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

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED JANUARY 31, 2006

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, including zip code)

(650) 584-5000
(Registrant’s telephone number, including area code)

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

Yes ☒ No ☐

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

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

143,884,846 shares of Common Stock as of March 4, 2006

SYNOPSYS, INC.
QUARTERLY REPORT ON FORM 10-Q
JANUARY 31, 2006

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

	JANUARY 31, 2006	OCTOBER 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 314,498	$ 404,436
Short-term investments	199,787	182,070
Total cash, cash equivalents and short-term investments	514,285	586,506
Accounts receivable, net	83,997	100,178
Deferred income taxes	197,110	195,501
Income taxes receivable	48,224	48,370
Prepaid expenses and other current assets	24,808	16,924
Total current assets	868,424	947,479
Property and equipment, net	165,116	170,195
Long-term investments	8,322	8,092
Goodwill	744,114	728,979
Intangible assets, net	135,570	142,519
Long-term deferred income taxes	83,232	82,384
Other assets	65,253	61,828
Total assets	$ 2,070,031	$ 2,141,476
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 146,477	$ 231,359
Accrued income taxes	171,775	169,632
Deferred revenue	475,962	415,689
Total current liabilities	794,214	816,680
Deferred compensation and other liabilities	68,360	63,841
Long-term deferred revenue	37,600	42,019
Total liabilities	900,174	922,540
Stockholders' equity:		
Preferred Stock, $0.01 par value: 2,000 shares authorized; none outstanding	—	—
Common Stock, $0.01 par value: 400,000 shares authorized; 142,680 and 145,897 shares outstanding, respectively	1,427	1,459
Capital in excess of par value	1,280,329	1,263,952
Retained earnings	171,559	171,108
Treasury stock, at cost: 14,477, and 11,259 shares, respectively	(268,800)	(199,482)
Deferred stock compensation	—	(2,100)
Accumulated other comprehensive loss	(14,658)	(16,001)
Total stockholders' equity	1,169,857	1,218,936
Total liabilities and stockholders' equity	$ 2,070,031	$ 2,141,476

See accompanying notes to unaudited condensed consolidated financial statements.

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

	THREE MONTHS ENDED JANUARY 31, 2006	THREE MONTHS ENDED JANUARY 31, 2005
Revenue:		
Time-based license	$ 211,110	$ 186,284
Upfront license	8,367	10,798
Maintenance and service	40,712	44,222
Total revenue	260,189	241,304
Cost of revenue:		
License*(1)*	29,989	24,891
Maintenance and service*(1)*	16,573	17,052
Amortization of intangible assets	8,659	28,032
Total cost of revenue	55,221	69,975
Gross margin	204,968	171,329
Operating expenses:		
Research and development*(1)*	87,604	73,256
Sales and marketing*(1)*	77,189	84,129
General and administrative*(1)*	30,804	25,005
In-process research and development	800	5,700
Amortization of intangible assets	7,340	8,342
Total operating expenses	203,737	196,432
Operating income (loss)	1,231	(25,103)
Other income, net	1,795	5,949
Income (loss) before income taxes	3,026	(19,154)
Provision (benefit) for income taxes	1,329	(4,829)
Net income (loss)	$ 1,697	$ (14,325)
Net income (loss) per share:		
Basic	$ 0.01	$ (0.10)
Diluted	$ 0.01	$ (0.10)
Shares used in computing per share amounts:		
Basic	144,989	146,060
Diluted	146,969	146,060

(1) Includes stock based compensation expense as follows:		
Cost of license	$ 1,619	$ 44
Cost of maintenance and service	856	23
Research and development expense	8,149	339
Sales and marketing expense	4,709	139
General and administrative expense	3,097	32
Total stock based compensation	$ 18,430	$ 577

See accompanying notes to unaudited condensed consolidated financial statements.

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

	THREE MONTHS ENDED JANUARY 31,	
	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 1,697	$ (14,325)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Amortization and depreciation	29,729	49,905
Stock based compensation	18,430	577
In-process research and development	800	5,700
Deferred income taxes	(52)	(7,205)
Write-down of long-term investments	—	1,568
Provision for doubtful accounts	—	(720)
Net change in deferred gains and losses on cash flow hedges	272	(4,458)
Gain (loss) on sale of short and long-term investments	14	30
Net changes in operating assets and liabilities, net of acquired assets and liabilities:		
Accounts receivable	17,203	31,480
Income taxes receivable	—	61
Prepaid expenses and other current assets	(7,607)	2,544
Other assets	(3,425)	(6,127)
Accounts payable and accrued liabilities	(93,130)	(32,909)
Accrued income taxes	(2,775)	2,062
Deferred revenue	54,745	107,129
Deferred compensation and other liabilities	3,900	6,763
Net cash provided by operating activities	19,801	142,075
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid for acquisitions, net of cash received	(11,894)	(91,293)
Proceeds from sales and maturities of short-term investments	84,671	97,114
Purchases of short-term investments	(102,453)	(71,538)
Purchases of long-term investments	(1,539)	—
Purchases of property and equipment	(7,539)	(6,330)
Capitalization of software development costs	(762)	(738)
Net cash used in investing activities	(39,516)	(72,785)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuances of common stock	10,433	2,268
Purchases of treasury stock	(80,982)	(40,160)
Net cash used in financing activities	(70,549)	(37,892)
Effect of exchange rate changes on cash and cash equivalents	326	(1,740)
Net increase (decrease) in cash and cash equivalents	(89,938)	29,658
Cash and cash equivalents, beginning of period	404,436	346,709
Cash and cash equivalents, end of period	$ 314,498	$ 376,367

See accompanying notes to unaudited condensed consolidated financial statements.

1. BASIS OF PRESENTATION

Synopsys, Inc. (Synopsys or the Company) has prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (the Commission. Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its annual consolidated financial statements prepared in accordance with generally accepted accounting principles (GAAP). In management's opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its financial position, results of operations and cash flows. The Company's interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in Synopsys' Annual Report on Form 10-K for the fiscal year ended October 31, 2005 on file with the Commission.

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

Certain prior year amounts have been reclassified to conform to the current year presentation. The Company has reclassified certain prior year amounts relating to deferred compensation as detailed in the statements of operations and in Note 2.

Synopsys' fiscal year and first fiscal quarter ended on the Saturday nearest October 31 and January 31, respectively. Fiscal 2006 and 2005 are both 52-week years. For ease of presentation, the unaudited condensed consolidated financial statements and accompanying notes refer to the applicable calendar month end.

2. STOCK-BASED COMPENSATION

Adoption of SFAS 123(R)

On November 1, 2005, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123(R)") which requires the measurement of stock-based compensation expense for all share-based payment awards made to employees for services. In January 2005, the Securities and Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") No. 107, which provided supplemental implementation guidance for SFAS 123(R). Prior to November 1, 2005, the Company accounted for its share-based compensation plans using the intrinsic value method under the recognition and measurement provisions of Accounting Principles Board Opinion ("APB") No. 25, *Accounting for Stock Issued to Employees* ("APB 25") and related guidance. Under the intrinsic value method, the Company did not recognize any significant amount of stock-based compensation expense in the Company's consolidated statements of operations, as options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

The Company has elected to adopt the modified-prospective transition method permitted by SFAS 123(R) and accordingly prior periods have not been restated to reflect the impact of SFAS 123(R). The modified prospective transition method requires that stock-based compensation expense be recorded for (a) any share-based payments granted through, but not yet vested as of October 31, 2005 based on the grant-date fair value estimated in accordance with the pro forma provisions of SFAS 123, and (b) any share-based payments granted subsequent to October 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). The Company has recorded $18.4 million of stock-based compensation expense during the first quarter of 2006 as a result of the adoption of SFAS 123(R). In accordance with SFAS 123(R), the Company will present excess tax benefits from the exercise of stock options as a financing activity in the consolidated statements of cash flows. The Company did not record any excess tax benefits for the three months ended January 31, 2006.

The Company estimates the fair value of stock options using a Black-Scholes option-pricing model to determine the fair value of stock-based awards under SFAS 123(R), and consistent with that used for pro forma disclosures under SFAS No. 123, Accounting for Stock-Based Compensation prior to the adoption of SFAS No. 123(R). The Black-Scholes option pricing model was developed for use in estimating the fair value of short lived exchange traded options that have no vesting restrictions and are fully transferable. In addition, the Black-Scholes option-pricing model incorporates various and highly subjective assumptions including expected volatility, expected term and interest rates. The expected volatility is based on historical volatility of the Company's common stock over the most recent period commensurate with the estimated expected term of the Company's stock options. The expected term of the Company's stock options are based on historical experience.

The assumptions used to estimate the fair value of stock options granted and stock purchase rights granted under our Employee Stock Purchase Plan for the three months ended January 31, 2006 and 2005 are as follows:

	Options		ESPP	
	Three Months Ended		Three Months Ended	
	January 31, 2006	January 31, 2005	January 31, 2006	January 31, 2005
Volatility	42.63% - 43.47%	53.98%	26.69% - 51.54%	53.98%
Expected term (years)	3.8	4.97	.5 - 2.0	.5 - 2.0
Risk free interest rate	4.29% - 4.45%	3.60%	3.24% - 3.68%	2.68%
Expected dividend yield	0%	0%	0%	0%

The following table illustrates the effect on net loss after taxes and net loss per share for the three months ended January 31, 2005 if it had applied the fair value recognition provisions of SFAS 123 to share-based compensation using the Black-Scholes model. Prior year stock-based compensation has been adjusted for the related tax effects.

(in thousands, except per share amounts)	Three Months Ended January 31, 2005
Net loss, as reported under APB 25	$ (14,325)
Add: Share-based employee compensation expense included in reported net loss, net of related tax effects	353
Deduct: Total share-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(20,288)
Pro-forma net loss under SFAS 123	$ (34,260)
Net loss per share from operations:	
Basic and diluted - as reported	$ (0.10)
Basic and diluted - pro forma	$ (0.23)

As of January 31, 2006, there was $115.8 million of unrecognized stock-based compensation expense related to approximately 11.9 million unvested stock awards net of 0.7 million of estimated stock award forfeitures. This cost is expected to be recognized over a weighted-average period of approximately 2.2 years. The total intrinsic value of options exercised in the first quarter of fiscal 2006 and fiscal 2005 were $3.0 million and $0.8 million, respectively.

The compensation cost that has been charged against our results of operations and the total income tax benefit, if any, that the Company recognized on our statement of operations for these share-based compensation arrangements was as follows for the first quarters of fiscal 2006 and 2005 (in thousands):

(in thousands, except per share amounts)	Three Months Ended January 31, 2006	2005
Cost of license	$ 1,619	$ 44
Cost of maintenance and service	856	23
Research and development expense	8,149	339
Sales and marketing expense	4,709	139
General and administrative expense	3,097	32
Stock based compensation expense before taxes	18,430	577
Income tax benefit	(4,289)	(224)
Stock based compensation expense after taxes	$ 14,141	$ 353
Effect on net income per share:		
Basic	$ 0.10	$ —
Diluted	$ 0.10	$ —

Prior to the adoption of SFAS 123(R), the Company presented deferred compensation as a separate component of stockholders' equity. In accordance with the provisions of SFAS 123(R), on November 1, 2005 the Company reclassified the balance in deferred compensation to additional paid-in capital on its balance sheet. Prior to the adoption of SFAS 123(R), the Company presented all tax benefits for deductions resulting from the exercise of stock options as operating cash flows on its statement of cash flows. SFAS 123(R) requires the cash flows resulting from the tax benefits for tax deductions in excess of the compensation expense recorded for those options (excess tax benefits) to be classified as financing cash flows. The Company recorded no excess tax benefits for the three months ended January 31, 2006. Prior year amounts have been reclassified to conform to current year's presentation.

Employee Stock Benefit Plans

Employee Stock Purchase Plan

Under the Company's Employee Stock Purchase Plan and International Employee Stock Purchase Plan (collectively, the ESPP), employees are granted the right to purchase shares of common stock at a price per share that is 85% of the lesser of the fair market value of the shares at (i) the beginning of a rolling two-year offering period or (ii) the end of each semi-annual purchase period, subject to a plan limit on the number of shares that may be purchased in a purchase period. During the fiscal quarters ended January 31, 2006 and 2005, respectively, the Company issued no additional shares under the ESPP. As of January 31, 2006, 7,828,034 shares of common stock were reserved for future issuance under the ESPP.

Stock Option Plans

1992 Stock Option Plan

Under the Company's 1992 Stock Option Plan (the 1992 Plan), 38,866,356 shares of common stock have been authorized for issuance. Pursuant to the 1992 Plan, the Board of Directors (the Board) may grant either incentive or non-qualified stock options to purchase shares of common stock to employees or consultants, excluding non-employee directors at not less than 100% of the fair market value of those shares on the grant date. Stock options granted under the 1992 Plan generally vest over a period of four years and expire seven to ten years from the date of grant. As of January 31, 2006, 9,372,580 stock options remain outstanding and 5,519,303 shares of common stock are reserved for future grants under this plan.

Under the 1992 Plan, certain executive officers of the Company were granted an aggregate total of 420,000 stock options whose vesting is contingent upon meeting Company-wide operating margin performance goals. These shares were granted at the fair market value on the date of grant and contingently vest over two years and have contractual life of seven years. Stock-based compensation expense is recorded assuming that performance goals will be achieved.

1998 Non-Statutory Stock Option Plan

Under the Company's 1998 Non-Statutory Stock Option Plan (the 1998 Plan), 50,295,546 shares of common stock have been authorized for issuance. Pursuant to the 1998 Plan, the Board may grant nonqualified stock options to employees or consultants, excluding executive officers. Exercisability, option price and other terms are determined by the Board but the option price shall not be less than 100% of the fair market value of those shares on the grant date. Stock options granted under the 1998 Plan generally vest over a period of four years and expire seven to ten years from the date of grant. As of January 31, 2006, 25,478,599 stock options remain outstanding and 2,189,134 shares of common stock were reserved for future grants under this plan.

2005 Assumed Stock Option Plan

Under the Company's 2005 Assumed Stock Option Plan (formerly, the Nassda Corporation 2001 Stock Option Plan), an aggregate of 3,427,529 shares of common stock have been authorized for issuance. Pursuant to the 2005 Plan, the Compensation Committee of the Board or its designee can grant nonqualified stock options to employees or consultants of the Company who either were (i) not employed by the Company or any of its subsidiaries on May 11, 2005 or (ii) providing services to Nassda Corporation (or any subsidiary corporation thereof) prior to May 11, 2005. Exercisability, option price and other terms are determined by the Board but the option price shall not be less than 100% of the fair market value of those shares on the grant date. Stock options granted under the 2005 Plan generally vest over a period of four years and expire seven to ten years from the date of grant. As of January 31, 2006, 1,012,871 stock options remain outstanding and 2,237,613 shares of common stock were reserved for future grant under this plan.

2005 Non-Employee Directors Equity Incentive Plan

On May 23, 2005 the Company's stockholders approved the 2005 Non-Employee Directors Equity Incentive Plan (the Directors Plan) and the reservation of 300,000 shares of common stock for issuance thereunder. The Directors Plan provides for annual equity awards to non-employee directors in the form of either stock options or restricted stock. On May 23, 2005, the Company issued non-employee directors an aggregate of 42,060 shares of restricted stock with an aggregate value of approximately $0.75 million on the date of grant. The stock-based compensation expense related to these shares will be amortized over the vesting period of three years. As of January 31, 2006, 257,940 shares of common stock were reserved for future grant under the Directors Plan.

1994 Non-Employee Directors Stock Option Plan

An aggregate of 1,080,162 stock options remain outstanding under the Company's 1994 Non-Employee Directors Stock Option Plan, which expired as to future grants in October 2004.

The Company has assumed certain option plans in connection with business combinations with respect to stock options outstanding at the time of such business combinations. Generally, the options granted under these plans have terms similar to the Company's own options. The exercise prices of such options have been adjusted to reflect the relative exchange ratios. Other than the 2005 Assumed Stock Option Plan, no shares were reserved for future grant under these plans.

Option Exchange Program

During the third quarter of fiscal 2005, our Board of Directors approved an option exchange program under which outstanding employee stock options (other than options held by executive officers) with exercise prices of $25.00 or greater per share could be exchanged for a lesser number of options granted at current fair market value and with a new vesting period. The Board adopted this program due to the fact that the exercise prices of a large number of outstanding employee stock options were significantly below the Company's stock price and thus did not provide adequate employee incentive. The Company's stockholders approved the program in May 2005. As a result, on June 23, 2005, the Company accepted for cancellation options to purchase 7.3 million shares of common stock and in exchange granted to eligible employees options to purchase 3.8 million shares of the Company's common stock at an exercise price of $17.16 per share, except for options to purchase approximately 22,000 shares which were issued with an exercise price of $18.06 due to regional laws regarding the pricing of stock option grants. Approximately 3.6 million options were retired in connection with the option exchange program. As a result of the exchange, the Company used variable accounting for all options eligible for the exchange under the provisions of APB 25 and related interpretations until the adoption of SFAS 123(R) on November 1, 2005. Total compensation expense recorded with respect to these options for the fiscal year ended October 31, 2005 was $0.6 million.

Additional Information about Stock Options

The following table summarizes stock option activity during the first quarter of fiscal 2006 under all plans:

(in thousands, except per share and life amounts)	Options Available for Grant	Options Outstanding	Weighted Average Exercise Price per Share	Weighted-Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value
Balance at October 31, 2005	13,012	36,491	$ 19.92		
Granted	(3,992)	3,992	$ 20.99		
Assumed in acquisitions		—	—		
Retired		—	—		
Exercised		(653)	$ 15.97		
Canceled	592	(865)	$ 21.66		
Balance at January 31, 2006	9,612 (1)	38,965	$ 20.06	5.41	$ 110,037
Exercisable at January 31, 2006		26,394	$ 20.59	4.88	$ 70,317

(1) Excludes 257,940 shares reserved for future issuance under the 2005 Non-Employee Directors Equity Incentive Plan, which may be issued as restricted stock or stock options.

The aggregate intrinsic value in the preceding table represents the total pretax intrinsic value, based on the Company's closing stock price of $21.83 as of January 27, 2006, which would have been received by the option holders had all option holders exercised their options as of that date.

The following table summarizes significant ranges of outstanding and exercisable options as of January 31, 2006.

	Options Outstanding			Exercisable Options		
Range of Exercise Prices	Number Outstanding (in thousands)	Weighted-Average Remaining Contractual Life (In Years)	Weighted-Average Exercise Price	Number Exercisable (in thousands)	Weighted-Average Remaining Contractual Life (In Years)	Weighted-Average Exercise Price
$ .001 - $15.955	2,749	5.87	$ 12.65	2,001	4.95	$ 11.95
$ 16.00 - $16.125	4,335	4.71	$ 16.10	3,821	4.58	$ 16.12
$ 16.188 - $17.16	4,617	5.63	$ 17.07	1,378	4.70	$ 16.96
$ 17.20 - $18.08	4,069	5.51	$ 17.70	1,869	4.94	$ 17.79
$ 18.125 - $19.75	5,375	4.27	$ 19.11	4,506	3.92	$ 19.22
$ 19.78 - $21.10	5,215	6.74	$ 20.76	1,308	6.34	$ 20.35
$ 21.125 - $23.125	4,639	5.28	$ 22.00	4,091	5.07	$ 22.05
$ 23.25 - $25.735	4,043	5.43	$ 24.45	3,814	5.32	$ 24.43
$ 26.185 - $33.295	3,905	5.42	$ 29.13	3,593	5.20	$ 29.01
$ 33.755 - $42.763	18	6.62	$ 34.71	13	6.17	$ 34.91
$ .001 - $42.763	38,965	5.41	$ 20.06	26,394	4.88	$ 20.59

The following table summarizes our unvested stock activity for the three months ended January 31, 2006.

(in thousands, except per share amounts)	Number of Shares	Weighted-Average Grant Date Fair Value
Unvested shares at October 31, 2005	36	$ 17.83
Granted	—	—
Vested	(3)	$ 17.83
Canceled	—	—
Unvested shares at January 31, 2006	33	$ 17.83

3. BUSINESS COMBINATIONS

Acquisition of HPL Technologies, Inc. (HPL)

The Company acquired HPL on December 7, 2005.

Reasons for the Acquisition. The Company believes that the acquisition will help solidify the Company's position as a leading EDA vendor in design for manufacturing (DFM) software and would give the Company a comprehensive design-to-silicon flow that links directly into the semiconductor manufacturing process. Integrating HPL's yield management and test chip technologies into the Company's industry-leading DFM portfolio will also enable customers to increase productivity and improve profitability in the design and manufacture of advanced semiconductor devices and will broaden Synopsys' DFM research and development expertise by adding HPL's team of experienced engineers. The results of operations of HPL are included in the accompanying unaudited condensed consolidated statement of operations since the date of the acquisition. The Company does not consider the acquisition of HPL to be material to its results of operations, and therefore is not presenting pro forma statements of operations for the three-month periods ended January 31, 2006 and 2005.

Purchase Price. The Company paid $11.0 million in cash on December 7, 2005 for all outstanding shares of HPL. In addition, the Company had a prior investment in HPL for $1.9 million. The total purchase consideration consisted of:

(in thousands)	
Cash paid	$ 11,001
Prior investment in HPL	1,872
Acquisition-related costs	3,567
Total purchase price	$ 16,440

Acquisition-related costs of $3.6 million consist primarily of legal, tax and accounting fees of $1.3 million, $0.4 million of estimated facilities closure costs and other directly related charges, $1.0 million in estimated contract termination costs, and $0.9 million in severance and other employee termination costs. As of January 31, 2006, the Company had paid $1.5 million of the acquisition related costs, of which $0.9 million were for professional services costs and $0.5 million were for severance costs. The $2.1 million balance remaining at January 31, 2006 consists of contract termination costs, professional service fees, severance and facilities closure costs.

The Company has performed a preliminary valuation and allocated the total purchase consideration to the assets and liabilities acquired, including identifiable intangible assets, based on their respective fair values at the acquisition date, resulting in goodwill of approximately $15.1 million. The Company expects to complete the valuation during its second fiscal quarter. The following table summarizes the preliminary allocation of the purchase price to the fair value of the assets and liabilities acquired.

	(in thousands)
Assets acquired	
Cash, cash equivalents and short-term investments	$ 107
Accounts receivable	1,026
Deferred tax asset	1,508
Identifiable intangible assets	8,000
Goodwill	15,135
Other assets	277
Total assets acquired	26,053
Liabilities assumed	
Accounts payable and accrued liabilities	5,257
Income taxes payable	779
Deferred revenue	1,109
Deferred tax liabilities	3,268
Total liabilities acquired	10,413
Net assets acquired	15,640
In-process research and development	800
Purchase price	$ 16,440

Approximately $0.8 million of the purchase price represents the estimated fair value of acquired in-process research and development projects that have not yet reached technological feasibility and have no alternative future use. Accordingly, the amount was immediately expensed and included in the 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 and is not deductible for tax purposes. The purchase price allocated to identifiable intangible assets is as follows:

Intangible Asset (in thousands)		Estimated Useful Life (years)
Core/developed technology	$ 5,200	4
Customer relationships	2,700	4
Backlog	100	2
	$ 8,000	

Amortization of the core/developed technology is included in cost of revenue in the condensed consolidated statement of operations for the three months ended January 31, 2006. The Company included amortization of the other intangible assets in operating expenses in its statement of operations for the three months ended January 31, 2006.

4. GOODWILL AND INTANGIBLE ASSETS

The Company's aggregate goodwill as of January 31, 2006 consisted of the following:

	(in thousands)
Balance at October 31, 2005	$ 728,979
HPL goodwill	15,135
Balance at January 31, 2006	$ 744,114

Intangible assets as of January 31, 2006 consisted of the following:

	Gross Assets	Accumulated Amortization	Net Assets
		(in thousands)	
Customer relationships	$ 139,640	$ 76,057	$ 63,583
Core/developed technology	320,175	263,928	56,247
Contract rights/backlog	65,970	61,442	4,528
Covenants not to compete	12,744	9,909	2,835
Trademarks and trade names	18,007	17,990	17
Other intangibles (1)	8,883	3,829	5,054
Capitalized software development costs	11,349	8,043	3,306
Total intangible assets	$ 576,768	$ 441,198	$ 135,570

Intangible assets as of October 31, 2005 consisted of the following:

	Gross Assets	Accumulated Amortization	Net Assets
		(in thousands)	
Customer relationships	$ 136,940	$ 70,125	$ 66,815
Core/developed technology	314,975	256,413	58,562
Contract rights/backlog	65,870	60,528	5,342
Covenants not to compete	12,744	9,074	3,670
Trademarks and tradenames	18,007	17,965	42
Other intangibles	7,883	3,051	4,832
Capitalized software development costs	10,587	7,331	3,256
Total intangible assets	$ 567,006	$ 424,487	$ 142,519

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

	THREE MONTHS ENDED JANUARY 31,	
	2006	2005
	(in thousands)	
Customer relationships	$ 5,932	$ 5,454
Core/developed technology	7,515	23,176
Contract rights/ backlog	914	4,822
Covenants not to compete	835	766
Trademarks and trade names	25	1,501
Other intangibles	778	654
Capitalized software development costs (2)	712	670
Total amortization of intangible assets	$ 16,711	$ 37,043

(1) In the three months ended January 31, 2006 $1 million of contingent consideration was paid for intangible assets related to an acquisition of assets on the three months ended January 31, 2005 related to an asset acquisition.

(2) Amortization of capitalized software development is included in cost of license on the statements of operations.

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

	(in thousands)
Nine months ending October 31, 2006	$ 41,350
Fiscal Years:	
2007	47,337
2008	29,222
2009	13,440
2010	3,084
2011 and thereafter	1,137
Total estimated future amortization of intangible assets	$ 135,570

5. STOCK REPURCHASE PROGRAM

The Company is authorized to purchase up to $500 million of its common stock under a stock repurchase program previously established by the Company's Board of Directors (Board) in December 2004. The Company uses all common shares repurchased to offset dilution caused by ongoing stock issuances such as existing employee stock option plans, existing stock purchase plans and acquisitions. During the three months ended January 31, 2006, the Company repurchased approximately 3.9 million shares at an average price of $20.92 per share, for a total of $81.0 million. During the three months ended January 31, 2005, the Company repurchased approximately 2.3 million shares at an average price of $17.11 per share, for a total of $40.2 million. As of January 31, 2006, $355.6 million remained available for repurchases under the program.

6. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of:

	January 31, 2006	October 31, 2005
	(in thousands)	
Payroll and related benefits	$ 86,813	$ 157,915
Acquisition related costs	7,286	6,616
Other accrued liabilities	42,978	54,772
Accounts payable	9,400	12,056
Total accounts payable and accrued liabilities	$ 146,477	$ 231,359

7. CREDIT FACILITY

In April 2004, Synopsys entered into a three-year, $250.0 million senior unsecured revolving credit facility. This facility contains financial covenants requiring that the Company maintain a minimum leverage ratio and specified levels of cash, as well as other non-financial covenants. The facility terminates on April 28, 2007. Borrowings under the facility bear interest at the greater of the administrative agent's prime rate or the federal funds rate plus 0.50%; however, the Company has the option to pay interest based on the outstanding amount at eurodollar rates plus a spread between 0.80% and 1.125% based on a pricing grid tied to a financial covenant. In addition, commitment fees are payable on the facility at rates between 0.20% and 0.25% per annum based on a pricing grid tied to a financial covenant. As of January 31, 2006, the Company had no outstanding borrowings under this credit facility and was in compliance with all covenants.

8. COMPREHENSIVE INCOME

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

	THREE MONTHS ENDED JANUARY 31,	
	2006	2005
	(in thousands)	
Net income (loss)	$ 1,697	$ (14,325)
Unrealized gains (loss) on investments, net of tax of ($196) and ($85), respectively	315	(133)
Correction of error in accounting for certain hedging transactions, net of tax benefit of $1,150 (1)	—	(1,808)
Deferred (losses) gains on cash flow hedges, net of tax of $407 and ($1,774), respectively	(361)	3,222
Reclassification adjustment on deferred gains (losses) on cash flow hedges, net of tax expense of ($551) and tax benefit of $2,500, respectively	489	(3,996)
Foreign currency translation adjustment	900	(1,483)
Total comprehensive income (loss)	$ 3,040	$ (18,523)

(1) See Note 11 for further explanation.

9. NET INCOME (LOSS) PER SHARE

In accordance with Statement of Financial Accounting Standards No. 128 (SFAS 128), *Earnings per Share*, the Company computes basic income (loss) per share by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period (excluding the dilutive effect of stock options and restricted stock). Diluted income per share reflects the dilution of potential common shares outstanding during the period using the treasury stock method. In computing diluted income (loss) per share, using the treasury stock method, the Company adjusts the share count by assuming options are exercised and that the Company repurchases shares with the proceeds of these hypothetical exercises along with the tax benefit resulting from the hypothetical option exercises. The Company further assumes that any unamortized stock based compensation is also used to repurchase shares. For shares issuable under the Employee Stock Purchase Plan, the Company assumes the employee withholdings are used to repurchase shares. In determining the hypothetical shares repurchased, the Company uses the average stock price for the period.

Diluted net income per share excludes anti-dilutive shares and unvested restricted stock totaling 23.9 million and 41.4 million shares, for the three months ended January 31, 2006 and 2005, respectively. While these options and unvested restricted stock are currently anti-dilutive, they could be dilutive in the future. A reconciliation of basic and diluted income per share is presented below:

The table below reconciles the weighted-average common shares used to calculate basic net income per share to the weighted-average common shares used to calculate diluted net income per share.

	THREE MONTHS ENDED JANUARY 31,	
	2006	2005
	(in thousands)	
Weighted-average common shares for basic net income (loss) per share	144,989	146,060
Weighted-average dilutive stock options outstanding under the treasury stock method	1,980	—
Weighted-average common shares for diluted net income (loss) per share	146,969	146,060

10. SEGMENT DISCLOSURE

Statement of Financial Accounting Standards No. 131 (SFAS 131), *Disclosures about Segments of an Enterprise and Related Information*, requires disclosures of certain information regarding operating segments, products and services, geographic areas of operation and major customers. SFAS 131 reporting is based upon the "management approach." Under this method, management organizes the Company's operating segments for which separate financial information is (i) available and (ii) evaluated regularly by the Chief Operating Decision Maker (CODM) in deciding how to allocate resources and in assessing performance. Synopsys' CODMs are the Company's Chief Executive Officer and Chief Operating Officer.

The Company provides software, intellectual property and consulting services to the semiconductor and electronics industries. In making operating decisions, the CODMs primarily consider consolidated financial information, accompanied by disaggregated information about revenues by geographic region and product platform. The CODMs have determined that the Company operates in a single segment.

Revenue and property and equipment, net, related to operations in the United States and other geographic areas were:

	THREE MONTHS ENDED JANUARY 31, 2006	THREE MONTHS ENDED JANUARY 31, 2005
	(in thousands)	
Revenue:		
United States	$ 133,340	$ 125,232
Europe	41,554	36,716
Japan	41,894	46,037
Asia-Pacific and other	43,401	33,319
Consolidated	$ 260,189	$ 241,304

	JANUARY 31, 2006	OCTOBER 31, 2005
	(in thousands)	
Property and equipment, net:		
United States	$ 142,594	$ 146,885
Other	22,522	23,310
Consolidated	$ 165,116	$ 170,195

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.

For management reporting purposes, the Company organizes its products and services into five distinct groups: Galaxy Design Platform, Discovery Verification Platform, Intellectual Property, Design for Manufacturing and Professional Service & Other. The Company includes revenue from companies or products it has acquired during the periods covered from the acquisition date through the end of the relevant periods. For presentation purposes, the Company allocates software maintenance revenue to the products to which those support services relate.

	THREE MONTHS ENDED JANUARY 31 2006	THREE MONTHS ENDED JANUARY 31 2005
	(in thousands)	
Revenue:		
Galaxy Design Platform	$ 142,878	$ 142,529
Discovery Verification Platform	61,458	52,129
Intellectual Property	16,828	15,345
Design for Manufacturing	26,757	23,458
Professional Service & Other	12,268	7,843
Consolidated	$ 260,189	$ 241,304

One customer accounted for more than ten percent of the Company's consolidated revenue in the three months ended January 31, 2006 and 2005 (See Note 13).

11. OTHER INCOME, NET (EXPENSE)

The following table presents a summary of other income (expense) components:

	THREE MONTHS ENDED JANUARY 31,	
	2006	2005
	(in thousands)	
Interest income	$ 2,998	$ 1,793
Gain (loss) on sale of investments, net of investment write-downs	(13)	(1,255)
Foreign currency exchange gain	101	2,233
Correction of an error in accounting for certain hedging transactions	—	2,958
Other (1)	(1,291)	220
Total	$ 1,795	$ 5,949

(1) For the three months ended January 31, 2006, this amount consists primarily of $0.8 million in premiums paid on foreign exchange forward contracts.

In the first quarter of fiscal 2005, the Company reevaluated its interpretation of certain provisions of Statement of Financial Accounting Standards No. 133, *Accounting for Derivatives and Hedging* (SFAS 133), resulting in the discovery of an error in the application of the standard to certain prior year foreign currency hedge transactions. The effect of the error was not material in any prior period and did not impact the economics of the Company's hedging program. To correct the error, the Company reclassified the remaining $3.0 million related to the disallowed hedges from accumulated other comprehensive loss to other income in the three months ended January 31, 2005.

12. TAXES

Effective Tax Rate. The Company estimates its annual effective tax rate at the end of each quarterly period. The Company's estimate takes into account estimates of annual pre-tax income (and losses), the geographic mix of pre-tax income (and losses) and our interpretations of tax laws and possible outcomes of current and future audits.

The Company's effective tax rate for the three months ended January 31, 2006 and 2005 was a tax expense rate of 43.9% and a tax benefit rate of 25.2% respectively. The provision for income taxes for the three months ended January 31, 2006 includes a tax expense of $100,000 relating to foreign taxes which was treated as a discrete event allocable to the quarter.

In November 2005, FASB issued Financial Statement Position ("FSP") on FAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards." Effective upon issuance, this FSP describes an alternative transition method for calculating the tax effects of stock based compensation pursuant to SFAS 123(R). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock based compensation, and to determine the subsequent impact on the APIC pool and the statement of cash flows of the tax effects of employee stock based compensation awards that are outstanding upon adoption of SFAS 123(R). Companies have one year from the later of the adoption of SFAS 123(R) or the effective date of the FSP to evaluate their transition alternatives and make a one-time election. The Company is evaluating which transition method to adopt and the potential impact of this new guidance on its results of operations and financial position.

IRS Revenue Agent's Report. On May 31, 2005, the Company received a Notice of Proposed Adjustment from the Internal Revenue Service (IRS) asserting a very large net increase to its U.S. taxable income arising from the audit of fiscal years 2000 and 2001. On June 8, 2005, the Company received a Revenue Agent's Report (RAR) in which the IRS proposed to assess a net tax deficiency for fiscal years 2000 and 2001 of approximately $476.8 million, plus interest. Interest accrues on the amount of any deficiency finally determined until paid, and compounds daily at the federal underpayment rate, which adjusts quarterly. A higher underpayment rate of interest may be charged as a result of the issuance of the RAR.

This proposed adjustment primarily relates to transfer pricing transactions between the Company and a wholly-owned foreign subsidiary. The proposed adjustment for fiscal years 2000 and 2001 is the total amount relating to these transactions asserted under the IRS theories.

On July 13, 2005, the Company filed a protest to the proposed deficiency with the IRS, which caused the matter to be referred to the Appeals Office of the IRS. Resolution of this matter could take a considerable time, possibly years. The Company strongly believes the proposed IRS adjustments and resulting proposed deficiency are inconsistent with applicable tax laws, and that the Company thus has meritorious defenses to these proposals. Accordingly, the Company will continue to challenge these proposed adjustments vigorously. While it believes the IRS' asserted adjustments are not supported by applicable law, the Company believes it is probable it will be required to make additional payments in order to resolve this matter. However, based on the Company's analysis to date, the Company believes it has adequately provided for this matter. If the Company is required to pay a significant amount of additional U.S. taxes and applicable interest in excess of its provision for this matter, its results of operations and financial condition could be materially and adversely affected.

13. RELATED PARTY TRANSACTIONS

Andy D. Bryant, Intel Corporation's Executive Vice President and Chief Financial and Enterprise Services Officer, served on the Company's Board of Directors from January 1999 to May 2005. Revenue derived from Intel Corporation and its subsidiaries in the aggregate accounted for approximately 12% of the Company's total revenue for the three months ended January 31, 2006 and 13% of the Company's total revenue for the three months ended January 31, 2005. Management believes all transactions between the two parties were carried out on an arm's length basis.

14. CONTINGENCIES

In connection with the Company's December 1, 2004 announcement that it had signed agreements to acquire Nassda Corporation (Nassda) and to settle all outstanding litigation between the two companies, a class action complaint entitled *Robert Israel v. Nassda Corporation, et. al*., No. 4705695, was filed in the Court of Chancery of the State of Delaware naming Nassda, its directors and Synopsys as defendants. The complaint purported to be a class action lawsuit brought on behalf of shareholders of Nassda, other than the defendant directors and their affiliates, who allegedly would be injured or threatened with injury if the proposed acquisition of Nassda by Synopsys proceeded forward on the terms announced. A class action complaint alleging substantially the same facts was also filed in California Superior Court. The purported class actions sought to enjoin the transaction or, alternatively, unspecified damages. In May 2005, Synopsys completed its acquisition of Nassda. In October, 2005, the Chancery Court approved a settlement of the Delaware action by which Synopsys would pay an aggregate of $0.15 per share to each former shareholder of Nassda (other than the defendant directors and their affiliates), for a total of approximately $1.8 million, and would pay certain fees and expenses of plaintiff's counsel. In December 2005, the plaintiffs in the Delaware action dismissed their complaint with prejudice and Synopsys paid the agreed-upon amounts. The California action was also dismissed with prejudice in December 2005, with each party bearing its own costs.

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

The following discussion of our financial condition and results of operations should be read together with our unaudited condensed consolidated financial statements and the related notes thereto contained in Item 1 of this report. This discussion contains forward-looking statements. Our actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, risks and uncertainties, including the risk factors set forth under the caption "Factors That May Affect Future Results." The words "may," "will," "could," "would," "anticipate," "expect," "intend," "believe," "continue," or the negatives of such terms, or other comparable terminology and similar expressions identify these forward-looking statements. The information included herein is as of the filing date of this Form 10-Q with the Securities and Exchange Commission (SEC); future events or circumstances could differ significantly from these forward-looking statements. Accordingly, we caution readers not to place undue reliance on these statements.

Overview

Synopsys, Inc. (Synopsys) is a world leader in electronic design automation (EDA) software and related services for semiconductor design. We deliver technology-leading semiconductor design and verification software platforms and integrated circuit (IC) manufacturing software products to the global electronics market, enabling the development and production of complex systems-on-chips (SoCs). In addition, we provide intellectual property (IP) and design services to simplify the design process, and accelerate time-to-market for our customers. We also provide software and services that help customers prepare and optimize their designs for manufacturing.

Business Environment

We generate substantially all of our revenue from customers in the semiconductor and electronics industries. Our customers typically fund purchases of our software and services largely out of their research and development (R&D) budgets and, to a lesser extent, their manufacturing and capital budgets. As a result, our customers' business outlook and willingness to invest in new and increasingly complex chip designs heavily influence our business.

Since the 2000 through 2002 semiconductor downturn and subsequent recovery, our customers have focused significantly on expense reductions, including in their R&D budgets. This expense outlook has affected us in a number of ways. First, some customers have reduced their overall level of EDA expenditures by decreasing their level of EDA tool purchases, using older generations of product, or not renewing maintenance services. Second, customers, bargain more intensely on pricing and payment terms, which has affected revenues industry-wide. For example, reduced demand for up-front licenses, and customers' desire to conserve cash by paying for licenses over time resulted in a shift of our license mix to an almost completely ratable model on the fourth quarter of fiscal 2004, in which substantially more revenue is recognized over time rather than at the time of shipment. This shift adversely affected our total revenue in fiscal 2004 and 2005. Third, customers are beginning to seek to consolidate their EDA purchases with fewer suppliers in order to lower their overall cost of ownership, while at the same time meeting new technology challenges. This has increased competition among EDA vendors.

Over the long term, we believe EDA industry spending growth will continue to depend on growth in semiconductor R&D spending and on continued growth in the overall semiconductor market. The Semiconductor Industry Association has forecasted modest growth in semiconductor revenues in 2006 and we believe semiconductor R&D spending will grow similarly during 2006. However, we cannot currently predict whether this outlook will contribute to higher R&D spending and/or to higher EDA industry spending. If EDA industry spending increases, we believe we are well positioned to capitalize on such increases. Further, recognizing that our customers will continue to spend cautiously and aggressively contain costs, we are intensely focused on improving our customers' overall economics of design by providing more fully-integrated design solutions and offering customers the opportunity to consolidate their EDA spending with us.

We are under no obligation (and expressly disclaim any such obligation) to update or alter any of the information contained in this Overview, whether as a result of new information, future events or otherwise, except to the extent required by law.

Product Developments for the Three Months Ended January 31, 2006

During the first quarter of fiscal 2006, we announced or introduced a number of new products and related developments, including:

- Availability of a new 90 nanometer low-power system-on-chip reference design flow for fabrication on a leading global semiconductor foundry's process.
- Expansion of our DesignWare® mixed-signal IP to include application-specific memory input/output libraries to help enable development of interfaces for mobile product applications.
- Our DesignWare digital controller IP for PCI Express™ becoming the first to support the 2.0 version of the PCI Express specification, enabling increased bandwidth in networking, embedded and computer applications.

Financial Performance for the Three Months Ended January 31, 2006

- Revenue was $260.2 million, up 8% from $241.3 million in the first quarter of fiscal 2005, primarily reflecting our fourth quarter fiscal 2004 license model shift, which has resulted in increases in time-based revenue which more than offset decreases in upfront and service revenue during the current quarter.
- Time-based license revenue increased 13% from $186.3 million in the first quarter of fiscal 2005 to $211.1 million in the current quarter, primarily reflecting the continued phase-in of our license model shift as time-based orders booked in prior periods contribute revenue to current and future periods.
- Upfront license revenue declined 22% from $10.8 million in the first quarter of fiscal 2005 to $8.4 million in the current quarter, reflecting our license model shift.
- We derived approximately 4% of our software license revenue from upfront licenses and 96% from time-based licenses in the current quarter, versus approximately 5% and 95%, respectively, in the same quarter last year, reflecting our license model shift.
- Maintenance revenue declined by 19% from $36.2 million in the first quarter of fiscal 2005 to $29.3 million in the current quarter, primarily as a result of the shift to a more ratable license model (which reduces new maintenance orders since maintenance is included with the license fee in time-based licenses and not billed separately), and, to a lesser extent, by non-renewal of maintenance by some of our existing perpetual license customers. Professional service and other revenue, at $11.4 million, increased 43% from $8.0 million in the first quarter of fiscal 2005 due to the timing of customer acceptance of services performed under ongoing contracts and continued full utilization of our services capacity.
- Net income was $1.7 million compared to net loss of $(14.3) million in the first quarter of fiscal 2005, primarily due to increased revenue, reduced cost of goods sold due to reduced amortization of intangible assets from acquisitions, reduced sales and marketing expenses driven by shipments, and a reduced in-process research and development charges compared to the prior period, partially offset by increased research and development expense caused by acquisitions and commencement of recognition of stock-based compensation expense, in accordance with SFAS No. 123(R).
- Net cash provided by operations decreased 86% from $142.1 million in the first quarter of fiscal 2005 to $19.8 million, primarily as a result of increased vendor and bonus and commission payments and a decrease in cash collections compared to the same period in fiscal 2005.
- We repurchased approximately 3.9 million shares of our common stock at an average price of $20.92 per share for approximately $81.0 million.

Acquisitions in the Three Months Ended January 31, 2006

During the quarter, we completed our acquisition of HPL Technologies, Inc. for a cash purchase price of $0.30 per share and total gross payments of $12.9 million, which will help solidify Synopsys' position as a leading EDA vendor in design for manufacturing (DFM) software and will give Synopsys a comprehensive design-to-silicon flow that links directly into the semiconductor manufacturing process. See Note 3 to *Notes to Unaudited Condensed Consolidated Financial Statements*.

Critical Accounting Policies and Estimates

The preparation of our financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires our management to make judgments and estimates that affect the amounts reported in our financial statements and accompanying notes. Our management believes that we consistently apply these judgments and estimates and the financial statements and accompanying notes fairly represent all periods presented. However, any differences between these judgments and estimates and actual results could have a material impact on our statement of operations and financial condition. Critical accounting policies and estimates, as defined by the Securities and Exchange Commission (SEC), are those that are most important to the portrayal of our financial condition and results of operations and require our management's most difficult and subjective judgments and estimates of matters that are inherently uncertain. Our critical accounting policies and estimates include those regarding (1) revenue recognition; (2) valuation of intangible assets and goodwill; (3) income taxes and; (4) stock-based compensation. We describe our revenue recognition and stock-based compensation policies below. Our remaining critical accounting policies and estimates are discussed in Part II, Item 7 *Management's Discussion and Analysis of Financial Condition and Results of Operations* of our annual report on Form 10-K for the fiscal year ended October 31, 2005, filed with the SEC on January 12, 2006.

Revenue Recognition. Synopsys recognizes revenue from software licenses and maintenance and service revenue. Software license revenue consists of fees associated with the licensing of Synopsys software. Maintenance and service revenue consists of maintenance fees associated with perpetual and term licenses and professional service fees.

Synopsys has designed and implemented revenue recognition policies in accordance with Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended by SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions.*

With respect to software licenses, Synopsys utilizes three license types:

- *Technology Subscription Licenses (TSLs)* are for a finite term, and generally provide the customer limited rights to receive, or to exchange certain quantities of licensed software for, unspecified future technology. We bundle and do not charge separately for post-contract customer support (maintenance) for the term of the license.

- *Term licenses* are also for a finite term, but do not provide the customer any rights to receive, or to exchange licensed software for unspecified future technology. Customers purchase maintenance separately for the first year and may renew annually for the balance of the term. The annual maintenance fee is typically calculated as a percentage of the net license fee.

- *Perpetual licenses* continue as long as the customer renews maintenance, plus an additional 20 years. Perpetual licenses do not provide the customer any rights to receive, or to exchange licensed software for, unspecified future technology. Customers purchase maintenance separately for the first year and may renew annually.

For the three software license types, we recognize revenue as follows:

- *Technology Subscription Licenses*. Synopsys typically recognizes revenue from TSL license fees (which include bundled maintenance) ratably over the term of the license period, or, if later, as customer installments become due and payable. All TSLs are reported as "time-based licenses."
- *Term Licenses*. Synopsys recognizes the term license fee in full upon shipment of the software if payment terms require the customer to pay at least 75% of the term license fee within one year from shipment and all other revenue recognition criteria are met. Such term licenses are reported as "upfront licenses." For term licenses where less than 75% of the term license fee is due within one year from shipment, Synopsys recognizes revenue as customer installments become due and payable. Due and payable term licenses are reported as "time-based licenses."
- *Perpetual Licenses*. Synopsys recognizes the perpetual license fee in full upon shipment of the software if payment terms require the customer to pay at least 75% of the perpetual license fee within one year from shipment and all other revenue recognition criteria are met. Such perpetual licenses are reported as upfront licenses. For perpetual licenses in which less than 75% of the license fee is payable within one year from shipment, we recognize the revenue as customer installments become due and payable. Such perpetual licenses are reported as time-based licenses.

Synopsys allocates revenue on software transactions (referred to as "arrangements") involving multiple elements to each element based on the relative fair values of the elements. Our determination of fair value of each element in multiple element arrangements is based on vendor-specific objective evidence (VSOE). We limit our assessment of VSOE for each element to the price charged when the same element is sold separately.

We have analyzed all of the elements included in our multiple-element arrangements and have determined that we have sufficient VSOE to allocate revenue to the maintenance components of our perpetual and term license products and to consulting. Accordingly, assuming all other revenue recognition criteria are met, we recognize revenue from perpetual and term licenses upon delivery using the residual method in accordance with SOP 98-9, we recognize revenue from maintenance ratably over the maintenance term, and we recognize revenue from consulting services as the related services are performed and accepted.

Synopsys makes significant judgments related to revenue recognition. Specifically, in connection with each transaction involving our products, we must evaluate whether: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred, (iii) its fee is fixed or determinable, and (iv) collectibility is probable. We apply these criteria as discussed below.

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

- *Delivery Has Occurred*. We deliver software to our customers physically or electronically. For physical deliveries, the standard transfer terms are typically FOB shipping point. For electronic deliveries, delivery occurs when we provide the customer access codes, or “keys,” that allow the customer to take immediate possession of the software on its hardware.

- *The Fee is Fixed or Determinable*. Our determination that an arrangement fee is fixed or determinable depends principally on the arrangement’s payment terms. Our standard payment terms require 75% or more of the arrangement fee to be paid within one year. Where these terms apply, we regard the fee as fixed or determinable, and recognize revenue upon delivery (assuming all other revenue recognition criteria are met). If the payment terms do not meet this standard, which we refer to as “extended payment terms,” we do not consider the fee to be fixed or determinable and generally recognize revenue when customer installments are due and payable. In the case of a TSL, we recognize revenue ratably even if the fee is fixed or determinable, due to the fact that maintenance services are included with the software license and due to guidelines relating to arrangements that include rights to receive unspecified future technology.

- *Collectibility is Probable*. To recognize revenue, we must judge collectibility of the arrangement fees, which we do on a customer-by-customer basis pursuant to our credit review policy. We typically sell to customers with whom we have a history of successful collection. For a new customer or where an existing customer substantially expands its commitments to us, we evaluate the customer’s financial position and ability to pay and typically assign a credit limit based on that review. We increase the credit limit only after we have established a successful collection history with the customer. If we determine at any time that collectibility is not probable based upon its credit review process or the customer’s payment history, we recognize revenue on a cash-collected basis.

We recognize maintenance and service revenue as follows:

- *Maintenance Fees Associated with Perpetual and Term Licenses*. Synopsys recognizes revenue from maintenance associated with perpetual and term licenses ratably over the maintenance term.

- *Professional Service Fees*. Synopsys recognizes revenue from consulting and training services as services are performed and accepted.

Valuation of Stock-Based Compensation. Effective November 1, 2005, we adopted the provisions of Statement of Financial Accounting Standards (“SFAS”) No. 123(R), *Share-Based Payment* (“SFAS 123(R)”). SFAS 123(R) establishes standards for accounting for transactions in which an entity exchanges its equity instruments, such as stock options, for goods or services, such as the services of the entity’s employees. SFAS 123(R) also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity’s equity instruments or that may be settled by the issuance of those equity instruments. SFAS 123(R) eliminates the ability to account for stock-based compensation transaction using the intrinsic value method under APB 25 and generally requires instead that such transactions be accounted for using a fair-value based method. Accordingly, we measure stock-based compensation cost at the grant date, based on the fair value of the award, and recognize the expense over the employee’s requisite service period using the modified prospective method. The measurement of stock-based compensation cost is based on several criteria including, but not limited to, the valuation model used and associated input factors such as expected term of the award, stock price volatility, dividend rate, risk free interest rate, and award cancellation rate. The input factors to use in the valuation model are based on subjective future expectations combined with management judgment. If there is a difference between the assumptions used in determining stock-based compensation cost and the actual factors which become known over time, we may change the input factors used in determining stock-based compensation costs. These changes may materially impact our results of operations in the period such change are made.

Results of Operations

Revenue Background

We generate our revenue from the sale of software licenses, maintenance and professional services. Under current accounting rules and policies applicable to different kinds of license arrangements, we recognize revenue from orders we receive for software licenses and services at varying times. In general, we recognize revenue on a time-based software license order over the license term and on an upfront term or perpetual software license order at the time the license is shipped. Substantially all of our current time-based licenses are technology subscription licenses, or TSLs, with an average license term of approximately three years. Maintenance orders generally generate revenue ratably over the maintenance period (generally one year). Professional service orders generally generate revenue upon completion and customer acceptance of contractually agreed milestones. A more complete description of our revenue recognition policy can be found above under *Critical Accounting Policies and Estimates*.

Our revenue in any fiscal quarter is equal to the sum of our time-based license, upfront license, maintenance and professional service revenue for such period. We derive time-based license revenue in any quarter almost entirely from TSL orders received and delivered in prior quarters. We derive upfront license revenue directly from upfront license orders booked and shipped during the quarter. We derive maintenance revenue in any quarter largely from maintenance orders received in prior quarters since our maintenance orders generally yield revenue ratably over a term of one year. We also derive professional service revenue almost entirely from orders received in prior quarters, since we recognize revenue from professional services when those services are delivered and accepted, not when they are booked.

Our license revenue is very sensitive to the mix of time-based and upfront licenses delivered during the quarter. A TSL order typically yields lower current quarter revenue but contributes to revenue in future periods. For example, a $120,000 order for a three-year TSL shipped on the last day of a quarter typically generates no revenue in that quarter, but $10,000 in each of the twelve succeeding quarters. Conversely, upfront licenses generate higher current quarter revenue but no future revenue (e.g., a $120,000 order for an upfront license generates $120,000 in revenue in the quarter the product is shipped, but no future revenue). TSLs also result in a shift of maintenance revenue to time-based license revenue since maintenance is included in TSLs, while maintenance on upfront orders is charged and reported separately.

License Order Mix

The percentage of upfront licenses we book is driven by a number of factors, including the level of overall license orders, customer demand, preferred customer payment terms and customer-requested ship dates. Prior to August 2000, substantially all of our license revenue was upfront. Beginning in August 2000, when we introduced TSLs, we shifted our target license order mix to approximately 75% TSLs and 25% upfront licenses, based on our expectations of total orders and our assessment of the demand for upfront licenses. We substantially maintained this mix from this date through fiscal 2003. However, as a result of reduced customer demand for upfront licenses as noted above in *Business Environment*, we shifted to an almost completely time-based license model in the fourth quarter of fiscal 2004. Our actual license order mix for the last nine fiscal quarters is set forth below.

	Q1-2006	Q4-2005	Q3-2005	Q2-2005	Q1-2005	Q4-2004	Q3-2004	Q2-2004	Q1-2004
Time-based licenses.......	94%	96%	92%	94%	97%	93%	80%	58%	43%
Upfront licenses.......	6%	4%	8%	6%	3%	7%	20%	42%	57%

In certain cases, our time-based and upfront term license agreements provide the customer the right to “re-mix” a portion of the software initially licensed for other specified Synopsys products. The customer’s re-mix of product, when allowed under the license arrangement, does not alter the timing of recognition of the license fees paid by the customer. Because in such cases the customer does not need to obtain a new license and pay additional license fees to use the additional products, these arrangements could result in reduced revenue compared to licensing the individual products separately. However, we believe providing our customers re-mix rights can also assist in broader adoption of our products.

Total Revenue

Three Months Ended January 31, 2006	2005	$ Change	% Change
	(dollars in millions)		
$ 260.2	$ 241.3	$ 18.9	8%

The increase in total revenue for the first quarter of fiscal 2006 compared to the same quarter of fiscal 2005 was due primarily to the change in the fourth quarter of fiscal 2004 in our license model to an almost completely ratable model which increased ratable license bookings that are recognized as revenue in future periods and to increased business levels.

Time-Based License Revenue

	January 31, 2006	2005	$ Change	% Change
	(dollars in millions)			
Three months ended	$ 211.1	$ 186.3	$ 24.8	13%
Percentage of total revenue	81%	77%		

The increase in time-based license revenue in the first quarter of fiscal 2006 compared to the same quarter in fiscal 2005 was primarily due to the license model shift under which previously booked orders continue to contribute to revenue in later periods.

Upfront License Revenue

	January 31, 2006	2005	$ Change	% Change
	(dollars in millions)			
Three months ended	$ 8.4	$ 10.8	$ (2.4)	(22)%
Percentage of total revenue	3%	4%		

The decrease in upfront license revenue was due primarily to changes in customer mix which can drive changes in the amount of upfront orders in a particular quarter.

Unfilled upfront license orders were approximately $4.8 million at January 31, 2006 compared to $6.6 million as of January 31, 2005. Unfilled upfront license orders represent non-cancelable license orders received from our customers prior to the end of the fiscal quarter but not shipped as of the end of such period. We generally ship our software products promptly after acceptance of customer orders. However, a number of factors can affect the timing of product shipments and, as a result, timing of revenue recognition, including the delivery dates requested by customers, the effect of the related license revenue on our business plan and our operational capacity to fulfill upfront software license orders at the end of a quarter.

Maintenance and Service Revenue

	January 31, 2006	January 31, 2005	$ Change	% Change
	(dollars in millions)			
Three months ended				
Maintenance revenue	$ 29.3	$ 36.2	$ (6.9)	(19)%
Professional service and other revenue	11.4	8.0	3.4	43%
Total maintenance and service revenue	$ 40.7	$ 44.2	$ (3.5)	(8)%
Percentage of total revenue	16%	18%		

Our maintenance revenue has declined due to (i) our continued shift towards TSLs, which include maintenance with the license fee and thus generate no separately recognized maintenance revenue, (ii) generally lower maintenance rates on larger perpetual license transactions, and (iii) to a lesser extent, non-renewal of maintenance by certain customers on perpetual or other upfront licenses. With our license model shift, we expect progressively more of our maintenance revenue to be included in TSL revenue, and therefore for our separately recognized maintenance revenue to continue to decline. In addition, some customers may choose in the future not to renew maintenance on upfront licenses for economic or other factors, which would also adversely affect future maintenance revenue.

Professional service and other revenue increased in the first quarter of fiscal 2006 compared to the same period in fiscal 2005 and 2004 due principally to timing of customer acceptance of services performed under ongoing contracts.

Revenue—Product Groups. For management reporting purposes, we organize our products and services into five groups: Galaxy™ Design Platform, Discovery™ Verification Platform, Intellectual Property, Design for Manufacturing, and Professional Services & Other.

Galaxy Design Platform. Our Galaxy Design Platform provides our customers a single, integrated IC design solution which incorporates common libraries and consistent timing, delay calculation and constraints throughout the design process. The principal products in the Galaxy platform are the IC Compiler physical design solution, Design Compiler® logic synthesis product, Physical Compiler® physical synthesis product, Apollo™ physical design product, Astro™ advanced physical design system, PrimeTime®/PrimeTime® SI timing analysis products, Formality® formal verification sign-off solution, Star RXCT™ extraction solution and Hercules™ physical verification family.

Discovery Verification Platform. Our Discovery Verification Platform combines our simulation and verification products and design-for-verification methodologies, and provides a consistent control environment to improve the speed, breadth and accuracy of our customers' verification efforts. The principal products in the Discovery platform are the VCS® comprehensive RTL verification solution, Vera® testbench generator, NanoSim® FastSPICE circuit simulation product, HSPICE® circuit simulator, our reusable verification IP and our Discovery AMS mixed-signal verification solution.

Intellectual Property. Our IP solutions include our DesignWare® Foundation Library of basic chip elements, DesignWare Verification Library of popular chip function models and DesignWare Cores, pre-designed and pre-verified digital and mixed-signal design blocks that implement many of the most important industry standards, including USB (1.1, 2.0 and On-the-Go), PCI (PCI, PCI-X and PCI-Express), Serial ATA, Ethernet and JPEG.

Design for Manufacturing. Our Design for Manufacturing products and technologies address the mask-making, yield enhancement and test chip challenges of very small geometry ICs and include our TCAD device modeling products, Proteus™ OPC /InPhase optical proximity correction products, phase-shift masking technologies, SiVL® layout verification product, CATS® mask data preparation product and Virtual Stepper® mask qualification product.

Professional Services & Other. Our Professional Services group provides consulting services, including design methodology assistance, specialized systems design services, turnkey design and training.

The following table summarizes the revenue attributable to these groups as a percentage of total revenue for the last eight quarters. We include revenue from companies or products we have acquired during the periods covered from the acquisition date through the end of the relevant periods. For presentation purposes, we allocate maintenance revenue, which represented approximately 11% and 15% of our total revenue for the three months ended January 31, 2006 and 2005, respectively, to the products to which those support services related.

	Q1-2006	Q4-2005	Q3 - 2005	Q2-2005	Q1 2005	Q4- 2004	Q3- 2004	Q2- 2004
Galaxy Design Platform...	55 %	54 %	55 %	55 %	59 %	60 %	61 %	64 %
Discovery Verification..... Platform	24	23	22	21	22	21	21	20
IP	6	8	7	8	6	6	7	6
Design for Manufacturing.............	10	10	11	10	10	9	7	7
Professional Services & ... Other	5	5	5	6	3	4	4	3
Total................................	100 %	100 %	100 %	100 %	100 %	100 %	100 %	100 %

The respective revenue contributions from our different groups have been relatively stable over the eight-quarter period shown in the table above. This stability is principally due to the fact that most of our customers purchase multiple products from us, and do so under TSLs, for which we recognize revenue ratably over the term of the license. Accordingly, significant changes in revenue contribution from different groups have been driven primarily by one-time events, such as acquisitions, by the mix of upfront versus time-based orders received for certain products during a given quarter or, in the case of professional services, by the timing of customer acceptance of performance milestones under ongoing contracts.

Factors Affecting Cost of Revenues and Operating Expenses

Temporary Shutdown of Operations. During the three months ended January 31, 2006 and January 31, 2005, we temporarily shut down our operations in North America for three days and four days, respectively, as a cost-saving measure, resulting in savings as follows:

	THREE MONTHS ENDED JANUARY 31, 2006	THREE MONTHS ENDED JANUARY 31, 2005
	(in thousands)	
Cost of revenue	$ 705	$ 856
Research and development	1,508	1,889
Sales and marketing	890	1,169
General and administrative	430	514
Total	$ 3,533	$ 4,428

Functional Allocation of Operating Expenses

We allocate certain human resource programs, information technology and facility expenses among our functional income statement categories based on headcount within each functional area. Annually, or upon a significant change in headcount (as in the case of a workforce reduction or realignment) or other factors, management reviews the allocation methodology and the expenses included in the allocation pool.

Cost of Revenue

	JANUARY 31, 2006	JANUARY 31, 2005	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended				
Cost of license revenue	$ 30.0	$ 24.9	$ 5.1	20%
Cost of maintenance and service revenue	16.6	17.0	(0.4)	(2)%
Amortization of intangible assets	8.6	28.1	(19.5)	(69)%
Total	$ 55.2	$ 70.0	$ (14.8)	(21)%
Percentage of total revenue	21%	29%		

We divide cost of revenue into three categories: cost of license revenue, cost of maintenance and service revenue and amortization costs. Expenses directly associated with providing consulting and training have been segregated from costs of revenue associated with internal functions which provide license delivery and post-customer contract support services. These group costs are then allocated by management between cost of license revenue and cost of maintenance and service revenue based on revenue reported during the quarter. In general, our total costs of revenue are relatively fixed and do not fluctuate significantly with changes in revenue or license mix.

Cost of license revenue. Cost of license revenue includes costs associated with the sale and licensing of our software products, both ratable and upfront. Cost of license revenue includes the allocated cost of employee salary and benefits providing services for software delivery, software production costs, product packaging, amortization of capitalized software development costs related to Synopsys products, documentation and royalties payable to third party vendors.

Cost of maintenance and service revenue. Cost of maintenance and service revenue includes employee salary and benefits for consulting professionals and associated costs to maintain the related infrastructure necessary to manage a services and training organization. Further, cost of maintenance and service revenue includes allocated costs of employee salary and benefits providing customer services, such as hot-line and on-site support, production employees and documentation of maintenance updates.

Amortization costs. See “Amortization of Intangible Assets” below for information regarding the amount of amortization charged to cost of revenue for the relevant periods.

The dollar decreases in total cost of revenue for the three months ended January 31, 2006 are primarily due to a decrease of $19.4 million in amortization of intangible assets as a result of certain intangible assets primarily acquired in the acquisition of Avant! Corporation being fully amortized in May 2005. This decrease is offset by an increase of (i) $2.5 million in stock compensation expense due to adoption of SFAS 123(R); (ii) $0.9 million in compensation and employee benefits due to our increased investment in personnel associated with acquisition of HPL during the quarter; and (iii) $1.4

million in corporate allocated expense including human resources, information technology and facilities costs allocated to this line item compared to the same period in fiscal 2005.

Operating Expenses

Research and Development

	JANUARY 31, 2006	JANUARY 31, 2005	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended	$ 87.6	$ 73.3	$ 14.3	20%
Percentage of total revenue	34%	30%		

For the three months ended January 31, 2006, the increase is primarily due to an increase of (i) $8.1 million in stock compensation expense due to adoption of SFAS 123(R); (ii) $ 3.4 million in research and development personnel and related costs as a result of acquisitions, increased worldwide research and development headcount and other research and development spending; and (ii) $3.3 million in corporate allocated expenses including human resources, information technology and facilities costs allocated to this line item compared to the same period in fiscal 2005.

Sales and Marketing

	JANUARY 31, 2006	JANUARY 31, 2005	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended	$ 77.2	$ 84.1	$ (6.9)	(8)%
Percentage of total revenue	30%	35%		

For the three months ended January 31, 2006, the decrease is primarily due to a decrease of $12.1 million in variable compensation driven by shipments and reduced head count. This decrease is partially offset by an increase of (i) $4.7 million in stock compensation due to adoption of SFAS 123(R) for stock based compensation and (ii) $1.0 million in corporate allocated expense, including human resources, information technology and facilities costs allocated to this line item compared to the same period in fiscal 2005.

General and Administrative

	JANUARY 31, 2006	JANUARY 31, 2005	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended	$ 30.8	$ 25.0	$ 5.8	23%
Percentage of total revenue	12%	10%		

The increase for the three months ended January 31, 2006 is primarily due to an increase of (i) $3.1 million in stock based compensation expense as a result of adoption of SFAS 123(R); and (ii) $4.0 million in professional service fees related primarily to audit activities, Sarbanes-Oxley Act compliance and litigation matters; these increases are partially offset by a decrease of $5.7 million in corporate allocated expenses including human resources, information technology and facilities costs allocated to this line item compared to the same period in fiscal 2005.

In-Process Research and Development. We recorded a $0.8 million in-process research and development (IPRD) charge related to our acquisition of HPL in the three months ended January 31, 2006. At the date of the HPL acquisition, the projects associated with the IPRD efforts had not yet reached technological feasibility and the research and development in process had no alternative future uses. Accordingly, the amounts were charged to expense on the acquisition date. We recorded a $5.7 million in-process research and development (IPRD) charge related to our acquisition of ISE Integrated Systems Engineering AG (ISE) in the three months ended January 31, 2005.

Amortization of Intangible Assets. Amortization of intangible assets includes the amortization of the contract rights intangible associated with certain executor contracts and the amortization of core/developed technology, trademarks, trade names, customer relationships, covenants not to compete and other intangibles related to acquisitions completed in prior years and in the three months ended January 31, 2006. Amortization expense is included in the unaudited condensed consolidated statements of operations as follows:

	JANUARY 31, 2006	JANUARY 31, 2005	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended				
Included in cost of revenue	$ 8.7	$ 28.1	$ (19.4)	(69)%
Included in operating expenses	7.3	8.3	(1.0)	(12)%
Total	$ 16.0	$ 36.4	$ (20.4)	(56)%
Percentage of total revenue	6%	15%		

For the three months ended January 31, 2006, the decrease in amortization of intangible assets is primarily due to completion of amortization of intangible assets acquired in the acquisition of Avant!. See Note 4 to *Notes to Unaudited Condensed Consolidated Financial Statements* for a schedule of future amortization amounts.

Other Income, Net

	JANUARY 31, 2006	JANUARY 31, 2005	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended				
Interest income, net	$ 3.0	$ 1.8	$ 1.2	66%
Gain (loss) on sale of investments, net of investment write-downs	—	(1.3)	1.3	100%
Foreign currency exchange gain(loss)	0.1	2.2	(2.1)	(95)%
Correction of an error in accounting for certain hedging transactions	—	3.0	(3.0)	(100)%
Other (1)	(1.3)	0.2	(1.5)	(750)%
Total	$ 1.8	$ 5.9	$ (4.1)	(69)%

(1) For the three months ended January 31, 2006, this amount is comprised primarily of $0.8 million in premiums paid on foreign exchange forward contracts.

For the three months ended January 31, 2006, the decrease is primarily due to the effect of the correction of the error in Synopsys' accounting under SFAS 133 of certain prior year foreign currency hedge transactions during the same period in fiscal 2005. See Note 11 to *Notes to Unaudited Condensed Consolidated Financial Statements*.

Income Tax Rate

Effective Tax Rate. We estimate our annual effective tax rate at the end of each quarterly period. Our estimate takes into account estimates of annual pre-tax income (and losses), the geographic mix of pre-tax income (and losses) and our interpretations of tax laws and possible outcomes of current and future audits.

Our effective tax rate for the three months ended January 31, 2006 and 2005 was a tax expense rate of 43.9% and a tax benefit rate of 25.2% respectively due primarily to the fact that we had net income for the first quarter of fiscal 2006 compared to a net loss in the first quarter of fiscal 2005. The provision for income taxes for the three months ended January 31, 2006 includes a tax expense of $100,000 relating to foreign taxes which was treated as a discrete event allocable to the quarter. Based on current estimates of future earnings and items affecting our taxable income, we expect our effective tax rate for the fiscal year ending October 31, 2006 to be an expense rate of approximately 32.2%. There can be no assurance that these estimates will prove correct, however, and, as a result, our actual annual effective tax rate could be materially different than projected.

In November 2005, FASB issued FSP FAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards." Effective upon issuance, this FSP describes an alternative transition method for calculating the tax effects of stock-based compensation pursuant to SFAS 123(R). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and the statement of cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R). Companies have one year from the later of the adoption of SFAS 123(R) or the effective date of the FSP to evaluate their transition alternatives and make a one-time election.

IRS Revenue Agent's Report. On May 31, 2005, we received a Notice of Proposed Adjustment from the Internal

Revenue Service (IRS) asserting a very large net increase to our U.S. taxable income arising from the audit of fiscal years 2000 and 2001. On June 8, 2005, we received a Revenue Agent's Report (RAR) in which the IRS proposed to assess a net tax deficiency for fiscal years 2000 and 2001 of approximately $476.8 million, plus interest. Interest accrues on the amount of any deficiency finally determined until paid, and compounds daily at the federal underpayment rate, which adjusts quarterly. A higher underpayment rate of interest may be charged as a result of the issuance of the RAR.

This proposed adjustment primarily relates to transfer pricing transactions between Synopsys and a wholly-owned foreign subsidiary. The proposed adjustment for fiscal years 2000 and 2001 is the total amount relating to these transactions asserted under the IRS theories.

On July 13, 2005, we filed a protest to the proposed deficiency with the IRS, which caused the matter to be referred to the Appeals Office of the IRS. Resolution of this matter could take a considerable time, possibly years. We strongly believe the proposed IRS adjustments and resulting proposed deficiency are inconsistent with applicable tax laws, and that we thus have meritorious defenses to these proposals. Accordingly, we will continue to challenge these proposed adjustments vigorously. While we believe the IRS' asserted adjustments are not supported by applicable law, we believes it is probable we will be required to make additional payments in order to resolve this matter. However, based on our analysis to date, we believe we have adequately provided for this matter. If we are required to pay a significant amount of additional U.S. taxes and applicable interest in excess of its provision for this matter, our results of operations and financial condition could be materially and adversely affected.

Liquidity and Capital Resources

We derive our liquidity and capital resources primarily from our cash generated from operations. We believe that our current cash, cash equivalents, short-term investments and cash generated from operations will satisfy our business requirements for at least the next twelve months. Cash, cash equivalents and short-term investments decreased $72.2 million, or 12%, to $514.3 million as of January 31, 2006 from $586.5 million as of October 31, 2005.

Cash provided by operations is in part dependent upon the payment terms of our license agreements. For an upfront license, we require that a substantial portion of the license fee be paid within the first year. Conversely, payment terms for time-based licenses are generally extended; typically the license fee is paid quarterly in even increments over the term of the license. Accordingly, we generally receive cash from upfront licenses sooner than on time-based licenses.

Cash provided by operations was $19.8 million for the three months ended January 31, 2006 compared to $142.1 million for the same period in fiscal 2005. The decrease of $122.3 million was comprised of (i) increase in payments to vendors of $60.2 million; (ii) increase in commission payments of $13.4 million, and (iii) a decrease in cash collections of $44.1 million for the three months ended January 31, 2006 when compared to the same period in fiscal 2005.

Accounts receivable, net of allowances, decreased $16.2 million to $84.0 million as of January 31, 2006 from $100.2 million as of October 31, 2005 as a result of strong collection efforts during the quarter. Days sales outstanding, calculated based on revenue for the three months ended January 31, 2006 and accounts receivable as of January 31, 2006, decreased to approximately 29 days as of January 31, 2006 from approximately 36 days as of October 31, 2005. The decrease in days sales outstanding is primarily due to a reduction in the level of accounts receivable, which in turn was driven by strong collections during the quarter and the increased amount of installment contract arrangements caused by our license model change.

Cash used in investing activities was $39.5 million for the three months ended January 31, 2006 compared to $72.8 million for the same period in fiscal 2005. The decrease of $33.3 million is primarily due to a decrease in cash used for acquisitions of $79.4 million, partially offset by an increase of (i) $44.9 million in payments made for purchase of short and long term investments, net of related proceeds of the short-term investments; and (ii) $1.2 million cash used for purchases of property and equipment.

Cash used in financing activities was $70.5 million for the three months ended January 31, 2006 compared to $37.9 million for the same period in fiscal 2005. The increase of $32.7 million is primarily due to an increase in purchases of shares of our common stock, partially offset by an $8.2 million increase in proceeds to Synopsys from sales of shares of our common stock pursuant to our employee stock option plans.

We hold our cash, cash equivalents and short-term investments in the U.S. and in foreign accounts, primarily Ireland, Bermuda and Japan. As of January 31, 2006, we held an aggregate of $418.7 million in cash, cash equivalents and short-term investments in the U.S. and an aggregate of $95.5 million in foreign accounts. Funds in foreign accounts are generated from revenue outside North America. With the exception of Japan, we currently maintain a policy under APB 23, *Accounting for Income Taxes-Special Areas*, of indefinitely reinvesting such funds outside of the U.S.

In April 2004, we entered into a three-year, $250.0 million senior unsecured revolving credit facility. This facility contains financial covenants requiring us to maintain a minimum leverage ratio and specified levels of cash, as well as other non-financial covenants. The facility terminates on April 28, 2007. Borrowings under the facility bear interest at the greater of the administrative agent's prime rate or the Federal funds rate plus 0.50%; however, we have the option to pay interest based on the outstanding amount at Eurodollar rates plus a spread between 0.80% and 1.125% based on a pricing grid tied to a financial covenant. In addition, commitment fees are payable on the facility at rates between 0.20% and 0.25% per annum based on a pricing grid tied to a financial covenant. As of January 31, 2006, we had no outstanding borrowings under this credit facility and we were in compliance with all covenants.

Factors That May Affect Future Results

Our reported results of operations have been and will continue to be materially and adversely affected by our adoption of SFAS 123R.

Effective in the first quarter of fiscal 2006, we adopted Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment* (SFAS 123(R)). Under SFAS 123R, we were required to adopt a fair value based method for measuring the compensation expense related to employee stock awards. This resulted in recognition of substantial additional compensation expense for the quarter and had a material adverse effect on our reported results of operations for the quarter. SFAS 123(R) will continue to cause recognition of substantial amounts of compensation expense relating to our employee stock options and employee stock purchase plans in future periods.

Weakness, budgetary caution or consolidation in the semiconductor and electronics industries may continue to negatively impact our business.

In recent years, we believe that EDA industry growth has been adversely affected by many factors, including ongoing efforts by semiconductor companies to control their spending, uncertainty regarding the long term growth rate of the semiconductor industry, excess EDA tool capacity at some customers and increased competition in the EDA industry itself. If these factors persist or expected semiconductor industry growth does not occur (or if we do not benefit from any such increases), our business, operating results and financial condition will be materially and adversely affected.

We also believe that, over the long term, growth in EDA spending will continue to depend on growth in semiconductor R&D spending and continued growth in the overall semiconductor market. However, we cannot predict the timing or magnitude of growth in semiconductor revenues, R&D spending or spending on EDA products, nor whether we will benefit from any such increases should they occur. For example, although the semiconductor industry grew by 18% in 2003 and 29% in 2004 and we estimate that R&D spending among large semiconductor companies increased approximately 10% from 2003 to 2004, EDA industry revenue during this period did not track these growth levels.

Competition in the EDA industry may have a material adverse effect on our business and financial results.

We compete with other EDA vendors that offer a broad range of products and services, primarily Cadence Design Systems, Inc. and Mentor Graphics Corporation, and with other EDA vendors that offer products focused on one or more discrete phases of the IC design process, such as Magma Design Automation, Inc, We also compete with customers' internally developed design tools and capabilities. If we fail to compete effectively, our business will be materially and adversely affected. We compete principally on technology leadership, product quality and features (including ease-of use), time-to-results, post-sale support, interoperability with our own and other vendors' products, price and payment terms. Additional competitive challenges include the following:

- Price continues to be a competitive factor. We believe that some EDA vendors are increasingly offering discounts, which could be significant. If we are unable to match a competitor's pricing for a particular solution, we may lose business, which could have a material adverse effect on our financial condition and results of operations, particularly if the customer chooses to consolidate all or a substantial portion of their other EDA purchase with such competitor.

- Technology in the EDA industry evolves rapidly. Accordingly, we must correctly anticipate and lead critical developments, innovate rapidly and efficiently, improve our existing products, and successfully develop or acquire new products. If we fail to do so, our business will be materially and adversely affected.

- To compete effectively, we believe we must offer products that provide both a high level of integration into a comprehensive platform and a high level of individual product performance. We have invested significant resources into further development of our Galaxy Design Platform, integration of our Discovery Verification Platform and enhancement of its System Verilog and other advanced features and development of our Design for Manufacturing and IP portfolios. We can provide no assurance that our customers will find these tool configurations more attractive than our competitors' offerings or that our efforts to balance the interests of integration versus individual product performance will be successful.

- Payment terms are also an important competitive factor and are aggressively negotiated by our customers. During the second half of fiscal 2003 and continuing through 2004 and 2005, payment terms on time-based licenses lengthened compared to prior periods, negatively affecting our cash flow from operations.

The decline in new IC design starts, industry consolidation and other potentially long-term trends may adversely affect the EDA industry, including demand for our products and services.

The increasing complexity of SoCs and ICs, and customers' concerns about managing cost and risk have also led to the following potentially long-term negative trends:

- The number of starts of new IC designs has declined since 2000. New IC design starts are a key driver of demand for EDA software.

- A number of mergers in the semiconductor and electronics industries have occurred, and more are likely. Mergers can reduce the aggregate level of purchases of EDA software and services, and in some cases, increase customers' bargaining power in negotiations with their suppliers, including Synopsys.

- Due to factors such as increased globalization, cost controls among customers appear to have become more permanent, adversely impacting our customers' EDA spending.

- Industry changes, plus the cost and complexity of IC design, may be leading some companies in these industries to limit their design activity in general, to focus only on one discrete phase of the design process while outsourcing other aspects of the design, or using Field Programmable Gate Arrays (FPGAs), an alternative chip technology.

These trends, if sustained, could have a material adverse effect on the EDA industry, including the demand for our products and services, which in turn would materially and adversely affect our financial condition and results of operations.

We have received a Revenue Agent's Report from the Internal Revenue Service claiming a significant increase in our U.S. taxable income. An adverse outcome of this examination or any future examinations involving similar claims could have a material adverse effect on our results of operations and financial condition.

Our operations are subject to income and transaction taxes in the United States and in multiple foreign jurisdictions and to review or audit by IRS and state, local and foreign tax authorities. In connection with an IRS audit of our United States federal income tax returns for fiscal years 2000 and 2001, on May 31, 2005 we received a Notice of Proposed Adjustment in which the IRS claimed a very large increase to our U.S. taxable income. On June 8, 2005, we received a Revenue Agent's Report in which the IRS proposed to assess a net tax deficiency for fiscal years 2000 and 2001 of approximately $476.8 million, plus interest. This proposed adjustment primarily relates to transfer pricing transactions between Synopsys and a wholly-owned foreign subsidiary. We have filed a protest to the proposed deficiency with the IRS, which caused the matter to be referred to the Appeals Office of the IRS. Resolution of this matter could take a considerable time, possibly years.

We strongly believe the proposed IRS adjustments and resulting proposed deficiency are inconsistent with applicable tax laws, and that we thus have meritorious defenses to these proposals. Accordingly, we will continue to challenge these proposed adjustments vigorously. While we believe the IRS' asserted adjustments are not supported by applicable law, we believe it is probable we will be required to make additional payments in order to resolve this matter. However, based on our analysis to date, we believe we have adequately provided for this matter. If we are required to pay a significant amount of additional U.S. taxes and applicable interest in excess of our provision for this matter, our results of operations and financial condition would be materially and adversely affected.

The failure to meet the semiconductor industry's demands for advancing EDA technology and continued cost reductions may adversely affect our financial results.

SoC and IC functionality continues to increase while feature widths decrease, substantially increasing the complexity, cost and risk of IC design and manufacturing. To address greater complexity, semiconductor designers and manufacturers demand continuous innovation from EDA suppliers. At the same time, as a general business trend, we believe customers and potential customers may be beginning to buy more products from fewer suppliers and at reduced overall prices in an effort to reduce overall cost and risk. In order to succeed in this environment, we must successfully meet our customers' technology requirements, while also striving to reduce their overall costs and our own operating costs. Failure to manage these conflicting demands successfully would materially and adversely affect our financial condition and results of operations.

Our revenue and earnings fluctuate, which could cause our financial results to not meet expectations and our stock price to decline.

Many factors affect our revenue and earnings, including customer demand, license mix, the timing of revenue recognition on products and services sold and committed expense levels, making it difficult to predict revenue and earnings for any given fiscal period. Accordingly, stockholders should not view our historical results as necessarily indicative of our future performance. If our financial results or targets do not meet investor and analyst expectations, our stock price could decline.

Some of the specific factors that could affect our revenue and earnings in a particular quarter or over several fiscal periods include, but are not limited to:

- We base our operating expenses in part on our expectations for future revenue and generally must commit to expense levels in advance of revenue being recognized. Since only a small portion of our expenses varies with revenue, any revenue shortfall typically causes a direct reduction in net income.

- Our revenue and earnings targets over a number of fiscal periods assume a certain level of orders and a certain mix between upfront and time-based licenses. The amount of orders received and changes in the mix due to factors such as the level of overall license orders, customer demand, preferred customer payment terms and requested customer ship dates could have a material adverse effect on our revenue and earnings. For example, if we ship more upfront licenses than expected during any given fiscal period, our revenue and earnings for that period could be above our targets even if orders are below target; conversely, if we ship fewer upfront licenses than expected our revenue and earnings for that period could fall below our targets even if orders meet or even exceed our target. Similarly, if we receive a lower-than-expected level of TBL orders during a given period, our revenue in future periods could be negatively affected.

- We may be required to implement a number of cost control measures in order to meet our externally-communicated financial targets, any of which could fail to result in the anticipated cost savings or could adversely affect our business.

- The market for EDA products is dynamic and depends on a number of factors including consumer demand for our customers' products, customer R&D and EDA tool budgets, pricing, our competitors' product offerings and customer design starts. It is difficult to predict in advance the effect of these and other factors on our customer's demand for our products on a medium or long term basis. As a result, actual future customer purchases could differ materially from our forecasts which, in turn could cause our actual revenue to be materially different than our publicly-disclosed targets.

- Certain of our upfront and time-based license agreements provide the right to re-mix a portion of the software initially subject to the license for other specified Synopsys products. For example, a customer may use our front-end design products for a portion of the term of its license and then re-mix such products for back-end placement software for the remainder of the term in order to complete the customer's IC design. While this practice helps assure the customer's access to the complete design flow needed to manufacture its product, use of these arrangements could result in reduced revenue compared to licensing the individual tools separately.

- In the past, we have regularly received a significant proportion of our orders for a given quarter in the last one or two weeks of the quarter. The delay of one or more orders, particularly an upfront order, could have a material adverse effect on our bookings, revenue and earnings for that quarter.

- Our customers spend a great deal of time reviewing and testing our products, either alone or against competing products, before making a purchase decision. Accordingly, our customers' evaluation and purchase cycles may not match our fiscal quarters. Further, sales of our products and services may be delayed if customers delay project approval or project starts because of budgetary constraints or their budget cycles.

Businesses we have acquired or that we may acquire in the future may not perform as we project.

We have acquired a number of companies or their assets in recent years, including one in fiscal 2006 to date, four in fiscal 2005 and six during fiscal 2004, and, as part of our efforts to expand our product and services offerings, we expect to acquire additional companies in the future.

In addition to direct costs, acquisitions pose a number of risks, including:

- Potential negative impact on our earnings per share;

- Failure of acquired products to achieve projected sales;
- Problems in integrating the acquired products with our products;
- Difficulties in retaining key employees and integrating them into our company;
- Failure to realize expected synergies or cost savings;

- Delays caused by regulatory scrutiny;
- Drain on management time for acquisition-related activities;
- Assumption of unknown liabilities; and
- Adverse effects on customer buying patterns or relationships.

While we review proposed acquisitions carefully and strive to negotiate terms that are favorable to us, we can provide no assurance that any acquisition will positively affect our future performance. Furthermore, if we later determine we cannot use or sell an acquired product or technology, we could be required to write down the goodwill and intangible assets associated with such product or technology; these write-downs, if significant, could have a material adverse effect on our results of operations.

A failure to timely recruit and retain key employees would have a material adverse effect on our business.

To be successful, we must attract and retain key technical, sales and managerial employees, including those who join Synopsys in connection with acquisitions. There are a limited number of qualified EDA and IC design engineers, and competition for these individuals is intense. Our employees are often recruited aggressively by our competitors and our customers. Any failure to recruit and retain key technical, sales and managerial employees would have a material adverse effect on our business, results of operations and financial condition.

We issue stock options and maintain employee stock purchase plans as a key component of our overall compensation. There is growing pressure on public companies from stockholders, who must approve any increases in our stock option pool, generally to reduce our overhang or amount of outstanding and unexercised stock options. In addition, our adoption of new accounting rules that require us to recognize on our income statement compensation expense from employee stock options and our employee stock purchase plan may increase pressure to limit future option grants. These factors may make it more difficult for Synopsys to grant attractive equity-based packages in the future, which could adversely impact our ability to attract and retain key employees.

Stagnation of foreign economies, foreign exchange rate fluctuations and the increasingly global nature of our operations could adversely affect our performance.

During the first quarter of fiscal 2006 and fiscal 2005 we derived 49% and 48%, respectively, of our revenue from outside the United States; going forward, we expect our overall orders and revenue targets will continue to depend on substantial contributions from outside the United States. Foreign sales are vulnerable to regional or worldwide economic, political and health conditions, including the effects of international political conflict, hostilities and natural disasters. Further, any stagnation of foreign economies would adversely affect our performance by reducing the amount of revenue derived from outside the United States.

Our operating results are also affected by fluctuations in foreign currency exchange rates. Our results of operations can be adversely affected when the U.S. dollar weakens relative to other currencies, including the Euro, the Japanese yen and the Canadian dollar, as a result of the conversion of expenses of our foreign operations denominated in foreign currencies into the dollar. Exchange rates are subject to significant and rapid fluctuations, and therefore we cannot predict the prospective impact of exchange rate fluctuations on our business, results of operations and financial condition. While we hedge certain foreign currency exposures of our business, there can be no assurance our hedging activities will completely mitigate our foreign currency risks.

In addition, we have expanded our non-U.S. operations significantly in the past several years. While the increased international presence of our business creates the potential for cost reductions locally and higher international sales, this strategy also requires us to recruit and retain qualified technical and managerial employees, manage multiple, remote locations performing complex software development projects and ensure intellectual property protection outside of the United States. The failure to effectively manage our global operations would have a material adverse effect on our business and results of operations.

Customer payment defaults could adversely affect our financial condition and results of operations.

Our backlog consists principally of customer payment obligations not yet due that are attributable to software we have already delivered. These customer obligations are typically not cancelable, but will not yield the expected revenue and cash flow if the customer defaults and fails to pay amounts owed. In these cases, we will generally take legal action to recover amounts owed. Moreover, existing customers may seek to renegotiate pre-existing contractual commitments due to adverse changes in their own businesses. Though we have not, to date, experienced a material level of defaults, any material payment default by our customers or significant reductions in existing contractual commitments could have a material adverse effect on our financial condition and results of operations.

A failure to protect our proprietary technology would have a material adverse effect on our business, results of operations and financial condition.

Our success depends in part upon protecting our proprietary technology. To protect this technology, we rely on agreements with customers, employees and others and on intellectual property laws worldwide. We can provide 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, certain foreign countries do not currently provide effective legal protection for intellectual property; our ability to prevent the unauthorized use of our products in those countries is therefore limited. For example, we are pursuing anti-piracy cases against several companies located in China. We have a policy of aggressively pursuing action against companies or individuals that wrongfully appropriate or use our products and technologies. However, there can be no assurance that these actions will be successful. If we do not obtain or maintain appropriate patent, copyright or trade secret protection, for any reason, or cannot fully defend our intellectual property rights in certain jurisdictions, our business, financial condition and results of operations would be materially and adversely affected. In addition, intellectual property litigation is lengthy, expensive and uncertain and legal fees related to such litigation may reduce our net income.

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

Under our customer agreements and other license agreements, we agree in many cases to indemnify our customers if our products infringe on a third party's intellectual property rights. As a result, we are from time to time subject to claims that our products infringe on these third party rights. For example, we are currently defending some of our customers against claims that their use of one of our products infringes on a patent held by a Japanese electronics company. We believe this claim is without merit and will continue to vigorously pursue this defense.

These types of claims can, however, result in costly and time-consuming litigation, require us to enter into royalty arrangements, subject us to damages or injunctions restricting our sale of products, require us to refund license fees to our customers or to forgo future payments or require us to redesign certain of our products, any one of which could materially and adversely affect our business, results of operations and financial condition.

Our business is subject to evolving corporate governance and public disclosure regulations that have increased both our costs and the risk of noncompliance, which could have an adverse effect on our stock price.

Because our common stock is publicly traded on the Nasdaq stock market, we are subject to rules and regulations promulgated by a number of governmental and self-regulated organizations, including the SEC, Nasdaq and the Public Company Accounting Oversight Board. Many of these regulations have only recently been enacted, and continue to evolve, making compliance more difficult and uncertain. In addition, our efforts to comply with these new regulations have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities.

In particular, Section 404 of Sarbanes-Oxley Act of 2002 and related regulations require us to include a management assessment of our internal controls over financial reporting and auditor attestation of that assessment in our annual reports. This effort has required, and will continue to require in the future, the commitment of significant financial and managerial resources. Although we believe that our ongoing review of our internal controls will enable us to provide favorable assessments of our internal controls and for our external auditors to provide their annual attestations in future SEC filings, as required by Section 404, we can give no assurance that these efforts will be completed on a timely and successful basis. For example, our annual report on Form 10-K for the fiscal year ended October 31, 2005 disclosed a material weakness in internal control over financial reporting. Any failure to complete a favorable assessment and obtain our auditors' attestation could have a material adverse effect on our stock price.

Product errors or defects could expose us to liability and harm our reputation.

Despite extensive testing prior to releasing our products, software products frequently contain errors or defects, especially when first introduced, when new versions are released or when integrated with technologies developed by acquired companies. Product errors could affect the performance or interoperability of our products, could delay the development or release of new products or new versions of products and could adversely affect market acceptance or perception of our products. In addition, allegations of IC manufacturability issues resulting from use of our IP products could, even if untrue, adversely affect our reputation and our customers' willingness to license IP products from us. Any such errors or delays in releasing new products or new versions of products or allegations of unsatisfactory performance could cause us to lose revenue or market share, increase our service costs, subject us to liability for damages and divert our resources from other tasks, any one of which could materially and adversely affect our business, results of operations and financial condition.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

For financial market risks related to changes in interest rates and foreign currency exchange rates, reference is made to Item 7A “Quantitative and Qualitative Disclosure About Market Risk” contained in Part II of our Annual Report on Form 10-K for the fiscal year ended October 31, 2005. Our exposure to market risk has not changed materially since October 31, 2005.

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures.* As of January 31, 2006 (the Evaluation Date), Synopsys carried out an evaluation under the supervision and with the participation of Synopsys’ management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of Synopsys’ disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act). There are inherent limitations to the effectiveness of any system of disclosure controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable, not absolute, assurance of achieving their control objectives. However, because our remediation of the material weakness identified in the fourth quarter of fiscal 2005, and described below is not yet complete, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, Synopsys’ disclosure controls and procedures were ineffective as of the end of the period covered by this report.

(b) *Changes in Internal Controls.* Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of October 31, 2005. As a result of such evaluation, management identified a material weakness in our internal control over financial reporting as of October 31, 2005 related to our accounting for income taxes. Specifically, our processes and procedures did not include adequate management oversight and review of our income tax accounting practices. As a result of the aforementioned material weakness, certain of our income tax accounting calculations and reserves contained errors which were, in aggregate, material. Specifically, (i) we did not appropriately consider the impact of existing tax reserves on the calculation of tax expense related to our repatriation of foreign earnings under the American Jobs Creation Act of 2004, thus overstating income tax expense and the related tax liability and (ii) upon expiration of the Federal statute of limitations, we did not reduce an existing tax reserve established upon consummation of a 2002 business combination, thus overstating tax reserves and goodwill as of October 31, 2005. These errors were corrected prior to the issuance of our 2005 consolidated financial statements.

We have taken the following actions to remediate the material weakness described above: (i) implemented additional recurring review procedures to help ensure compliance with Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes*, SFAS No. 5, *Accounting for Contingencies*, and other applicable rules and regulations with respect to tax matters, (ii) engaged external tax advisors to assist in the review of our income tax calculations, (iii) implemented controls with respect to tracking the statute of limitations, and (iv) increased contact and coordination between members of the Corporate Tax Department and the Vice President and Corporate Controller and other senior finance department management. In addition, we are working to complete the process of reorganizing and augmenting our tax department to improve communication, which we began in the first quarter of fiscal 2006. We expect to complete this reorganization and therefore to remediate the material weakness described above during fiscal 2006.

Other than as noted above, there were no changes in Synopsys’ internal control over financial reporting during the three months ended January 31, 2006 that have materially affected, or are reasonably likely to materially affect, Synopsys’ internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In connection with our December 1, 2004 announcement that we had signed agreements to acquire Nassda Corporation (Nassda) and to settle all outstanding litigation between the two companies, a class action complaint entitled *Robert Israel v. Nassda Corporation, et. al*., No. 4705695, was filed in the Court of Chancery of the State of Delaware naming Nassda, its directors and Synopsys as defendants. The complaint purported to be a class action lawsuit brought on behalf of shareholders of Nassda, other than the defendant directors and their affiliates, who allegedly would be injured or threatened with injury if the proposed acquisition of Nassda by Synopsys proceeded forward on the terms announced. A class action complaint alleging substantially the same facts was also filed in California Superior Court. The purported class actions sought to enjoin the transaction or, alternatively, unspecified damages. In May 2005, Synopsys completed its acquisition of Nassda. In

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October 2005, the Chancery Court approved a settlement of the Delaware action by which Synopsys would pay an aggregate of $0.15 per share to each former shareholder of Nassda (other than the defendant directors and their affiliates), for a total of approximately $1.8 million, and would pay certain fees and expenses of plaintiff's counsel. In December 2005, the plaintiffs in the Delaware action dismissed their complaint with prejudice and Synopsys paid the agreed-upon amounts. The California action was also dismissed with prejudice in December 2005, with each party bearing its own costs.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The table below sets forth information regarding repurchases of Synopsys' common stock by Synopsys during the three months ended January 31, 2006.

Period (1)	TOTAL NUMBER OF SHARES PURCHASED	AVERAGE PRICE PAID PER SHARE	TOTAL NUMBER OF SHARES PURCHASED AS PART OF PUBLICLY ANNOUNCED PROGRAMS	MAXIMUM DOLLAR VALUE OF SHARES THAT MAY YET BE PURCHASED UNDER THE PROGRAMS
Month #1 October 30, 2005 through December 3, 2005	—	$ —	—	$ 436,614,898
Month #2 December 4, 2005 through December 31, 2005	1,968,810	20.89	1,968,810	395,492,450
Month #3 January 1, 2006 through January 29, 2006	1,901,900	20.96	1,901,900	355,633,088
Total	3,870,710	$ 20.92	3,870,710	$ 355,633,088

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

All shares were purchased pursuant to a $500 million stock repurchase program originally approved by Synopsys' Board of Directors in July 2001 and last renewed in December 2004. The Company uses all common shares repurchased to offset dilution caused by on going stock issuances such as existing employee stock option plans, existing stock purchase plans and acquisitions. Funds are available until expended or until the program is suspended by the Chief Financial Officer or the Board of Directors.

ITEM 5. OTHER INFORMATION

In December 2005 and January 2006, Synopsys granted an aggregate of 420,000 stock options to its executive officers (the “Performance Options”), including 255,000 options to the Chief Executive Officer and the four next most highly compensated executive officers whose fiscal 2005 salary and bonus exceeded $100,000 (the “Named Executive Officers”). All of such options were granted under Synopsys’ 1992 Stock Option Plan. The Performance Options vest as to 50% of the shares upon achievement of certain Synopsys financial targets for fiscal year 2006 and as to the remaining 50% upon achievement of certain financial targets for fiscal year 2007. Should the financial targets not be achieved, none of the Performance Options shall vest. Set forth below is information about the Performance Options granted to the Named Executive Officers.

Name	**Number of Securities Underlying Options Granted**	**Exercise Price ($ /Share)**	**Expiration Date**
Aart J. de Geus.. Chief Executive Officer and Chairman of the Board	90,000	$ 20.73	12/6/2012
Chi-Foon Chan.. President and Chief Operating Officer	60,000	$ 20.73	12/6/2012
Vicki L. Andrews.. Senior Vice President, Worldwide Sales	30,000	$ 20.73	12/6/2012
Antun Domic .... Senior Vice President and General Manager, Implementation Group	40,000	$ 20.73	12/6/2012
Raul Camposano... Senior Vice President and General Manager, Silicon Engineering Group	35,000	$ 20.73	12/6/2012

ITEM 6. EXHIBITS

3.1 Amended and Restated Certificate of Incorporation of Synopsys, Inc. (1)

3.2 Restated Bylaws of Synopsys, Inc. (2)

4.1 Reference is made to Exhibit 3.1 and 3.2.

10.18 Synopsys Deferred Compensation Plan dated November 14, 2004. (3)(4)

10.31 2005 Non-Employee Directors Equity Incentive Plan. (4)(5)

10.35 Executive Compensation Summary. (4)(6)

10.36 Form of Synopsys, Inc. Executive Operating Plan Incentive. (4)(7)

10.37 Form of Restricted Stock Purchase Agreement under 2005 Non-Employee Directors Equity Incentive Plan. (4)

10.38 Form of Stock Option Agreement under 2005 Non-Employee Directors Equity Incentive Plan. (4)

31.1 Certification of Chief Executive Officer as required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.

31.2 Certification of Chief Financial Officer as required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended.

32.1 Certification of Chief Executive Officer and Chief Financial Officer as required by Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended and Section 1350 of Chapter 63 of Title 18 of the United States Code.(8)

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(1) Incorporated by reference to exhibit to Synopsys’ Quarterly Report on Form 10-Q for the quarterly period ended

July 31, 2003.

(2) Incorporated by reference to exhibit to Synopsys' Quarterly Report on Form 10-Q for the quarterly period ended March 31, 1999.

(3) Incorporated by reference to the like referenced exhibit to Synopsys' Current Report on Form 8-K filed on December 12, 2005.

(4) Compensation plan or arrangement in which executive officer or director participates.

(5) Incorporated by reference from exhibit to the Registration Statement of Form S-8 (Filed No. 333-125224) of Synopsys, Inc. filed with the Securities and Exchange Commission on May 25, 2005.

(6) Incorporated by reference to the disclosure under Item 1.01 of Synopsys' Current Report on Form 8-K filed on December 12, 2005.

(7) Incorporated by reference to the like-referenced exhibit to Synopsys' Current Report on Form 8-K filed on December 12, 2005.

(8) The certification attached as Exhibit 32.1 accompanies this Quarterly Report on Form 10-Q but is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of Synopsys, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Form 10-Q, irrespective of any general incorporation language contained in such filing.

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/ Brian M. Beattie

Brian M. Beattie
Chief Financial Officer
(Principal Financial Officer)

Date: March 8, 2006

EXHIBIT INDEX

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Exhibit 10.37

FORM OF SYNOPSYS, INC.
2005 NON-EMPLOYEE DIRECTORS EQUITY INCENTIVE PLAN

RESTRICTED STOCK GRANT NOTICE

(ANNUAL AWARD)

Synopsys, Inc. (the "***Corporation***"), pursuant to its 2005 Non-Employee Directors Equity Incentive Plan (the "***Plan***") hereby grants to Eligible Director the right to acquire the number of shares of the Corporation's Common Stock set forth below ("***Annual Award***"). This Annual Award is subject to all of the terms and conditions as set forth herein and in the Restricted Stock Agreement and the Plan, both of which are attached hereto and incorporated herein in their entirety.

Eligible Director:
Date of Grant:
Number of Shares Subject to Annual Award:
Closing Date:

Vesting Schedule: The shares subject to this Annual Award will vest in a series of thirty-six (36) successive equal installments for each month the Eligible Director continues in Board service from the Date of Grant through the third anniversary of the Date of Grant.

Additional Terms/Acknowledgements: The undersigned Eligible Director acknowledges receipt of, and understands and agrees to, this Restricted Stock Grant Notice, the Restricted Stock Agreement, and the Plan. Eligible Director further acknowledges that as of the Date of Grant, this Restricted Stock Grant Notice, the Restricted Stock Agreement, and the Plan set forth the entire understanding between Eligible Director and the Corporation regarding the acquisition of stock in the Corporation pursuant to the Annual Award specified above and supersede all prior oral and written agreements on that subject.

SYNOPSYS, INC.	**ELIGIBLE DIRECTOR:**
By: ______________________	______________________
Signature	Signature
Title: ______________________	Date: ______________________
Date: ______________________	

ATTACHMENTS: Restricted Stock Agreement, and 2005 Non-Employee Directors Equity Incentive Plan

ATTACHMENT I

SYNOPSYS, INC.
2005 NON-EMPLOYEE DIRECTORS EQUITY INCENTIVE PLAN

RESTRICTED STOCK AGREEMENT

Synopsys, Inc. (the "***Corporation***") wishes to issue to the Eligible Director ("***you***") named in the attached Restricted Stock Grant Notice ("***Grant Notice***"), and you wish to acquire, shares of Common Stock from the Corporation, as set forth in your Grant Notice pursuant to the provisions of the Corporation's 2005 Non-Employee Directors Equity Incentive Plan (the "***Plan***") as set forth in the Grant Notice. A copy of the Plan is attached to the Grant Notice as Attachment II.

Therefore, pursuant to the terms of the Grant Notice and this Restricted Stock Agreement (the "***Agreement***") (collectively, the "***Annual Award***"), the Corporation grants you the right to acquire the number of shares of Common Stock indicated in the Grant Notice in exchange for past or future services to be rendered to the Corporation. In the event additional consideration is required by law so that the Common Stock acquired under this Agreement is deemed fully paid and nonassessable, the Board shall determine the amount and character of such additional consideration to be paid. Defined terms not explicitly defined in this Agreement but defined in the Plan shall have the same definitions as in the Plan.

The details of your Annual Award are as follows:

1. ACQUISITION OF SHARES. By signing the Grant Notice, you hereby agree to acquire from the Corporation, and the Corporation hereby agrees to issue to you, the aggregate number of shares of Common Stock specified in your Grant Notice for the consideration set forth in Section 3 and subject to all of the terms and conditions of the Annual Award and the Plan. You may not acquire less than the aggregate number of shares specified in the Grant Notice.

2. CLOSING. Your acquisition of the shares shall be consummated as follows:

(a) You will acquire the shares by delivering your Grant Notice, executed by you in the manner required by the Corporation, to the Corporate Secretary of the Corporation, or to such other person as the Corporation may designate, during regular business hours, on the Closing Date specified in the Grant Notice (or at such other time and place as you and the Corporation may mutually agree upon in writing) along with any consideration, other than your past or future services, required to be delivered by you by law on the Closing Date pursuant to Section 3 and such additional documents as the Corporation may then require.

(b) The Corporation will direct the transfer agent for the Corporation to deliver to the Escrow Agent pursuant to the terms of Section 9, below, the certificate or certificates evidencing the shares of Common Stock being acquired by you. You acknowledge and agree that any such shares may be held in book entry form directly registered with the transfer agent or in such other form as the Corporation may determine.

3. **CONSIDERATION**. Unless otherwise required by law, the shares of Common Stock to be delivered to you on the Closing Date shall be deemed paid, in whole or in part in exchange for past and future services to be rendered to the Corporation in the amounts and to the extent required by law.

4. **VESTING**. Subject to the limitations contained herein, the shares you acquire will vest as follows:

(a) The shares will vest as provided in the Vesting Schedule set forth in your Grant Notice, provided that vesting will cease upon the termination of your Board service.

(b) In the event of your death or Permanent Disability during the period of your Board service, the shares will vest in that number of additional shares of Common Stock subject to the Annual Award in which you would have vested had you continued in Board service until the next Annual Meeting.

(c) Shares acquired by you that have vested in accordance with the Vesting Schedule set forth in the Grant Notice and this Section 4 are "***Vested Shares***." Shares acquired by you pursuant to this Agreement that are not Vested Shares are "***Unvested Shares***."

5. **CAPITALIZATION CHANGES**. The number of shares of Common Stock subject to your Annual Award and referenced in your Grant Notice may be adjusted from time to time for changes in capitalization pursuant to Section IV.C of the Plan.

6. **SECURITIES LAW COMPLIANCE**. Notwithstanding anything to the contrary contained herein, you may not acquire any shares of Common Stock under your Annual Award unless the shares of Common Stock issuable upon such acquisition are then registered under the Securities Act of 1933, as amended (the "***Securities Act***") or, if such shares of Common Stock are not then so registered, the Corporation has determined that such acquisition would be exempt from the registration requirements of the Securities Act. The acquisition of shares under your Annual Award also must comply with other applicable laws and regulations governing your Annual Award, and you may not acquire such shares if the Corporation determines that such acquisition would not be in material compliance with such laws and regulations.

7. **RIGHT OF REACQUISITION**. The Corporation shall simultaneously with the termination of your Board service automatically reacquire (the "***Reacquisition Right***") for no consideration all of the Unvested Shares, unless the Corporation agrees to waive its Reacquisition Right as to some or all of the Unvested Shares. Any such waiver shall be exercised by the Corporation by written notice to you or your representative (with a copy to the Escrow Agent, as defined below) within ninety (90) days after the termination of your Board service, and the Escrow Agent may then release to you the number of Unvested Shares not being reacquired by the Corporation. If the Corporation does not waive its reacquisition right as to all of the Unvested Shares, then upon such termination of your Board service, the Escrow Agent shall transfer to the Corporation the number of Unvested Shares the Corporation is reacquiring. The Reacquisition Right shall expire when all of the shares have become Vested Shares in accordance with Section 4.

8. CERTAIN CORPORATE TRANSACTIONS. In the event of a Corporate Transaction as defined in the Plan, the Reacquisition Right may be assigned by the Corporation to the successor of the Corporation (or such successor's parent Corporation), if any, in connection with such transaction. To the extent the Reacquisition Right remains in effect following such transaction, it shall apply to the new capital stock or other property received in exchange for the Common Stock in consummation of the transaction, but only to the extent the Common Stock was at the time covered by such right.

9. ESCROW OF UNVESTED COMMON STOCK. As security for your faithful performance of the terms of this Agreement and to insure the availability for delivery of your Common Stock upon execution of the Reacquisition Right provided in Section 7, above, you agree to the following "Joint Escrow" and "Joint Escrow Instructions," and you and the Corporation hereby authorize and direct the Corporate Secretary of the Corporation or the Corporate Secretary's designee ("***Escrow Agent***") to hold the documents delivered to Escrow Agent pursuant to the terms of this Agreement and of your Grant Notice, in accordance with the following Joint Escrow Instructions:

(a) In the event you cease your Board service, the Corporation shall pursuant to the Reacquisition Right in Section 7, above, automatically reacquire for no consideration all Unvested Shares, within the meaning of Section 4, above, as of the date of such termination, unless the Corporation elects to waive such right as to some or all of the Unvested Shares. If the Corporation (or its assignee) elects to waive the Reacquisition Right, the Corporation or its assignee will give you and Escrow Agent a written notice specifying the number of shares of stock not to be reacquired. You and the Corporation hereby irrevocably authorize and direct Escrow Agent to close the transaction contemplated by such notice as soon as practicable following the date of termination of service in accordance with the terms of this Agreement and the notice of waiver, if any.

(b) Vested Shares shall be delivered to you upon your request given in the manner provided in Section 19 for providing notices.

(c) At any closing involving the transfer or delivery of some or all of the property subject to the Grant Notice and this Agreement, Escrow Agent is directed (i) to date any stock assignments necessary for the transfer in question, (ii) to fill in the number of shares being transferred, and (iii) to deliver same, together with the certificate, if any, evidencing the shares of Common Stock to be transferred, to you or the Corporation, as applicable.

(d) You irrevocably authorize the Corporation to deposit with Escrow Agent the certificates, if any, evidencing shares of Common Stock to be held by Escrow Agent hereunder and any additions and substitutions to said shares as specified in this Agreement. You do hereby irrevocably constitute and appoint Escrow Agent as your attorney-in-fact and agent for the term of this escrow to execute with respect to such securities and other property all documents of assignment and/or transfer and all stock certificates necessary or appropriate to make all securities negotiable and complete any transaction herein contemplated.

(e) This escrow shall terminate upon the expiration or application in full of the Reacquisition Right, whichever occurs first, and the completion of the tasks contemplated by these Joint Escrow Instructions.

(f) If at the time of termination of this escrow, Escrow Agent should have in its possession any documents, securities, or other property belonging to you, Escrow Agent shall deliver all of same to you and shall be discharged of all further obligations hereunder.

(g) Except as otherwise provided in these Joint Escrow Instructions, Escrow Agent's duties hereunder may be altered, amended, modified, or revoked only by a writing signed by all of the parties hereto.

(h) Escrow Agent shall be obligated only for the performance of such duties as are specifically set forth herein and may rely and shall be protected in relying or refraining from acting on any instrument reasonably believed by Escrow Agent to be genuine and to have been signed or presented by the proper party or parties or their assignees. Escrow Agent shall not be personally liable for any act Escrow Agent may do or omit to do hereunder as Escrow Agent or as attorney-in-fact for you while acting in good faith and any act done or omitted by Escrow Agent pursuant to the advice of Escrow Agent's own attorneys shall be conclusive evidence of such good faith.

(i) Escrow Agent is hereby expressly authorized to disregard any and all warnings given by any of the parties hereto or by any other person or corporation, excepting only orders or process of courts of law, and is hereby expressly authorized to comply with and obey orders, judgments, or decrees of any court. In case Escrow Agent obeys or complies with any such order, judgment, or decree of any court, Escrow Agent shall not be liable to any of the parties hereto or to any other person, firm, or corporation by reason of such compliance, notwithstanding any such order, judgment, or decree being subsequently reversed, modified, annulled, set aside, vacated, or found to have been entered without jurisdiction.

(j) Escrow Agent shall not be liable in any respect on account of the identity, authority, or rights of the parties executing or delivering or purporting to execute or deliver this Agreement or any documents or papers deposited or called for hereunder.

(k) Escrow Agent shall not be liable for the outlawing of any rights under any statute of limitations with respect to these Joint Escrow Instructions or any documents deposited with Escrow Agent.

(l) Escrow Agent's responsibilities as Escrow Agent hereunder shall terminate if Escrow Agent shall cease to be the Secretary of the Corporation or if Escrow Agent shall resign by written notice to each party. In the event of any such termination, the Corporation may appoint any officer or assistant officer of the Corporation or other person who in the future assumes the position of Secretary for the Corporation as successor Escrow Agent and you hereby confirm the appointment of such successor or successors as your attorney-in-fact and agent to the full extent of such successor Escrow Agent's appointment.

(m) If Escrow Agent reasonably requires other or further instruments in connection with these Joint Escrow Instructions or obligations in respect hereto, the necessary parties hereto shall join in furnishing such instruments.

(n) It is understood and agreed that should any dispute arise with respect to the delivery and/or ownership or right of possession of the securities, Escrow Agent is authorized and directed to retain in its possession without liability to anyone all or any part of said securities until such dispute shall have been settled either by mutual written agreement of the parties concerned or by a final order, decree, or judgment of a court of competent jurisdiction after the time for appeal has expired and no appeal has been perfected, but Escrow Agent shall be under no duty whatsoever to institute or defend any such proceedings.

(o) By signing this Agreement below Escrow Agent becomes a party hereto only for the purpose of said Joint Escrow Instructions in this Section 9; Escrow Agent does not become a party to any other rights and obligations of this Agreement apart from those in this Section 9.

(p) Escrow Agent shall be entitled to employ such legal counsel and other experts as Escrow Agent may deem necessary properly to advise Escrow Agent in connection with Escrow Agent's obligations hereunder. Escrow Agent may rely upon the advice of such counsel, and may pay such counsel reasonable compensation therefor. The Corporation shall be responsible for all fees generated by such legal counsel in connection with Escrow Agent's obligations hereunder.

(q) These Joint Escrow Instructions set forth in this Section 9 shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns. It is understood and agreed that references to "Escrow Agent" or "Escrow Agent's" herein refer to the original Escrow Agent and to any and all successor Escrow Agents. It is understood and agreed that the Corporation may at any time or from time to time assign its rights under the Agreement and these Joint Escrow Instructions in whole or in part.

10. EXECUTION OF DOCUMENTS. You hereby acknowledge and agree that the manner selected by the Corporation by which you indicate your consent to your Grant Notice is also deemed to be your execution of your Grant Notice and of this Agreement. You further agree that such manner of indicating consent may be relied upon as your signature for establishing your execution of any documents to be executed in the future in connection with your Annual Award.

11. IRREVOCABLE POWER OF ATTORNEY. You constitute and appoint the Corporation's Secretary as attorney-in-fact and agent to transfer said Common Stock on the books of the Corporation with full power of substitution in the premises, and to execute with respect to such securities and other property all documents of assignment and/or transfer and all stock certificates necessary or appropriate to make all securities negotiable and complete any transaction herein contemplated. This is a special power of attorney coupled with an interest (specifically, the Corporation's underlying security interest in retaining the shares of Common Stock in the event you do not perform the associated services for the Corporation), and is irrevocable and shall survive your death or legal incapacity. This power of attorney is limited to the matters specified in this Agreement.

12. RIGHTS AS STOCKHOLDER. Subject to the provisions of this Agreement, you shall have the right to exercise all rights and privileges of a stockholder of the Corporation with respect to the shares deposited in the Joint Escrow. You shall be deemed to be the holder of the shares for purposes of receiving any dividends that may be paid with respect to such shares and for purposes of exercising any voting rights relating to such shares, even if some or all of the shares are Unvested Shares.

13. LIMITATIONS ON TRANSFER OF THE COMMON STOCK. In addition to any other limitation on transfer created by applicable securities laws, you shall not sell, assign, hypothecate, donate, encumber, or otherwise dispose of any interest in the Common Stock while such shares of Common Stock are Unvested Shares or continue to be held in the Joint Escrow; *provided, however*, that an interest in such shares may be transferred pursuant to a qualified domestic relations order as defined in the Internal Revenue Code of 1986, as amended (the "***Code***") or Title I of the Employee Retirement Income Security Act. After any Common Stock has been released from the Joint Escrow, you shall not sell, assign, hypothecate, donate, encumber, or otherwise dispose of any interest in the Common Stock except in compliance with the provisions herein and applicable securities laws.

14. RESTRICTIVE LEGENDS. Any certificates representing the Common Stock shall have endorsed thereon appropriate legends as determined by the Corporation.

15. NON-TRANSFERABILITY OF THE ANNUAL AWARD. Your Annual Award (except for Vested Shares issued pursuant thereto) is not transferable except by will or by the laws of descent and distribution. In the event of the termination of your Board service prior to the Closing Date, the closing contemplated in this Agreement shall not occur.

16. ANNUAL AWARD NOT A SERVICE CONTRACT. Your Annual Award is not an employment or service contract, and nothing in your Annual Award shall be deemed to create in any way whatsoever any obligation on your part to continue in the service of the Corporation. In addition, nothing in your Annual Award shall obligate the Corporation, its respective stockholders, or the Board to continue any relationship that you might have as an Eligible Director.

17. WITHHOLDING OBLIGATIONS. At the time your Annual Award is granted, or at any time thereafter as requested by the Corporation, you hereby authorize withholding from any amounts payable to you, or otherwise agree to make adequate provision in cash for, any sums required to satisfy the federal, state, local and foreign tax withholding obligations of the Corporation, if any, which arise in connection with your Annual Award. In the Corporation's sole discretion, the Corporation may elect, and you hereby authorize the Corporation, to withhold Vested Shares in such amounts as the Corporation determines are necessary to satisfy your obligation pursuant to the preceding sentence.

18. TAX CONSEQUENCES. You agree to review with your own tax advisors the federal, state, local and foreign tax consequences of this investment and the transactions contemplated by this Agreement. You shall rely solely on such advisors and not on any statements or representations of the Corporation or any of its agents. You understand that you (and not the Corporation) shall be responsible for your own tax liability that may arise as a result of this investment or the transactions contemplated by this Agreement. You understand that Section 83 of the Code taxes as ordinary income to you the fair market value of the shares of Common Stock as of the date any restrictions on the shares lapse (that is, as of the date on which part or all of the shares vest). In this context, “restriction” includes the right of the Corporation to reacquire the shares pursuant to its Reacquisition Right. You understand that you may elect to be taxed on the fair market value of the shares at the time the shares are acquired rather than when and as the Corporation’s Reacquisition Right expires by filing an election under Section 83(b) of the Code with the Internal Revenue Service within thirty (30) days after the date you acquire the shares pursuant to your Annual Award. YOU ACKNOWLEDGE THAT IT IS YOUR SOLE RESPONSIBILITY, AND NOT THE CORPORATION’S, TO FILE A TIMELY ELECTION UNDER CODE SECTION 83(b), EVEN IF YOU REQUEST THE CORPORATION OR ITS REPRESENTATIVES TO MAKE THE FILING ON YOUR BEHALF. You further acknowledge that you are aware that should you file an election under Section 83(b) of the Code and then subsequently forfeit the shares, you will not be able to report as a loss the value of any shares forfeited and will not get a refund of any of the tax paid.

19. NOTICES. Any notice or request required or permitted hereunder shall be given in writing to each of the other parties hereto and shall be deemed effectively given on the earlier of (i) the date of personal delivery, including delivery by express courier, or (ii) the date that is five (5) days after deposit in the United States Post Office (whether or not actually received by the addressee), by registered or certified mail with postage and fees prepaid, addressed at the following addresses, or at such other address(es) as a party may designate by ten (10) days’ advance written notice to each of the other parties hereto:

CORPORATION:	Synopsys, Inc. 700 East Middlefield Road Mountain View, California 94043 Attn: General Counsel
YOU:	Your address as on file with the Corporation at the time notice is given
ESCROW AGENT:	Corporate Secretary Synopsys, Inc. 700 East Middlefield Road Mountain View, California 94043

20. MISCELLANEOUS.

(a) The rights and obligations of the Corporation under your Annual Award shall be transferable to any one or more persons or entities, and all covenants and agreements hereunder shall inure to the benefit of, and be enforceable by, the Corporation’s successors and assigns. Your rights and obligations under your Annual Award may only be assigned with the prior written consent of the Corporation.

(b) You agree upon request to execute any further documents or instruments necessary or desirable in the sole determination of the Corporation to carry out the purposes or intent of your Annual Award.

(c) You acknowledge and agree that you have reviewed your Annual Award in its entirety, have had an opportunity to obtain the advice of counsel prior to executing and accepting your Annual Award and fully understand all provisions of your Annual Award.

21. **GOVERNING PLAN DOCUMENT**. Your Annual Award is subject to all the provisions of the Plan, the provisions of which are hereby made a part of your Annual Award, and is further subject to all interpretations, amendments, rules and regulations which may from time to time be promulgated and adopted pursuant to the Plan. In the event of any conflict between the provisions of your Annual Award and those of the Plan, the provisions of the Plan shall control.

22. **OTHER DOCUMENTS**. You hereby acknowledge receipt or the right to receive a document providing the information required by Rule 428(b)(1) promulgated under the Securities Act. In addition, you acknowledge receipt of the Company's Insider Trading Policy.

* * * * *

This Restricted Stock Agreement shall be deemed to be signed by the Corporation and the Eligible Directors upon the signing by the Eligible Director of the Restricted Stock Grant Notice to which it is attached.

The Escrow Agent hereby acknowledges and accepts its rights and responsibilities pursuant to Section 9, above.

____

Escrow Agent

Exhibit 10.38

FORM OF SYNOPSYS, INC.
2005 NON-EMPLOYEE DIRECTORS EQUITY INCENTIVE PLAN

OPTION GRANT NOTICE
([INITIAL] [ANNUAL OR INTERIM] AWARD)

Synopsys, Inc. (the "***Corporation***"), pursuant to its 2005 Non-Employee Directors Equity Incentive Plan (the "***Plan***"), hereby grants to the Eligible Director an option to purchase the number of shares of the Corporation's Common Stock set forth below. This option is subject to the terms and conditions as set forth herein and in the Option Agreement, the Notice of Exercise, and the Plan, all of which are attached hereto and incorporated herein in their entirety.

Eligible Director:
Date of Grant:
Number of Shares Subject to Option:
Exercise Price (Per Share):
Total Exercise Price:
Expiration Date:

Type of Grant: Nonstatutory Stock Option

Exercise Schedule: [Initial Award: The shares vest and become exercisable in a series of four (4) successive equal installments as the Eligible Director continues in Board service through the date immediately preceding each of the first four (4) Annual Meetings following the Date of Grant.]

[Annual or Interim Award: The shares vest and become exercisable in a series of thirty-six (36) successive equal installments for each month the Eligible Director continues in Board service from the Date of Grant through the third anniversary of the Date of Grant.]

Payment: By one or a combination of the following items (described in the Option Agreement):

☒ By cash or check
☒ Pursuant to a broker-dealer sale and remittance procedure
☒ By delivery of already-owned shares

Additional Terms/Acknowledgements: The undersigned Eligible Director acknowledges receipt of, and understands and agrees to, this Option Grant Notice, the Option Agreement, and the Plan. Eligible Director further acknowledges that as of the Date of Grant, this Option Grant Notice, the Option Agreement, and the Plan set forth the entire understanding between Eligible Director and the Corporation regarding the option granted hereby and supersede all prior oral and written agreements on that subject.

SYNOPSYS, INC.	**ELIGIBLE DIRECTOR:**
By: ______________________	______________________
Signature	Signature
Title: ______________________	Date: ______________________
Date: ______________________	

ATTACHMENTS: Option Agreement, Notice of Exercise, and 2005 Non-Employee Directors Equity Incentive Plan

ATTACHMENT I
SYNOPSYS, INC. 2005 NON-EMPLOYEE DIRECTORS EQUITY INCENTIVE PLAN
OPTION AGREEMENT
(NONSTATUTORY STOCK OPTION)

Pursuant to your Option Grant Notice ("***Grant Notice***") and this Option Agreement, Synopsys, Inc. (the "***Corporation***") has granted you an option under its 2005 Non-Employee Directors Equity Incentive Plan (the "***Plan***") to purchase the number of shares of the Corporation's Common Stock indicated in your Grant Notice at the exercise price indicated in your Grant Notice. Defined terms not explicitly defined in this Option Agreement but defined in the Plan shall have the same definitions as in the Plan. A copy of the Plan is attached to the Grant Notice as Attachment III.

The details of your option are as follows:

1. VESTING. Subject to the limitations contained herein, your option will vest as provided in your Grant Notice, provided that vesting will cease upon the termination of your Board service.

2. NUMBER OF SHARES AND EXERCISE PRICE. The number of shares of Common Stock subject to your option and your exercise price per share referenced in your Grant Notice may be adjusted from time to time for changes in capitalization pursuant to Section IV.C of the Plan.

3. METHOD OF PAYMENT. Payment of the exercise price is due in full upon exercise of all or any part of your option. You may elect to make payment of the exercise price in cash or by check or in any other manner permitted by your Grant Notice, which may include one or more of the following:

(a) Provided that at the time of exercise the Common Stock is publicly traded on a national securities exchange, by full payment through a broker-dealer sale and remittance procedure developed under Regulation T as promulgated by the Federal Reserve Board pursuant to which you (i) shall provide irrevocable written instructions to a brokerage firm acceptable to the Corporation to effect the immediate sale of the purchased shares and remit to the Corporation, out of the sale proceeds available on the settlement date, sufficient funds to cover the aggregate exercise price payable for the purchased shares, and (ii) shall concurrently provide written directives to the Corporation to deliver the certificates for the purchased shares directly to such brokerage firm in order to complete the sale transaction.

(b) Delivery to the Corporation (either by actual delivery or attestation) of already-owned shares of Common Stock.

4. WHOLE SHARES. You may exercise your option only for whole shares of Common Stock.

5. SECURITIES LAW COMPLIANCE. Notwithstanding anything to the contrary contained herein, you may not exercise your option unless the shares of Common Stock issuable upon such exercise are then registered under the Securities Act of 1933, as amended (the "***Securities Act***") or, if such shares of Common Stock are not then so registered, the Corporation has determined that such exercise and issuance would be exempt from the registration requirements of the Securities Act. The exercise of your option also must comply with other applicable laws and regulations governing your option, and you may not exercise your option if the Corporation determines that such exercise would not be in material compliance with such laws and regulations.

6. **TERM.** You may not exercise your option before the commencement or after the expiration of its term. The term of your option commences on the Date of Grant and expires upon the earliest of the following:

(a) six (6) months after the termination of your Board service for any reason other than your death or Permanent Disability, provided that if during any part of such six (6) month period your option is not exercisable solely because of the condition set forth in Section 5, your option shall not expire until the earlier of the Expiration Date or until it shall have been exercisable for an aggregate period of six (6) months after the termination of your Board service;

(b) twelve (12) months after the termination of your Board service due to your Permanent Disability;

(c) twelve (12) months after your death if you die either during your Board service or within six (6) months after your Board service terminates; or

(d) the Expiration Date indicated in your Grant Notice, not to exceed the day before the seventh (7th) anniversary of the Date of Grant.

7. **ACCELERATION UPON DEATH OR PERMANENT DISABILITY.** In the event of your death or Permanent Disability during the period of your Board service, the option shall vest and become exercisable in that number of additional shares of Common Stock subject to the option in which you would have vested had you continued in Board service until the next Annual Meeting.

8. **EXERCISE.** You may exercise the vested portion of your option during its term by delivering a Notice of Exercise (or in another form designated by the Corporation) together with the exercise price to the Secretary of the Corporation, or to such other person as the Corporation may designate, during regular business hours, together with such additional documents as the Corporation may then require.

9. **TRANSFERABILITY.** Your option is transferable only by will or by the laws of descent and distribution and is exercisable only by you during your lifetime. However, you may transfer your option for no consideration upon written consent of the Board if, at the time of transfer, a Form S-8 registration statement under the Securities Act is available for the issuance of shares by the Corporation upon the exercise of such transferred option. Any such transfer is subject to such limits as the Board may establish, and subject to the transferee agreeing to remain subject to all the terms and conditions applicable to your option prior to such transfer. The forgoing right to transfer your option shall apply to the right to consent to amendments to the Option Agreement for such option. In addition, until you transfers the option, you may, by delivering written notice to the Corporation, in a form provided by or otherwise satisfactory to the Corporation, designate a third party who, in the event of your death, shall thereafter be entitled to exercise your option.

10. OPTION NOT A SERVICE CONTRACT. Your option is not an employment or service contract, and nothing in your option shall be deemed to create in any way whatsoever any obligation on your part to continue in the service of the Corporation. In addition, nothing in your option shall obligate the Corporation, its respective stockholders, or the Board to continue any relationship that you might have as an Eligible Director of the Corporation.

11. WITHHOLDING OBLIGATIONS. At the time you exercise your option, in whole or in part, or at any time thereafter as requested by the Corporation, you hereby authorize withholding from any amounts payable to you, or otherwise agree to make adequate provision in cash for, any sums required to satisfy the federal, state, local and foreign tax withholding obligations of the Corporation, if any, which arise in connection with the exercise of your option or the subsequent vesting of any shares acquired thereby. In the Corporation's sole discretion, the Corporation may withhold from fully vested shares of Common Stock otherwise issuable to you in such amounts as the Corporation determines are necessary to satisfy your obligation pursuant to the preceding sentence.

12. NOTICES. Any notices provided for in your option or the Plan shall be given in writing and shall be deemed effectively given upon receipt or, in the case of notices delivered by mail by the Corporation to you, five (5) days after deposit in the United States mail, postage prepaid, addressed to you at the last address you provided to the Corporation.

13. GOVERNING PLAN DOCUMENT. Your option is subject to all the provisions of the Plan, the provisions of which are hereby made a part of your option, and is further subject to all interpretations, amendments, rules and regulations, which may from time to time be promulgated and adopted pursuant to the Plan. In the event of any conflict between the provisions of your option and those of the Plan, the provisions of the Plan shall control.

14. OTHER DOCUMENTS. You hereby acknowledge receipt or the right to receive a document providing the information required by Rule 428(b)(1) promulgated under the Securities Act. In addition, you acknowledge receipt of the Company's Insider Trading Policy.

* * * * *

This Option Agreement shall be deemed to be signed by the Corporation and the Eligible Director upon the signing by the Eligible Director of the Option Grant Notice to which it is attached.

ATTACHMENT II
NOTICE OF EXERCISE

Synopsys, Inc.
700 East Middlefield Road
Mountain View, CA 94043 Date of Exercise:

Ladies and Gentlemen:

This constitutes notice under my stock option that I elect to purchase the number of shares for the price set forth below.

Type of option:	Nonstatutory
Stock option dated:	
Number of shares as to which option is exercised:	
Certificates to be issued in name of:	
Total exercise price:	$
Exercise Method:	
• Cash or check payment delivered herewith:	$
• Value of shares of Synopsys, Inc. Common Stock delivered herewith:	$
• Pursuant to a broker-dealer sale and remittance procedure	

By this exercise, I agree to provide such additional documents as you may require pursuant to the terms of the Synopsys, Inc. 2005 Non-Employee Directors Equity Incentive Plan.

Very truly yours,

____

EXHIBIT 31.1

CERTIFICATION

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 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 8, 2006

/s/ Aart J. de Geus
Aart J. de Geus
Chief Executive Officer
(Principal Executive Officer)

EXHIBIT 31.2

CERTIFICATION

I, Brian M. Beattie, certify that:

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

2. Based on my knowledge, this 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 report;

3. Based on my knowledge, the financial statements, and other financial information included in this 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 report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 8, 2006

/s/ Brian M. Beattie
Brian M. Beattie
Chief Financial Officer
(Principal Financial Officer)

EXHIBIT 32.1

Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code)

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) and Section 1350, Chapter 63 of Title 18 of the United States Code (18 U.S.C-§1350), each of Aart J. de Geus, Chief Executive Officer of Synopsys, Inc., a Delaware corporation (the “Company”), and Brian M. Beattie, Chief Financial Officer of the Company, does hereby certify, to such officer’s knowledge that:

The Quarterly Report on Form 10-Q for the fiscal quarter ended January 31, 2006 (the “Form 10-Q”) to which this Certification is attached as Exhibit 32.1 fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act. The information contained in the Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

IN WITNESS WHEREOF, the undersigned have set their hands hereto as of the 8th day of March, 2006.

/s/ Aart J. de Geus
Aart J. de Geus
Chief Executive Officer

/s/ Brian M. Beattie
Brian M. Beattie
Chief Financial Officer

The foregoing certification is being furnished solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (Subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code) and is not deemed filed with the Securities and Exchange Commission as part of the Form 10-Q or as a separate disclosure document and is not to be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.