
Total	3,870

RESEARCH AND DEVELOPMENT. Research and development expenses increased to $61.6 million during the third quarter of fiscal 2002 compared to $49.4 million for the third quarter of fiscal 2001. Research and development expenses represented 26% and 28% of total revenue in the third fiscal quarter of 2002 and 2001, respectively. The increase in research and development expenses resulted principally from the increase in headcount as a result of the Avant!

acquisition. The increased expenditures consist principally of increases of $8.8 million in compensation expense, $2.0 million in depreciation expense and of $5.3 million in research and development-related human resources, technology and facilities costs. These increases are offset by decreases of $1.9 million in consulting and contractor costs and $1.9 million in other costs including travel, communications and supplies as a result of the Company's cost reduction programs.

Research and development expenses were $156.9 million for the nine-month period ended July 31, 2002 and $143.2 million for the nine-month period ended July 31, 2001. As a percentage of total revenue, research and development expenses represented 26% and 29% for the nine-month periods ended July 31, 2002 and 2001, respectively. The increase in terms of dollars is due to the increase in compensation and compensation-related costs of $14.0 million related to higher levels of research and development staffing as a result of the Avant! acquisition and annual merit and cost of living increases, which were implemented in the second quarter of 2001. Depreciation expense also increased $3.2 million and human resources, technology and facilities costs for research and development increased $5.1 million as a result of the increase in research and development staffing. These increases are offset by decreases in expenses related to consultants and other expenses, including facilities, travel, communications, supplies and recruiting, which decreased $4.5 million and $3.5 million, respectively, as a result of our cost reduction programs.

SALES AND MARKETING. Sales and marketing expenses remained relatively flat at $69.1 million the third quarter of fiscal 2002 compared to $69.0 million in the same quarter last year. Sales and marketing expenses represented 29% and 39% of total revenue in the third fiscal quarter of 2002 and 2001, respectively. In the three-month period in fiscal 2002 compared to fiscal 2001, in terms of dollars, compensation and compensation-related costs increased $3.6 million due to the Avant! acquisition. These increases were offset by decreases in

advertising expenses of $1.0 million due to the fact that the Company launched a brand recognition program during the third quarter of fiscal 2001, resulting in additional expenses in 2001. The corporate costs allocated to sales and marketing also decreased $2.5 million as a result of a decrease in human resources, technology and facilities costs as a result of decreased sales and marketing headcount as a percentage of total headcount.

Sales and marketing expenses were $192.1 million and $207.7 million (32% and 42% of total revenue) for the nine-month periods ended July 31, 2002 and 2001, respectively. The decrease in the nine-month period in fiscal 2002 in comparison to the fiscal 2001 period, in terms of dollars, resulted from a decrease in compensation and compensation-related costs of $4.1 million due to a decline in sales commissions and a decrease in the cost of benefits related to a change in our health and welfare benefit programs. These decreases were offset by an increase in compensation related to additional employees added during the third quarter as a result of the Avant! acquisition. Human resources, technology and facilities costs also decreased $5.6 million as a result of a decrease in sales and marketing headcount as a percentage of total headcount. Employee functions, consulting expenses, and other expenses including facilities, travel and information technology also decreased $1.1 million, $2.3 million and $2.1 million, respectively, as a result of the Company's cost reduction efforts.

GENERAL AND ADMINISTRATIVE. General and administrative expenses increased 14% to $21.9 million in the third quarter of fiscal 2002, compared to $19.1 million in the same quarter last year. General and administrative expenses represented 9% and 11% of total revenue for the three-month periods ended July 31, 2002 and 2001, respectively. This increase is due in part to an increase in litigation expenses relating to certain legal actions. Compensation and compensation-related costs increased $2.2 million, communications costs of $1.5 million and facilities costs of $3.6 million due to the acquisition of Avant!. These increases were offset by decreases in consulting costs of $2.6 million as a result of the Company's cost reduction efforts and human resources, technology and facilities costs decreased $6.2 million as a result of a decrease in the percentage of general and administrative headcount.

General and administrative expenses increased 14% to $58.2 million from $50.9 million for the nine months ended July 31, 2002 and 2001, respectively. General and administrative expenses represented 10% of total revenue in each of the nine-month periods ended July 31, 2002 and 2001. This increase is due in part to an increase in litigation expenses relating to certain legal actions initiated by Synopsys. In addition, compensation and compensation-related costs increased $2.3 million, communications costs increased $1.9 million, and facilities costs increased $9.8 million as a result of the Avant! acquisition. These increases were offset by decreased consulting costs of $3.0 million as a result of the Company's cost reduction efforts and decreased human resources, technology and facilities costs of $13.0 million as a result of a decrease in general and administrative headcount.

AMORTIZATION OF INTANGIBLE ASSETS. Goodwill represents the excess of the aggregate purchase price over the fair value of the tangible and identifiable intangible assets we have acquired. Intangible assets and goodwill are amortized over their estimated useful lives of three to six years. We assess the

recoverability of goodwill by estimating whether the unamortized cost will be recovered through estimated future undiscounted cash flows. Amortization of intangible assets charged to operations in the third quarter of fiscal 2002 was $8.8 million compared to $4.2 million for the same period last year. Amortization of intangible assets charged to operations was $17.2 million and $12.5 million for the nine months ended July 31, 2002 and 2001, respectively.

The increased amortization in the fiscal 2002 periods is due to the amortization of intangible assets acquired in the Avant! merger. The Financial Accounting Standards Board recently issued new guidance with respect to the amortization and evaluation of goodwill. This new guidance is discussed below under "Effect of New Accounting Standards".

OTHER INCOME, NET. Other income, net was $11.4 million in the third quarter of fiscal 2002 compared to $19.5 million in the same quarter in the prior year. This decrease is due in part to the lower level of gains recognized on the sale of securities, which were $10.3 million during the third quarter of fiscal 2002 compared to $13.1 million for the same period during 2001. Interest income for the third quarter of 2002 was $2.4 million compared to $2.7 million for the third quarter of 2001. Although cash balances were higher as of July 31, 2002 than a year ago, significantly lower interest rates and the Company's shift of its investments into shorter maturity instruments in anticipation of the Avant! merger resulted in a decrease in interest income. Rental income in the third quarter of fiscal 2002 and 2001 was $2.6 million and $2.5 million, respectively. The third quarter of fiscal 2002 includes investment impairment charges of approximately $4.0 million to write down the carrying value of certain assets held in our venture fund to the best estimate of net realizable value.

Other income, net was $33.7 million and $66.9 million for the nine months ended July 31, 2002 and 2001, respectively. The nine-month decrease is due in part to the gain of $10.6 million on the sale of our silicon libraries business to Artisan during 2001 and in part to realized gains on investments, which were $22.7 million for fiscal 2002 as compared to $43.1 million for fiscal 2001. These gains were partially offset by the write-down of certain assets in our venture portfolio in the amount of $7.5 million and $4.3 million for the nine months of fiscal 2002 and 2001, respectively. Interest income in the nine months ended July 31, 2002 was $6.9 million, as compared to $10.5 million in the same quarter last year. Although cash balances were higher as of July 31, 2002 than a year ago, a significantly lower interest rate environment and a shortened average investment maturity in anticipation of the Avant! acquisition resulted in a decrease in interest income. The nine months ended July 31, 2002 also include a gain of $3.1 million related to the termination fee for the IKOS agreement, net of costs incurred. Further, rental income was $7.5 million and $6.2 for the nine-month periods ended July 31, 2002 and 2001, respectively. The remaining changes to other income, net relate to the amortization of premium forwards and foreign exchange gains and losses recognized during the nine-month period.

During the nine months ended July 31, 2002 and 2001, we determined that certain of the assets held in our venture fund valued at $9.5 million and $6.6 million, respectively, were impaired and that the impairment was other than temporary. Accordingly, we recorded charges of approximately $7.5 million and $4.3 million for the nine months ended July 31, 2002 and 2001, respectively, to write down the carrying value of the investments to the best estimate of net realizable value. Impairment charges relate to certain investments in non-public companies and represent management's estimate of the impairment incurred during the period as a result of 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, among others, those related to financial performance such as achievement of planned financial results or completion of capital raising activities, and those that are not primarily financial in nature such as the launching of technology or the hiring of key employees. 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.

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

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The following table presents the carrying value and related weighted-average total return for our investment portfolio. The carrying value approximates fair value at July 31, 2002. In accordance with our investment policy, the weighted-average duration of our total invested funds does not exceed one year.

Principal (Notional) Amounts in U.S. Dollars:

(IN THOUSANDS, EXCEPT INTEREST RATES)	CARRYING AMOUNT	WEIGHTED-AVERAG AFTER TAX TOTAL RETURN
Short-term investments - fixed rate	96,647	4.09%
Short-term investments (RESTRICTED) - fixed rate	1,900	1.56%
Cash-Equivalent investments (RESTRICTED)- variable rate	3,597	1.10%
Money market funds - variable rate	236,678	1.28%
Total interest bearing instruments	$ 338,822	2.08%

FOREIGN CURRENCY RISK. At the present time, we do not generally hedge anticipated foreign currency cash flows but hedge only those currency exposures associated with certain assets and liabilities denominated in nonfunctional currencies. Hedging activities undertaken are intended to offset the impact of currency fluctuations on these balances. The success of this activity depends upon the accuracy of our estimates of balances denominated in various currencies, primarily the Euro, Japanese yen, Taiwan dollar, British pound sterling, Canadian dollar, Singapore dollar, Korean Won and Israeli Shekel. We had contracts for the sale and purchase of foreign currencies with a notional value expressed in U.S. dollars of $255.1 million as of July 31, 2002. Looking forward, we do not anticipate any material adverse effect on our consolidated financial position, results of operations, or cash flows resulting from the use of these instruments. There can be no assurance that these hedging transactions will be effective in the future.

The following table provides information about our foreign exchange forward contracts at July 31, 2002. Due to the short-term nature of these contracts, the contract rate approximates the weighted-average contractual foreign currency exchange rate at July 31, 2002. These forward contracts mature in approximately thirty days.

Short-Term Forward Contracts to Sell and Buy Foreign Currencies in U.S.

Dollars:

(IN THOUSANDS, EXCEPT FOR CONTRACT RATES)	USD AMOUNT	CONTRACT RATE
Forward Net Contract Values:		
Euro	$ 202,024	1.0148
Japanese yen	24,645	118.3700
Taiwan dollar	15,285	33.7670
Korean Won	3,310	1,196.2500
Israeli Shekel	1,319	4.7400
Canadian dollar	5,784	1.5744
Singapore dollar	2,770	1.7633
	$ 255,137	

The unrealized gains/losses on the outstanding forward contracts at July 31, 2002 were immaterial to our consolidated financial statements. The realized gain/losses on these contracts as they matured were not material to our consolidated financial position, results of operations or cash flows for the periods presented.

We apply Statement of Financial Accounting Standards No. 133 (SFAS 133), ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES, as amended, in accounting for our derivative financial instruments. SFAS 133 establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS 133 requires that all derivatives be recognized as either assets or liabilities at fair value. Derivatives that are not designated as hedging instruments are adjusted to fair value through earnings. If the derivative is designated as a hedging instrument, depending on the nature of the exposure being hedged, changes in fair value will either be offset against the change in fair value of the hedged asset, liability, or firm commitment through earnings, or recognized in other comprehensive income until the hedged anticipated transaction affects earnings. The ineffective portion of the hedge is recognized in earnings immediately. We do not believe that ongoing application of SFAS 133 will significantly alter our hedging strategies. However, its application may increase the volatility of other income and expense

and other comprehensive income. Apart from our foreign currency hedging and forward sales of certain equity investments, we do not use derivative financial instruments. In particular, we do not use derivative financial instruments for speculative or trading purposes.

TERMINATION OF AGREEMENT TO ACQUIRE IKOS SYSTEMS, INC. On July 2, 2001, we entered into an Agreement and Plan of Merger and Reorganization (the "Merger Agreement") with IKOS Systems, Inc. (IKOS). The Merger Agreement provided for the acquisition of all outstanding shares of IKOS common stock by Synopsys.

On December 7, 2001, Mentor Graphics Corporation (Mentor) commenced a cash tender offer to acquire all of the outstanding shares of IKOS common stock at $11.00 per share, subject to certain conditions. On March 12, 2002, Synopsys and IKOS executed a termination agreement by which the parties terminated the Synopsys-IKOS merger agreement and pursuant to which IKOS paid Synopsys the $5.5 million termination fee required by the Synopsys-IKOS merger agreement. This termination fee and $2.4 million of expenses incurred in conjunction with the acquisition are included in other income, net on the unaudited condensed consolidated statement of income for the nine month period ended July 31, 2002. Synopsys subsequently executed a revised termination agreement with Mentor and

IKOS in order to add Mentor as a party thereto.

ACQUISITION OF AVANT! CORPORATION. On June 6, 2002 (the "closing date"), the Company completed its merger with Avant!.

REASONS FOR THE ACQUISITION. The Company's Board of Directors unanimously approved the Company's merger with Avant! at its December 1, 2001 meeting. In approving the merger agreement, the Board of Directors consulted with legal and financial advisors as well as with management and considered a number of factors. These factors include the fact that the merger is expected to enable Synopsys to offer its customers a complete end-to-end solution for system-on-chip design that includes Synopsys' logic synthesis and design verification tools with Avant!'s advanced place and route, physical verification and design integrity products, thus increasing customers' design efficiencies. By increasing customer design efficiencies, Synopsys expects to be able to better compete for customers designing the next generation of semiconductors. Further, by gaining access to Avant!'s physical design and verification products, as well as its broad customer base and relationships, Synopsys will gain new opportunities to market its existing products. The foregoing discussion of the information and factors considered by the Company's Board of Directors is not intended to be exhaustive but includes the material factors considered by the Company's Board of Directors.

PURCHASE PRICE. Holders of Avant! common stock received 0.371 of a share of Synopsys common stock (including the associated preferred stock rights) in exchange for each share of Avant! common stock owned as of the closing date, aggregating 14.5 million shares of Synopsys common stock. The fair value of the Synopsys shares issued was based on a per share value of $54.74, which is equal to Synopsys' average last sale price per share as reported on the Nasdaq National Market for the trading-day period two days before and after December 3, 2001, the date of the merger agreement.

The total purchase consideration consists of the following:

(IN THOUSANDS)	
Fair value of Synopsys common stock issued	$ 795,388
Estimated acquisition related costs	37,342
Estimated facilities closure costs	62,638
Estimated employee severance costs	50,367
Estimated fair value of options to purchase Synopsys common stock to be issued, less $8.1 million representing the portion of the intrinsic value of Avant!'s unvested options applicable to the remaining vesting period	63,033
	$ 1,008,768

The estimated acquisition-related costs of $37.3 million consist primarily of banking, legal and accounting fees, printing costs, and other directly related charges including contract termination costs of $6.7 million. The Company is currently reviewing all outstanding Avant! contracts to determine the cost, if any, to exit existing contracts which may result in additional accruals for contract termination costs in accordance with Emerging Issues Task Force (EITF) Issue No. 95-3. Any such accruals would increase the purchase consideration and the allocation of the purchase consideration to goodwill.

Estimated facilities closure costs includes $54.2 million related to Avant!'s corporate headquarters. The lessor has brought a claim against the

Company for the future amounts payable under the lease agreements. The amount accrued at the closing date is equal to the future amounts payable under the related lease agreements, without taking into consideration in the accrual any defenses we 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 allocated to goodwill. The remaining estimated facilities closure costs totaling $8.4 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.

Estimated employee severance costs include (i) $39.6 million in cash paid to Avant!'s Chairman of the Board, consisting of severance plus a cash payment equal to the intrinsic value of his in-the-money stock options at the closing date, (ii) $4.5 million in cash severance payments paid to redundant employees (primarily sales and corporate infrastructure personnel) terminated on or subsequent to the consummation of the merger under an approved plan of termination and (iii) $6.3 million in termination payments to certain executives in accordance with their respective pre-merger employment agreements. The total number of Avant! employees expected to be terminated as a result of the merger is approximately 250.

As of July 31, 2002, $73.3 million of costs described in the three preceding paragraphs have been paid and $77.1 million of these costs have not yet been paid. The following table presents the components of acquisition-related costs recorded, along with amounts paid through the third quarter of 2002.

(IN THOUSANDS)	Total Cost	Payments through July 31, 2002	Balance at July 31, 2002
Estimated acquisition related costs	$ 37,342	$23,967	$13,375
Estimated facilities closure costs	62,638	262	62,376
Estimated employee severance costs	50,367	49,031	1,336
Total	$150,347	$73,260	$77,087

The total purchase consideration has been allocated on a preliminary basis to the assets and liabilities acquired, including identifiable intangible assets, based on their respective fair value at the acquisition date and resulted in excess purchase consideration over the net tangible and identifiable intangible assets acquired of $344.9 million. The following unaudited condensed balance sheet data presents the preliminary fair value of the assets and liabilities acquired and recorded at June 6, 2002.

(IN THOUSANDS)	
Assets acquired	
Cash, cash equivalents and short-term investments	$ 241,313
Accounts receivable	67,154
Prepaid expenses and other current assets	19,483
Assets held for sale	33,220
Intangible assets	365,000
Goodwill	344,949
Other assets	3,876

Total assets acquired	$1,074,995
Liabilities acquired	
Accounts payable and accrued liabilities	$ 172,528
Deferred revenue	30,080
Income taxes payable	94,576
Other liabilities	4,651
Total liabilities acquired	$ 301,835

Other current assets acquired includes an investment in a venture-capital fund valued at $12.8 million. Management intends to dispose of this investment; however, the Company has been unable to obtain certain financial records and information required to effectively market the investment. The fair value of the asset recorded does not include any adjustment of this investment due to this contingency. Any adjustment to the fair-value of this investment that is ultimately made will increase or decrease the purchase consideration and the allocation of the purchase consideration to goodwill.

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UNAUDITED PRO FORMA RESULTS OF OPERATIONS. The following table presents pro forma results of operations and gives effect to the proposed merger as if the merger had been consummated on November 1, 2000. The unaudited pro forma results of operations are not necessarily indicative of the results of operations had the acquisition actually occurred at the beginning of fiscal 2001, nor is it necessarily indicative of future operating results:

	THREE MONTHS ENDED JULY 31,		NINE MONTHS JULY 31	
(IN THOUSANDS, EXCEPT PER SHARE DATA)	2002	2001	2002	
Revenues	$ 278,217	$ 276,922	$ 861,822	$
Net income (loss)	16,099	18,434	71,697	
Basic earnings (loss) per share	$ 0.23	$ 0.25	$ 1.12	$
Weighted average common shares outstanding	71,157	74,578	64,157	
Diluted earnings (loss) per share	$ 0.21	$ 0.23	$ 1.04	$
Weighted average common shares and dilutive stock options outstanding	74,955	80,351	68,698	

The unaudited pro forma results of operations for each of the periods presented exclude non-recurring merger costs of $95,000 and $82,500 for the contingently refundable insurance policy and IPRD recorded by Synopsys in the third quarter of 2002 and included in the historical condensed consolidated statement of operations.

GOODWILL AND INTANGIBLE ASSETS. Goodwill, representing the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired in the merger will not be amortized consistent with the guidance with SFAS 142. The goodwill associated with the Avant! acquisition is not deductible for tax purposes. In addition, a portion of the purchase price was allocated to the following identifiable intangible assets:

Intangible Asset	(IN THOUSANDS)	Estimated Useful Life
Core/developed technology	$184,000	3 years
Contract rights intangible	51,700	3 years
Customer installed base/relationship	102,500	6 years
Trademarks and tradenames	17,700	3 years
Covenants not to compete	9,100	The life of the related agreement (2
Total	$365,000	

CONTRACT RIGHTS INTANGIBLE. Avant! had executed signed license agreements and delivered the initial configuration of licensed technologies under ratable license arrangements, had executed signed contracts to provide PCS over a one to three year period, for which Avant! did not consider the fees to be fixed and determinable at the outset of the arrangement. There were no receivables or deferred revenues recorded on Avant!'s historical financial statements at the closing date as the related payments were not yet due under extended payment terms and deliveries are scheduled to occur over the term of the arrangements. These ratable licenses and PCS arrangements require future performance by both parties and, as such, represent executory contracts. The contract rights intangible asset associated with these arrangements is amortized to cost of revenue over the related contract lives.

The amortization of intangible assets, with the exception of the contract rights intangible and core/developed technology, is included in operating expenses in the statement of operations for the three- and nine-month periods ended July 31, 2002. Amortization of core/developed technology is included in cost of revenue.

ASSET HELD FOR SALE. In January 2001, Synopsys sold the assets of its silicon libraries business to Artisan Components, Inc. ("Artisan") and entered into an agreement not to engage, directly or indirectly, in the physical libraries business before January 3, 2003. Synopsys also agreed that if it acquired a physical libraries business as part of a larger acquisition, then Artisan would have certain preferential rights to negotiate and bid for such business. Prior to the merger, Avant! engaged in the physical libraries business. As a result of the merger, Synopsys acquired Avant!'s physical libraries business, and Synopsys is obligated to offer and sell such business to Artisan under the terms of the January 2001 agreement. The value allocated to

the acquired libraries business has been recorded as net assets held for sale and is based on the estimated future net cash flows from the libraries business in accordance with EITF 87-11, ALLOCATION OF PURCHASE PRICE TO ASSETS TO BE SOLD. The carrying value of the libraries business as of July 31, 2002 is approximately $33.1 million and losses for the period from June 6, 2002 through July 31, 2002 that have been excluded from the consolidated income statement were approximately $0.5 million.

CADENCE LITIGATION. Avant! and its subsidiaries are engaged in the Avant!/Cadence litigation, a material civil litigation matter. The Avant!/Cadence litigation generally arises out of the same set of facts that

were the subject of a criminal action brought against Avant! and several individuals by the District Attorney of Santa Clara

County, California, which action we refer to as the Santa Clara criminal action. Avant!, Gerald C. Hsu, Chairman of Avant! and five former Avant! employees pled no contest to certain of the charges in the Santa Clara criminal action. As part of that plea, Avant! paid approximately $35.3 million in fines and a hearing was held on the amount of restitution owed to Cadence. During the hearing, Cadence claimed losses of $683.3 million. Ultimately, the court in the Santa Clara criminal action required Avant! to pay Cadence restitution in the amount of $195.4 million. That amount has been fully paid.

Cadence seeks compensatory damages and treble or other exemplary damages from Avant! in the Avant!/Cadence litigation under theories of copyright infringement, misappropriation of trade secrets, inducing breach of contract and false advertising. Synopsys believes Avant! has defenses to all of Cadence's claims in the Avant!/Cadence litigation. Cadence has not fully quantified the amount of damages it seeks in the Avant!/Cadence litigation. Should Cadence ultimately succeed in the prosecution of its claims, however, Avant! could be required to pay substantial monetary damages to Cadence. Some or all of these damages may be offset by the $195.4 million restitution paid to Cadence in the Santa Clara criminal action. Approximately $500 million in additional damages would be covered by the insurance policy Synopsys has obtained with respect to the Avant!/Cadence litigation, which is described below.

Injunctions entered in 1997 and 1998 enjoined Avant! from marketing its early place and route products, ArcCell and Aquarius, based on a judicial determination that they incorporated portions of Cadence's Design Framework II source code (DFII). The injunctions also prohibit Avant! from possessing, using, selling or licensing any product or work copied or derived from DFII and directly or indirectly marketing, selling leasing, licensing, copying or transferring any of the ArcCell or Aquarius products. Avant! ceased marketing, selling, leasing, licensing or supporting all of the ArcCell or Aquarius products in 1996 and 1999, respectively. The DFII code is not incorporated in any current Avant! product. Although Cadence has not made a claim in the Avant!/Cadence litigation against any current Avant! product, including its Apollo and Astro place and route products, and has not introduced any evidence that any such product infringes Cadence's intellectual property rights, Cadence has publicly implied that it intends to assert such claims. Synopsys believes it would have defenses to any such claims. Nonetheless, should Cadence be successful at proving that any past or then-current Avant! product incorporated intellectual property misappropriated from Cadence, Synopsys could be permanently enjoined from further use of such intellectual property, which might require modification to existing products and/or suspension of the sale of such products until such Cadence intellectual property was removed.

In connection with the merger, Synopsys has entered into a policy with a subsidiary of American International Group, Inc., a AAA-rated insurance company, whereby insurance has been obtained for certain compensatory, exemplary and punitive damages, penalties and fines and attorneys' fees arising out of pending litigation between Avant! and Cadence. The policy does not provide coverage for litigation other than the Avant!/Cadence litigation.

The Company paid total premium of $335 million for the policy, of which $240 million is contingently refundable. Under the policy the insurer is obligated to pay covered loss up to a limit of liability equaling (a) $500 million plus (b) interest accruing at the fixed rate of 2%, compounded semi-annually, on $250 million (the "interest component"), as reduced by previous covered losses. The policy will expire following a final judgment or settlement of the Avant!/Cadence litigation or any earlier date upon Synopsys' election. Upon such expiration, Synopsys will be entitled to a payment equal to $240 million plus the interest component less any covered loss (which, for this purpose, shall

include legal fees only to the extent that the aggregate amount of such fees exceeds $10 million).

The contingently refundable portion of the insurance premium ($240 million) is included in the July 31, 2002 balance sheet as a long-term restricted asset. Interest earned on $250 million will be included in other income, net in the post-merger statement of operations. The balance of the premium paid to the insurer ($95 million) is included in integration expense for the three- and nine-month periods ended July 31, 2002.

At the closing date, the Avant!/Cadence litigation was accounted for as a pre-merger contingency because a litigation judgment or settlement amount, if any, is not probable or estimable. If a litigation loss becomes probable and estimable after the date of the merger, such loss will be included in net income.

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INTEGRATION COSTS. Non-recurring integration costs incurred by the Company relate to merger activities which are not included in the purchase consideration under EITF 95-3. These costs are expensed as incurred. During the third quarter of 2002, integration costs totaled $117.3 million. These costs consisted primarily of (i) a premium of $95.0 million related to the contingently refundable insurance policy, (ii) $14.7 million related to write-downs of Synopsys facilities and property under the approved facility exit plan, (iii) severance costs for Synopsys employees who were terminated as a result of the merger and costs associated with transition employees totaled $6.2 million, and (iv) $1.3 million related to the write-off of software licenses owned by Synopsys which were originally purchased from Avant!.

VALUATION OF IPRD. Upon consummation of the Avant! merger, the Company immediately recognized expense of $82.5 million representing the value of the acquired in-process technology for which technological feasibility had not been achieved and no alternative future uses had been established. The value assigned to acquired in-process technology was determined by identifying products under research in areas for which technological feasibility had not been established. The in-process technology was then segmented into two classifications: (i) in-process technology -- completed and (ii) in-process technology -- to-be-completed, giving explicit consideration to the value created by the research and development efforts of the acquired business prior to the acquisition and to be created by Synopsys after the acquisition. These value creation efforts were estimated by considering the following major factors: (i) time-based data, (ii) cost-based data and (iii) complexity-based data.

The value of the in-process technology was determined using a discounted cash flow model similar to the income approach, focusing on the income-producing capabilities of the in-process technologies. Under this approach, the value is determined by estimating the revenue contribution generated by each of the identified products classified within the classification segments. Revenue estimates were based on (i) individual product revenues, (ii) anticipated growth rates (iii) anticipated product development and introduction schedules (iv) product sales cycles, and (v) the estimated life of a product's underlying technology. From the revenue estimates, operating expense estimates, including costs of sales, general and administrative, selling and marketing, income taxes and a use charge for contributory assets, were deducted to arrive at operating income. Revenue growth rates were estimated by management for each product and gave consideration to relevant market sizes and growth factors, expected industry trends, the anticipated nature and timing of new product introductions by us and our competitors, individual product sales cycles, and the estimated life of each product's underlying technology. Operating expense estimates reflect Synopsys' historical expense ratios. Additionally, these projects will

require continued research and development after they have reached a state of technological and commercial feasibility. The resulting operating income stream was discounted to reflect its present value at the date of the acquisition. These estimates are subject to change, given the uncertainties of the development process, and no assurance can be given that deviations from these estimates will not occur or that Synopsys will realize any anticipated benefits of the acquisition.

The rate used to discount the net cash flows from purchased in-process technology is the weighted average cost of capital (WACC) for the Company, taking into account its required rates of return from investments in various areas of the enterprise, and reflecting the inherent uncertainties in future revenue estimates from technology investments including the uncertainty surrounding the successful development of the acquired in-process technology, the useful life of such technology, the profitability levels of such technology, if any, and the uncertainty of technological advances, all of which are unknown at this time.

At the date of the Avant! merger, the principal in-process technologies were identified based on the following product families: PPD Division, VPD Division, APD Division, LPD Division, MTB, TCAD and Analogy. For purposes of valuing the IPRD in accordance with the methodology discussed above, the following estimates were used: revenue growth ranging from 16% in year two to 10% in year nine; cost of sales -- 7% of revenue in each year; general and administrative expenses -- 5% of revenue in each year; and sales and marketing -- 28% of revenue in each year. In addition, it was assumed there would be no expense reduction due to economic synergies as a result of the acquisition. The rate used to discount the net cash flows from the purchased in-process technology was 27%. The technologies were approximately 40% to 90% complete at the acquisition date. The nature of the efforts to complete these projects related, in varying degrees, to the completion of all planning, designing, prototyping, verification, and testing activities that are necessary to establish that the proposed technologies met their design specifications, including functional, technical, and economic performance requirements. Expenditures to complete the acquired in-process technologies are expected to total approximately $17.5 million.

ACQUISITION OF INSILICON CORPORATION. On July 23, 2002, we entered into an Agreement and Plan of Merger with inSilicon Corporation (inSilicon) under which we commenced a cash tender offer to acquire all of the outstanding shares of inSilicon common stock at $4.05 per share or approximately $64.9 million, subject to certain conditions. Following the consummation of the tender offer, inSilicon will merge with and into a wholly owned subsidiary of Synopsys. We will account for the merger under the purchase method of accounting. The merger is subject to certain conditions, including approval of the merger and the Agreement and Plan of Merger by the inSilicon stockholders, compliance with regulatory requirements and customary closing conditions.

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ACQUISITION OF CO-DESIGN. On September 6, 2002, we acquired all of the outstanding shares of capital stock of Co-Design Automation, Inc. (Co-Design) for consideration consisting of cash and notes of $29.7 million and $4.8 million, respectively, and assumed options with an aggregate value of approximately $1.3 million. We will account for the merger under the purchase method of accounting. As of the date of filing the Form 10-Q, the valuation of Co-Design's assets and liabilities, including identifiable intangible assets, as of the closing date has not been completed. We purchased Co-Design for a number of reasons, including (i) the combination of Co-Design's technology with our verification tools is expected to speed the delivery of next-generation hardware description language solutions; (ii) the acquisition will help promote the use of the Superlog language, which we believe will be important in developing next

generation verification tools and increasing designer productivity; and (iii) the acquisition gives us access to Co-Design's industry experts. As of the date of filing the Form 10-Q, the valuation of Co-Design's assets and liabilities, including identifiable intangible assets, as of the closing date has not been completed.

EFFECT OF NEW ACCOUNTING STANDARDS. In July 2001, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards No. 141, BUSINESS COMBINATIONS (SFAS 141), and No. 142, GOODWILL AND OTHER INTANGIBLE ASSETS (SFAS 142). 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 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually in accordance with the provisions of SFAS 142.

The Company adopted the provisions of SFAS 141 on July 1, 2001. Under SFAS 141, goodwill and intangible assets with indefinite useful lives acquired in a purchase business combination completed after June 30, 2001, but before SFAS 142 is adopted, will not be amortized but will continue to be evaluated for impairment in accordance with SFAS 121. Goodwill and intangible assets acquired in business combinations completed before July 1, 2001 will continue to be amortized and tested for impairment in accordance with current accounting guidance until the date of adoption of SFAS 142.

Upon adoption of SFAS 142, the Company must evaluate its existing intangible assets and goodwill acquired in purchase business combinations prior to July 1, 2001, and make any necessary reclassifications in order to conform with the new criteria in SFAS 141 for recognition apart from goodwill. Upon adoption of SFAS 142, the Company will be required to reassess the useful lives and residual values of all intangible assets acquired, and make any necessary amortization period adjustments. The Company will also be required to test goodwill for impairment in accordance with the provisions of SFAS 142 within the six-month period following adoption. Any impairment loss will be measured as of the date of adoption and recognized immediately as the cumulative effect of a change in accounting principle. Any subsequent impairment losses will be included in operating activities.

The Company expects to adopt SFAS 142 on November 1, 2002. As of July 31, 2002, unamortized goodwill is $23.1 million which, in accordance with the Statements, will continue to be amortized until the date of adoption of SFAS 142. Amortization of goodwill and other intangible assets for the nine-month period ended July 31, 2002 is $12.1 million. Goodwill totaling $344.9 relates to acquisitions subsequent to July 1, 2001 and is therefore not amortized in accordance with FAS 142. The Company does not have any intangible assets with an indefinite useful life. The Company is currently evaluating the impact of the adoption of this statement on its financial position and results of operations.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 143, ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS (SFAS 143). 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 is required to adopt the provisions of SFAS 143 effective November 1, 2002. The adoption of SFAS 143 will not have a significant impact on the company's financial position and results of operations.

In August 2001, the FASB issued Statement of Financial Accounting Standards No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS (SFAS

144), 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 APB Opinion No. 30, REPORTING THE RESULTS OF OPERATIONS FOR A DISPOSAL OF A SEGMENT OF A BUSINESS. The Company is

required to adopt the provisions of SFAS 144 no later than November 1, 2002. The Company does not expect that the adoption of SFAS 144 will have a significant impact on its financial position and results of operations.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145, RESCISSION OF FASB STATEMENTS NO. 4, 44, AND 64, AMENDMENT OF FASB STATEMENT NO. 13, AND TECHNICAL CORRECTIONS (SFAS 145). SFAS 145 eliminates the requirement that gains and losses from the extinguishments of debt be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. However, an entity would not be prohibited from classifying such gains and losses as extraordinary items so long as they are both unusual in nature and infrequent in occurrence. The Company is required to adopt the provisions of SFAS 145 effective November 1, 2002. SFAS 145 also amends SFAS 13, ACCOUNTING FOR LEASES and certain other authoritative pronouncements to make technical corrections or clarifications. SFAS 145 will be effective related to the amendment of SFAS 13 for all transactions occurring after May 15, 2002. The Company does not expect that the adoption of SFAS 145 will have a significant impact on its financial position and results of operations.

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 will be effective for exit or disposal activities of the Company that are initiated after December 31, 2002. The Company believes that the adoption of SFAS 146 will not have a significant impact on its financial position and results of operations.

LIQUIDITY AND CAPITAL RESOURCES

Cash, cash equivalents and short-term investments were $446.2 million at July 31, 2002, a decrease of $30.2 million, or 6%, from October 31, 2001. Cash used in operating activities was $78.1 million for the nine months ended July 31, 2002 compared to $123.4 million provided by operating activities for the same period in the prior year. The decrease in cash flows from operating activities is due primarily to payments for income taxes made during the first quarter, payments made for the insurance premium, professional fees, severance and integration of Avant! as well as a payment to settle pending litigation.

Cash provided by investing activities was $94.3 million and $110.8 million in the first nine months of 2002 and 2001, respectively. This decrease in cash provided by investing activities relates primarily to the purchase of a contingently refundable insurance policy relating to the Avant!/Cadence litigation, totaling $240.0 million, the effect of which was partially offset by the cash received from Avant! on the closing date, totaling $235.0 million. Net proceeds from the sale of short- and long-term investments totaled $136.4

million for the nine months ended July 31, 2002 compared to net proceeds of investments totaling $159.6 million for the same period during 2001. Capital expenditures decreased $16.1 to $35.9 million for the nine-months ended July 31, 2002 from $52.0 million during the same period in fiscal 2001 due to the expenditures related to construction of our Oregon facilities and computing equipment to upgrade our infrastructure systems incurred during fiscal 2001. In addition, cash proceeds from the sale of our silicon libraries business were $4.1 million in the first quarter of fiscal 2001.

Cash provided by financing activities was $61.8 million for the nine months ended July 31, 2002 compared to $249.0 million used in financing activities during the same period during fiscal 2001. Financing proceeds from the exercise of stock options during the nine months ended July 31, 2002 and 2001 were $103.6 million and $89.3 million, respectively. The primary financing uses of cash during the nine months ended July 31, 2002 and 2001 were for the purchase of treasury stock, net of reissuances, totaling $41.8 million and $331.9 million, respectively.

Accounts receivable increased to $233.2 million at July 31, 2002 compared to $146.3 million at October 31, 2001. Days sales outstanding, which is calculated based on revenues for the most recent quarter and accounts receivable as of the balance sheet date, increased to 85 days as of July 31, 2002 from 73 days at October 31, 2001 as a result of an increase in accounts receivable due to the Avant! acquisition.

Our principle sources of cash are collections of accounts receivable and the issuance of common stock. During fiscal 2002 we have increasingly agreed to

extended payment terms on our TSLs, which has had a negative effect on cash flow from operations. Since the middle of last year to this past quarter, the percentage of cash scheduled to be collected within 60 days of the order has moved from approximately 65% to approximately 22%, and the percentage of cash scheduled to be collected within one year has moved from approximately 88% to 66%. We believe that our current cash, cash equivalents, short-term investments, lines of credit, and cash generated from operations will satisfy our business requirements for at least the next twelve months.

FACTORS THAT MAY AFFECT FUTURE RESULTS

WEAKNESS IN THE SEMICONDUCTOR AND ELECTRONICS BUSINESSES MAY NEGATIVELY IMPACT SYNOPSYS' BUSINESS. Synopsys' business depends on the semiconductor and electronics businesses. In 2001, these businesses experienced their sharpest decline in orders and revenue in over 20 years and this weakness has continued in 2002.

Purchases of our products are largely dependent upon the commencement of new design projects by semiconductor manufacturers and their customers, the number of design engineers and the increasing complexity of designs. During 2001 many semi-conductor and electronic companies cancelled or deferred design projects and reduced their design engineering staffs, which negatively impacted our orders and revenues, particularly orders and revenues from our professional services business. Demand for our products and services may also be affected by partnerships and/or mergers in the semiconductor and systems industries, which may reduce the aggregate level of purchases of our products and services by the companies involved. Continuation or worsening of the current conditions in the semiconductor industry, and continued consolidation among our customers, all could have a material adverse effect on our business, financial condition and results of operations.

SYNOPSYS' REVENUE AND EARNINGS MAY FLUCTUATE. Many factors affect our revenue and earnings, which makes it difficult to achieve predictable revenue and earnings growth. Among these factors are customer product and service demand, product license terms, and the timing of revenue recognition on products and services sold. The following specific factors could affect our revenue and earnings in a particular quarter or over several quarterly or annual periods:

- Our products are complex, and before buying them customers spend a great deal of time reviewing and testing them. Our customers' evaluation and purchase cycles do not necessarily match our quarterly periods. In the past, we have received a disproportionate volume of orders in the last week of a quarter, and this trend has become more pronounced in recent quarters. In addition, a large proportion of our business is attributable to our largest customers. As a result, if any order, and especially a large order, is delayed beyond the end of a fiscal period, our orders for that period could be below our plan and our revenue for that period or future periods could be below any targets we may have published.

- Accounting rules determine when revenue is recognized on our orders, and therefore impact how much revenue we will report in any given fiscal period. The authoritative literature under which Synopsys recognizes revenue has been, and is expected to continue to be, the subject of much interpretative guidance. In general, revenue is recognized on TSLs ratably over the term of the license and on perpetual licenses upon delivery of the license. For any given order, however, the specific terms agreed to with a customer may have the effect under the accounting rules of requiring revenue treatment different from the treatment we intended and, in developing our financial plans, expected. Therefore, for any given fiscal period it is possible for us to fall short in our revenue and/or earnings plan even while orders and backlog remain on plan or, conversely, to meet or exceed our revenue and/or earnings plan because of backlog and deferred revenue, while aggregate orders are under plan.

- Our revenue and earnings targets are based, in part, upon an assumption that we will achieve a license mix of perpetual licenses (on which revenue is generally recognized in the quarter shipped) and TSLs (on which revenue is recognized over the term of license) within a specified range, which is adjusted from time to time. If we are unable to achieve a mix in this range our ability to achieve short-term or long-term revenue and/or earnings targets may be impaired.

SYNOPSYS MAY NOT BE ABLE TO SUCCESSFULLY COMPETE IN THE EDA INDUSTRY, WHICH WOULD HAVE A MATERIAL ADVERSE EFFECT ON SYNOPSYS' RESULTS OF OPERATIONS. The EDA industry is highly competitive. We compete against other EDA vendors, and with customers' internally developed design tools and internal design capabilities for a share of the overall EDA budgets of our potential customers. In general, competition is based on product quality and features, post-sale support, price, payment terms and, as discussed below, the ability to offer a complete design flow. Our competitors include companies that offer a broad range of products and

services, such as Cadence Design Systems, Inc. and Mentor Graphics Corporation, as well as companies, including numerous recently public and start-up companies, that offer products focused on a discrete phase of the integrated circuit design process. In the current economic environment price and payment terms have increased in importance as a basis for competition. During fiscal 2002 we have increasingly agreed to extended payment terms on our TSLs, which has had a negative effect on cash flow from operations. In addition, in certain situations our competitors are offering aggressive discounts on their products. As a result, average prices may fall.

IF WE ARE UNABLE TO DEVELOP AN INTEGRATED DESIGN FLOW PRODUCT AND OTHER NEW PRODUCTS WE MAY BE UNABLE TO COMPETE EFFECTIVELY Increasingly, EDA companies compete on the basis of design flows involving integrated logic and physical design products rather than on the basis of individual point tools performing a discrete phase of the design process. The need to offer an integrated design flow will become increasingly important as ICs grow more complex. After the acquisition of Avant! we offer all of the point tools required to design an IC, some of which integrate logic and physical design capabilities. Our products compete principally with design flow products from Cadence and Magma Design Automation, which are in some respects more integrated than our products. Our future success depends on our ability to integrate Synopsys' logic design and physical synthesis products with the physical design products acquired from Avant!, which will require significant engineering and development work. There can be no guarantee that we will be able to offer a competitive complete design flow to customers. If we are unsuccessful in developing integrated design flow products on a timely basis or if we are unsuccessful in developing or convincing customers to adopt such a such products, our competitive position could be significantly weakened.

In order to sustain revenue growth over the long term, we will have to enhance our existing products, introduce new products that are accepted by a broad range of customers and to generate growth in our consulting services business. Product success is difficult to predict. The introduction of new products and growth of a market for such products cannot be assured. In the past we, like all companies, have introduced new products that have failed to meet our revenue expectations. Expanding revenue from consulting services may be difficult in the current economic environment. Increasing consulting orders and revenue while maintaining an adequate level of profit can be difficult. There can be no assurance that we will be successful in expanding revenue from existing or new products at the desired rate or in expanding our services business, and the failure to do so would have a material adverse effect on our business, financial condition and results of operations.

SYNOPSYS MAY FAIL TO INTEGRATE SUCCESSFULLY SYNOPSYS' AND AVANT!'S OPERATIONS. AS A RESULT, SYNOPSYS MAY NOT ACHIEVE THE ANTICIPATED BENEFITS OF THE ACQUISITION. Achieving the benefits of our acquisition of Avant! will depend on many factors, including the successful and timely integration of the products, technology and sales operations of the two companies. These integration efforts may be difficult and time consuming, especially considering the highly technical and complex nature of each company's products. Failure to achieve a successful and timely integration of the Synopsys and Avant! products and sales operations could result in the loss of existing or potential customers of Synopsys and Avant! and could have a material adverse effect on our business, financial condition and results of operations. Integration efforts will also divert significant management attention and resources. This diversion of attention and resources could have an adverse effect on Synopsys during such transition period.

OTHER BUSINESSES THAT SYNOPSYS HAS ACQUIRED OR THAT SYNOPSYS MAY ACQUIRE IN THE FUTURE MAY NOT PERFORM AS PROJECTED. We have acquired or merged with a number of companies in recent years, and as part of our efforts to increase revenue and expand our product and services offerings we may acquire additional companies. In addition to acquiring Avant!, in July 2002, we announced an agreement to acquire inSilicon Corporation and in September 2002 we completed the acquisition of Co-Design Automation, Inc. In addition to direct costs, acquisitions pose a number of risks, including potential dilution of earnings per share, problems in integrating the acquired products and employees into our business, the failure to realize expected synergies or cost savings, the failure of acquired products to achieve projected sales, the drain on management time for acquisition-related activities, adverse effects on customer buying patterns and assumption of unknown liabilities. While we attempt to review proposed

acquisitions carefully and negotiate terms that are favorable to us, there is no assurance that any acquisition will have a positive effect on our performance.

CONTINUED STAGNATION OF INTERNATIONAL ECONOMIES WOULD ADVERSELY AFFECT OUR PERFORMANCE. During the three and nine months ended July 31, 2002, 35% of our revenue was derived from outside North America, as compared to 37% and 38% during the same periods in fiscal 2001, respectively. International sales are vulnerable to regional or worldwide economic or political conditions and to changes in foreign currency exchange rates. Economic conditions in Europe and Japan have been stagnant for several quarters, and the longer this weakness persists the more likely it is to have a negative impact on our business. In particular, a number of our largest European customers are in the telecommunications equipment business, which has weakened considerably. The Japanese economy has been stagnant for several years, and there is no expectation of improvement in the near future. If the Japanese economy remains

weak, revenue and orders from Japan, and perhaps the rest of Asia, could be adversely affected. In addition, the yen-dollar and Euro-dollar exchange rates remain subject to unpredictable fluctuations. Weakness of either currency could adversely affect revenue and orders from those regions. Asian countries other than Japan also have experienced economic and currency problems in recent years, and in most cases they have not fully recovered. Although the Asia Pacific region is growing it is relatively small as a percentage of our business and it could be difficult to sustain growth in the region if the rest of the world's economies continue to stagnate. If economic conditions worsen orders and revenues from the Asia Pacific region would be adversely affected.

AVANT! MAY BE REQUIRED TO PAY SUBSTANTIAL AMOUNTS UNDER PENDING CIVIL LITIGATION. Avant! is a defendant in litigation brought by Cadence (the Avant!/Cadence litigation) in which Cadence seeks compensatory damages and treble or other exemplary damages under theories of copyright infringement, misappropriation of trade secrets, inducing breach of contract and false advertising. As part of the proceeding, in 1997 and 1998 Avant! was enjoined from marketing two products based on a judicial determination that they incorporated certain Cadence intellectual property. In July 2001 Avant!, Gerald C. Hsu, former Chairman of Avant!, and five former Avant! employees pled no contest to certain criminal charges based on generally the same set of facts. As part of that plea, Avant! paid fines of approximately $35 million and paid restitution to Cadence of approximately $195 million. Cadence has not fully quantified the amount of damages it seeks in the Avant!/Cadence litigation, nor has it made a claim against any existing product, although it has publicly implied that it intends to assert such claims. Synopsys believes Avant! has defenses to any Cadence claims. Should Cadence's claims ultimately succeed, however, Avant! could be required to pay substantial monetary damages to Cadence. Some or all of these damages may be offset by the $195 million restitution already paid to Cadence, and approximately $500 million in damages (over and above whatever amount is subject to offset by the restitution payment) owed by Synopsys would be paid by litigation insurance obtained by Synopsys. See "Cadence Litigation". Should Cadence be successful at proving that any current product incorporated intellectual property misappropriated from Cadence, Avant! and Synopsys could be permanently enjoined from further use of such intellectual property. To the extent that damages owed to Cadence exceeded the any offset plus the proceeds from the insurance policy, or that Synopsys is precluded from using any intellectual property acquired from Avant! and in use at the time of a judgment and is unable to develop a suitable replacement for such intellectual property, the Avant!/Cadence litigation could have a material adverse effect on Synopsys' business, financial condition and results of operation.

THE INSURER UNDER THE LITIGATION INSURANCE MAY BE PREVENTED FROM PAYING FOR

CERTAIN LOSSES ON THE GROUNDS THAT SUCH PAYMENT VIOLATES PUBLIC POLICY. Synopsys has obtained litigation insurance issued by a subsidiary of American International Group, Inc., an insurance company rated AAA by Standard & Poors. See "Litigation". In some jurisdictions, it is against public policy to provide insurance for willful acts, punitive damages or similar claims. This could potentially affect the validity and enforceability of certain elements of the litigation insurance. The legal agreement governing the litigation insurance expressly provides that the agreement will be governed by the laws of the State of Delaware and that any disputes arising out of or relating to the agreement will be resolved in the courts of the State of Delaware. Synopsys believes, based upon advice it has received from Delaware counsel, that a Delaware court would enforce both of these provisions, and moreover would enforce the arrangement under Delaware law, including to the extent it provides for insurance for Avant!'s willful acts and punitive damages. Nonetheless, there can be no assurance in this regard. In other cases, courts, including courts in California, have applied local law to insurance contracts irrespective of the parties' choice of law. Thus a court in a state other than Delaware could assert jurisdiction over the enforceability of this agreement and rule pursuant to the law of a state other than Delaware that the litigation protection insurance is not enforceable in whole or in part on grounds of public policy. For example, if there were to be litigation before a California court regarding the enforceability of the insurance policy it is possible that a California court might rule that the enforceability of the litigation protection insurance should be governed by California law, despite the parties' agreement that all disputes arising out of or relating to the agreement be resolved in the courts of the State of Delaware, and that California law prevents certain payments under the policy. A Delaware court might abide by such a ruling of a California court. To the extent the insurer is prevented from paying certain losses on grounds of public policy that would otherwise be covered by the insurance, Avant! will be required to pay that portion of the losses and the insurer may be obligated to refund a portion of the premium to Synopsys.

SYNOPSYS DOES NOT HAVE CONTROL OVER DEFENSE OF THE AVANT!/CADENCE LITIGATION OR THE AUTHORITY TO SETTLE THE AVANT!/CADENCE LITIGATION EXCEPT IN LIMITED CIRCUMSTANCES. Under the terms of the litigation insurance, the insurer has the right to exercise full control over the defense of the Avant!/Cadence litigation, and the right to exclusively control the negotiation, discussion and terms of any proposed settlement, except that (i) Synopsys retains the right to settle the Avant!/Cadence litigation, with the consent of the insurer, for up to $250 million plus accrued interest less certain costs, and (ii) Synopsys and the defendants in the Avant!/Cadence litigation each retain the right to consent or

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reasonably withhold consent to any settlement terms proposed by the insurer which are non-monetary and can be satisfied only by future performance or non-performance by Synopsys or such defendants, as the case may be. Therefore, Synopsys has a severely limited ability to control the strategy and tactics adopted with respect to the litigation and may be subject to certain risks and liabilities relating to the defense and/or potential settlement of such litigation.

A FAILURE TO RECRUIT AND RETAIN KEY EMPLOYEES WOULD HAVE A MATERIAL ADVERSE EFFECT ON OUR ABILITY TO COMPETE. Our success is dependent on technical and other contributions of key employees. We participate in a dynamic industry, and our headquarters is in Silicon Valley, where, despite recent economic conditions, skilled technical, sales and management employees are in high demand. There are a limited number of qualified EDA and IC design engineers, and the competition for such individuals is intense. Despite economic conditions, start-up activity in EDA remains significant. Experience at Synopsys is highly valued in the EDA industry and the general electronics industry, and our

employees, including employees that joined Synopsys in the Avant! merger, are recruited aggressively by our competitors and by start-up companies in many industries. In the past, we have experienced, and may continue to experience, significant employee turnover. There can be no assurance that we can continue to recruit and retain the technical and managerial personnel we need to run our business. Failure to do so could have a material adverse effect on our business, financial condition and results of operations.

A FAILURE TO PROTECT OUR PROPRIETARY TECHNOLOGY WOULD HAVE A MATERIAL ADVERSE EFFECT ON SYNOPSYS' FINANCIAL CONDITION AND RESULTS OF OPERATIONS. Our success is dependent, in part, upon our proprietary technology and other intellectual property rights. We rely on agreements with customers, employees and others, and intellectual property laws, to protect our proprietary technology. There can be no assurance that these agreements will not be breached, that we would have adequate remedies for any breach or that our trade secrets will not otherwise become known or be independently developed by competitors. Moreover, effective intellectual property protection may be unavailable or limited in certain foreign countries. Failure to obtain or maintain appropriate patent, copyright or trade secret protection, for any reason, could have a material adverse effect on our business, financial condition and results of operations. In addition, there can be no assurance that infringement claims will not be asserted against us and any such claims could require us to enter into royalty arrangements or result in costly and time-consuming litigation or could subject us to damages or injunctions restricting our sale of products or could require us to redesign products.

OUR OPERATING EXPENSES DO NOT FLUCTUATE PROPORTIONATELY WITH FLUCTUATIONS IN REVENUES, WHICH COULD MATERIALLY ADVERSELY AFFECT OUR RESULTS OF OPERATIONS IN THE EVENT OF A SHORTFALL IN REVENUE. Our operating expenses are based in part on our expectations of future revenue, and expense levels are generally committed in advance of revenue. Since only a small portion of our expenses varies with revenue, a shortfall in revenue translates directly into a reduction in net income. If we are unsuccessful in generating anticipated revenue or maintaining expenses within this range, however, our business, financial condition and results of operations could be materially adversely affected.

SYNOPSYS HAS ADOPTED ANTI-TAKEOVER PROVISIONS, WHICH MAY HAVE THE EFFECT OF DELAYING OR PREVENTING CHANGES OF CONTROL OR MANAGEMENT. We have adopted a number of provisions that could have anti-takeover effects. Our Board of Directors has adopted a Preferred Shares Rights Plan, commonly referred to as a poison pill. In addition, our Board of Directors has the authority, without further action by its stockholders, to issue additional shares of Common Stock and to fix the rights and preferences of, and to issue authorized but undesignated shares of Preferred Stock. These and other provisions of Synopsys' Restated Certificate of Incorporation and Bylaws and the Delaware General Corporation Law may have the effect of deterring hostile takeovers or delaying or preventing changes in control or management of Synopsys, including transactions in which the stockholders of Synopsys might otherwise receive a premium for their shares over then current market prices.

SYNOPSYS IS SUBJECT TO CHANGES IN FINANCIAL ACCOUNTING STANDARDS, WHICH MAY AFFECT OUR REPORTED REVENUE, OR THE WAY WE CONDUCT BUSINESS. We prepare our financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP). GAAP are subject to interpretation by the Financial Accounting Standards Board, the American Institute of Certified Public Accountants (AICPA), the SEC and various bodies appointed by these organizations to interpret existing rules and create new accounting policies. In particular, a task force of the Accounting Standards Executive Committee, a subgroup of the AICPA, meets on a quarterly basis to review various issues arising under the existing software revenue recognition rules, and interpretations of these rules. Additional interpretations issued by the task force may have an adverse effect on how we report revenue or on the way we

conduct our business in the future.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Information relating to quantitative and qualitative disclosure about market risk is set forth under the captions "Interest Rate Risk" and "Foreign Currency Risk" in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations. Such information is incorporated herein by reference.

SIGNATURES

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

SYNOPSYS, INC.

By: /S/ ROBERT B. HENSKE

Robert B. Henske
Senior Vice President, Finance and
Operations, and Chief Financial Officer
(Principal Financial Officer)

Date: September 20, 2002

CERTIFICATIONS

I, Aart J. de Geus, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Synopsys, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: September 19, 2002

/S/ AART J. DE GEUS

Aart J. de Geus

CHIEF EXECUTIVE OFFICER
(PRINCIPAL EXECUTIVE OFFICER)

I, Robert B. Henske, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Synopsys, Inc.;

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: September 19, 2002

/S/ ROBERT B. HENSKE

Robert B. Henske

CHIEF FINANCIAL OFFICER
(PRINCIPAL FINANCIAL OFFICER)