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 APRIL 30, 2005

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)

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

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

Yes ☒ No ☐

Indicate by check mark whether the registrant is an accelerated filer (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.

143,702,268 shares of Common Stock as of May 25, 2005

SYNOPSYS, INC.
QUARTERLY REPORT ON FORM 10-Q
APRIL 30, 2005

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ITEM 1. FINANCIAL STATEMENTS

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

	APRIL 30, 2005 (unaudited)	OCTOBER 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 343,129	$ 346,709
Short-term investments	181,192	232,320
Total cash, cash equivalents and short-term investments	524,321	579,029
Accounts receivable, net of allowances of $4,931 and $7,113, respectively	134,808	132,258
Deferred income taxes	127,721	125,601
Income taxes receivable	46,521	46,583
Prepaid expenses and other current assets	32,756	29,562
Total current assets	866,127	913,033
Property and equipment, net	175,625	178,155
Long-term investments	11,030	12,831
Goodwill	667,113	593,706
Intangible assets, net	151,591	198,069
Long-term deferred income taxes	173,214	146,360
Other assets	57,597	50,033
Total assets	$ 2,102,297	$ 2,092,187
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 185,338	$ 184,146
Accrued income taxes	189,664	188,096
Deferred revenue	467,162	368,913
Total current liabilities	842,164	741,155
Deferred compensation and other liabilities	59,783	51,794
Long-term deferred revenue	28,119	34,189
Stockholders' equity:		
Common stock, $0.01 par value; 400,000 shares authorized; 143,736 and 147,378 shares outstanding, respectively	1,437	1,474
Additional paid-in capital	1,242,313	1,240,568
Retained earnings	176,841	202,146
Treasury stock, at cost; 13,409 and 9,759 shares, respectively	(237,802)	(175,762)
Deferred stock compensation	(1,330)	(2,732)
Accumulated other comprehensive loss	(9,228)	(645)
Total stockholders' equity	1,172,231	1,265,049
Total liabilities and stockholders' equity	$ 2,102,297	$ 2,092,187

See accompanying notes to unaudited condensed consolidated financial statements.

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

	THREE MONTHS ENDED APRIL 30,		SIX MONTHS ENDED APRIL 30,	
	2005	**2004**	**2005**	**2004**
Revenue:				
Time-based license	**$ 175,781**	$ 162,946	**$ 362,065**	$ 333,544
Upfront license	**17,183**	75,812	**27,981**	135,302
Service	**51,375**	55,846	**95,597**	111,022
Total revenue	**244,339**	294,604	**485,643**	579,868
Cost of revenue:				
License	**23,201**	22,192	**48,048**	42,523
Maintenance & Services	**18,423**	16,991	**35,452**	32,542
Amortization of intangible assets and deferred stock compensation	**28,099**	25,715	**56,198**	50,955
Total cost of revenue	**69,723**	64,898	**139,698**	126,020
Gross margin	**174,616**	229,706	**345,945**	453,848
Operating expenses:				
Research and development	**80,025**	70,136	**152,942**	140,473
Sales and marketing	**80,779**	74,885	**164,769**	145,631
General and administrative	**25,311**	38,474	**49,534**	67,611
In-process research & development	**—**	—	**5,700**	—
Amortization of intangible assets and deferred stock compensation	**8,829**	8,636	**17,681**	17,880
Total operating expenses	**194,944**	192,131	**390,626**	371,595
Operating income (loss)	**(20,328)**	37,575	**(44,681)**	82,253
Other income (expense), net	**1,322**	925	**6,521**	(144)
Income (loss) before income taxes	**(19,006)**	38,500	**(38,160)**	82,109
Income taxes	**(14,034)**	9,761	**(18,863)**	21,218
Net income (loss)	**$ (4,972)**	$ 28,739	**$ (19,297)**	$ 60,891
Basic earnings (loss) per share:				
Net income (loss) per share	**$ (0.03)**	$ 0.19	**$ (0.13)**	$ 0.39
Weighted-average number of common shares outstanding	**144,801**	154,806	**145,429**	155,556
Diluted earnings (loss) per share:				
Net income (loss) per share	**$ (0.03)**	$ 0.18	**$ (0.13)**	$ 0.37
Weighted-average common shares and potential common shares outstanding	**144,801**	161,840	**145,429**	163,779

See accompanying notes to unaudited condensed consolidated financial statements

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

	SIX MONTHS ENDED APRIL 30, 2005	SIX MONTHS ENDED APRIL 30, 2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	**$ (19,297)**	$ 60,891
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization and depreciation	**101,112**	96,272
In-process research and development	**5,700**	—
Write-down of long-term investments	**2,564**	1,901
Provision for or recovery of doubtful accounts	**(2,757)**	2,000
Net change in unrecognized gains and losses on foreign exchange	**(9,739)**	(5,963)
Gain on sale of short-and long-term investments	**322**	(756)
Net changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable	**7,182**	(21,731)
Income taxes receivable	**62**	22,796
Prepaid expenses and other current assets	**(2,502)**	(14,034)
Other assets	**(7,484)**	(11,219)
Accounts payable and accrued liabilities	**(14,065)**	(50,365)
Accrued income taxes	**(4,703)**	(20,186)
Deferred taxes	**(23,220)**	—
Deferred revenue	**89,556**	31,269
Deferred compensation	**7,877**	10,842
Net cash provided by operating activities	**130,608**	101,717
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from sales and maturities of short-term investments	**201,800**	533,313
Purchases of short-term investments	**(151,410)**	(516,099)
Proceeds from sale of long-term investments	**—**	300
Purchases of long-term investments	**—**	(1,254)
Purchases of property and equipment	**(21,436)**	(24,129)
Cash paid for acquisitions, net of cash received	**(91,293)**	(38,815)
Capitalization of software development costs	**(1,476)**	(1,371)
Net cash used in investing activities	**(63,815)**	(48,055)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuances of common stock	**17,208**	117,996
Purchases of treasury stock	**(85,139)**	(238,338)
Proceeds from credit facility	**—**	200,000
Payments on credit facility	**—**	(200,000)
Net cash used in financing activities	**(67,931)**	(120,342)
Effect of exchange rate changes on cash and cash equivalents	**(2,442)**	(1,505)
Net decrease in cash and cash equivalents	**(3,580)**	(68,185)
Cash and cash equivalents, beginning of period	**346,709**	524,308
Cash and cash equivalents, end of period	**$ 343,129**	$ 456,123

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, 2004 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.

Synopsys' fiscal year and second fiscal quarter ended on the Saturday nearest October 31 and April 30, respectively. Fiscal 2005 and 2004 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.

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

In the first quarter of fiscal 2005, the Company revised its methodology for allocating and reporting costs of revenue. The Company has reclassified cost of revenue for comparable periods of fiscal 2004 to conform to the fiscal 2005 allocation methodology.

2. BUSINESS COMBINATIONS

Acquisition of ISE Integrated Systems Engineering AG (ISE)

The Company acquired ISE on November 2, 2004.

Reasons for the Acquisition. ISE's Technology Computer Aided Design (TCAD) software provides process simulation and device and circuit simulation, helping semiconductor manufacturers shorten the time needed to design chips and to test those designs prior to actual manufacturing. In approving the merger agreement, Synopsys' Board considered a number of factors, including its opinions that (i) the merger of ISE's TCAD organization with Synopsys' own TCAD business would permit the introduction of a consolidated TCAD platform that addresses the challenges posed by future technologies while maintaining continuity with existing software, and (ii) the merger would enable Synopsys to help further reduce its customers' costs and manufacturing risks as they create smaller, faster and more power-efficient chips. ISE's results of operations since the date of acquisition are included in the accompanying unaudited condensed consolidated statements of operations. The Company does not consider the ISE acquisition material to its results of operations, and therefore is not presenting pro forma statements of operations for the three and six month periods ended April 30, 2005.

Purchase Price. The Company paid $100.0 million in cash on November 2, 2004 to the former shareholders of ISE. The total purchase consideration consisted of:

(in thousands)		
Cash paid	$	100,000
Acquisition-related costs		2,896
Holdback payable		5,000
Total purchase price	$	107,896

Under the acquisition agreement, the Company has also agreed to pay up to $20 million over three years to certain former shareholders of ISE now employed by Synopsys based upon achievement of certain sales and employee retention milestones. Any amounts payable under this arrangement will be accrued as compensation expense when, and if management deems it probable such amounts will have been earned by the applicable milestone dates. As of April 30, 2005 the Company has accrued $3.8 million under the agreement for probable achievement against the first year milestones.

Acquisition-related costs of $2.9 million consist primarily of legal, tax and accounting fees of $1.3 million, approximately $1.1 million of estimated facilities closure costs and other directly related charges. As of April 30, 2005, the Company had paid $1.5 million of the acquisition-related costs, including $0.7 million in professional services and $0.2 million in facilities closure costs. The $1.4 million balance remaining at April 30, 2005 primarily relates to facilities closure costs, contract terminations and tax-related services.

The Company has 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 $73.4 million. The following table summarizes the 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	$	10,527
Accounts receivable		6,983
Prepaid expenses and other current assets		763
Identifiable intangible assets		25,700
Goodwill		73,376
Other assets		1,015
Total assets acquired		118,364
Liabilities assumed		
Accounts payable and accrued liabilities		10,332
Deferred revenue		2,623
Deferred tax liabilities		3,213
Total liabilities acquired		16,168
Net assets acquired		102,196
In-process research and development		5,700
Total purchase price	$	107,896

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	$	19,100	2-5
Customer contracts		6,100	5
Non-compete agreements		500	3

The Company included amortization of the core/developed technology in cost of revenue and amortization of other intangible assets in operating expenses in its statement of operations for the three and six months ended April 30, 2005.

3. GOODWILL AND INTANGIBLE ASSETS

The Company's aggregate goodwill as of April 30, 2005 consisted of:

	(in thousands)
Balance at October 31, 2004	$ 593,706
ISE goodwill	73,376
Other adjustments	31
Balance at April 30, 2005	$ 667,113

Intangible assets as of October 31, 2004 consisted of:

	Gross Assets	Accumulated Amortization	Net Assets
		(in thousands)	
Contract rights	$ 51,700	$ 41,647	$ 10,053
Acquired core/developed technology	279,110	188,023	91,087
Covenants not to compete	10,744	5,866	4,878
Customer backlog	8,270	5,821	2,449
Customer relationships	123,540	47,579	75,961
Trademarks and trade names	18,007	14,420	3,587
Other intangibles	5,993	397	5,596
Capitalized software development costs	7,635	4,590	3,045
Total intangible assets (1)	$ 504,999	$ 308,343	$ 196,656

(1) Total intangible assets do not include $1.4 million related to foreign currency fluctuations for intangible assets which are not denominated in U.S. dollars.

Intangible assets as of April 30, 2005 consisted of:

	Gross Assets	Accumulated Amortization	Net Assets
		(in thousands)	
Contract rights	$ 51,700	$ 50,264	$ 1,436
Acquired core/developed technology	298,210	234,376	63,834
Covenants not to compete	11,244	7,392	3,852
Customer backlog	8,270	6,850	1,420
Customer relationships	129,640	58,487	71,153
Trademarks and trade names	18,007	17,421	586
Other intangibles	7,882	1,743	6,139
Capitalized software development costs	9,110	5,939	3,171
Total intangible assets	$ 534,063	$ 382,472	$ 151,591

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

	THREE MONTHS ENDED APRIL 30,		SIX MONTHS ENDED APRIL 30,	
	2005	2004	2005	2004
		(in thousands)		
Contract rights	**$ 4,308**	$ 4,308	**$ 8,616**	$ 8,616
Core/developed technology	**23,177**	21,415	**46,353**	40,806
Covenants not to compete	**760**	625	**1,526**	1,251
Customer backlog	**514**	514	**1,028**	2,545
Customer relationships	**5,454**	5,152	**10,908**	10,639
Trademarks and trade names	**1,501**	1,501	**3,002**	3,001
Other intangibles	**654**	38	**1,308**	77
Capitalized software development costs	**680**	562	**1,350**	1,088
Total intangible assets	**$ 37,048**	$ 34,115	**$ 74,091**	$ 68,023

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

	(in thousands)
Six months ending October 31, 2005	$ 38,300
Fiscal Year	
2006	47,260
2007	38,362
2008	24,263
2009 and thereafter	5,406
Total estimated future amortization of intangible assets	$ 151,591

4. 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 and replenished up to the $500 million maximum in December 2004. During the three and six months ended April 30, 2005, the Company repurchased approximately 2.6 million shares at an average price of $17.32 per share and 4.9 million shares at an average price of $17.22 per share, respectively, for a total of $85.1 million during the six months ended April 30, 2005. During the three and six months ended April 30, 2004, the Company repurchased approximately 2.2 million shares at an average price of approximately $35.59 per share and 6.8 million shares at an average price of approximately $35.28 per share, respectively, for a total of $238.0 million. As of April 30, 2005, $439.9 million remained available for further repurchase under the program.

5. 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 April 30, 2005, the Company had no outstanding borrowings under this credit facility and was in compliance with all covenants. Subsequent to the end of the quarter, the Company borrowed an aggregate of $75 million under this facility. The Company repaid such amount in full as of May 27, 2005 (*See Note 13 – Subsequent Events).*

6. COMPREHENSIVE INCOME (LOSS)

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

	THREE MONTHS ENDED APRIL 30,		SIX MONTHS ENDED APRIL 30,	
	2005	**2004**	**2005**	**2004**
		(in thousands)		
Net income (loss)	**$ (4,972)**	$ 28,739	**$ (19,297)**	$ 60,891
Unrealized gain (loss) on investments, net of tax expense of $221 and $136 for the three and six months ended April 30, 2005, respectively, and tax benefit of $(251) and $(243) for the same periods in fiscal 2004, respectively	**347**	(388)	**214**	(375)
Correction of error in accounting for certain hedging transactions, net of tax benefit of $(1,150) for the six months ended April 30, 2005(1)	**—**	—	**(1,808)**	—
Unrealized gain (loss) on currency contracts, net of tax benefit of $(1,030) and $(905) for the three and six months ended April 30, 2005, respectively, and $(916) and $(1,114) for the same periods in fiscal 2004, respectively	**(2,244)**	(1,415)	**(1,680)**	(1,721)
Reclassification adjustment for realized gain (loss) on currency contracts, net of tax benefit of $(492) and $(1,343) for the three and six months ended April 30, 2005, respectively, and $(1,134) and $(2,663) for each of the same periods in fiscal 2004, respectively	**(1,516)**	(1,753)	**(2,854)**	(4,116)
Foreign currency translation adjustment	**(972)**	(1,313)	**(2,455)**	(93)
Total comprehensive income (loss)	**$ (9,357)**	$ 23,870	**$ (27,880)**	$ 54,586

(1) See Note 11 for further explanation.

7. EARNINGS (LOSS) PER SHARE

The Company computes basic earnings (loss) per share using the weighted-average number of common shares outstanding during the period. The Company computes diluted earnings (loss) per share using the weighted-average number of common shares and potential common shares outstanding under the treasury stock method.

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

	THREE MONTHS ENDED APRIL 30,		SIX MONTHS ENDED APRIL 30,	
	2005	2004	2005	2004
	(in thousands)			
Weighted-average common shares for basic net income (loss) per share	**144,801**	154,806	**145,429**	155,556
Weighted-average dilutive stock options outstanding under the treasury stock method	**—**	7,034	**—**	8,223
Weighted-average common shares for diluted net income (loss) per share	**144,801**	161,840	**145,429**	163,779

The effect of dilutive stock options outstanding excludes approximately 30.2 million and 2.5 million stock options for the three months ended April 30, 2005 and 2004, respectively, and 41.1 million and 1.7 million stock options for the six months ended April 30, 2005 and 2004, respectively, which were anti-dilutive for net income (loss) per share calculations. No stock options were considered dilutive for the three and six months ended April 30, 2005 due to the net loss for such periods.

8. STOCK-BASED COMPENSATION

As permitted by Statement of Financial Accounting Standards No. 123 (SFAS 123), *Accounting for Stock-Based Compensation*, the Company has elected to use the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees,* to measure compensation expense for stock-based awards to employees. Accordingly, the Company generally recognizes no compensation expense with respect to stock-based awards to employees as awards are issued with exercise prices equal to the fair value of the common stock on the grant date. The Company reports the pro forma information below regarding net income (loss) and earnings (loss) per share as if the Company had accounted for employee stock awards under the fair value method as required by SFAS No. 123, as amended by Statement of Financial Accounting Standards No. 148 (SFAS 148), *Accounting for Stock-Based Compensation—Transition and Disclosure*. The fair value of these stock-based awards to employees was estimated using the Black-Scholes option pricing model, assuming no expected dividends. The weighted-average expected life, risk-free interest rate and volatility for the three and six months ended April 30, 2005 and 2004 are comparable to those for the fiscal year ended October 31, 2004.

The Company's unaudited pro forma net income (loss) and earnings (loss) per share data under SFAS 123 are as follows:

	THREE MONTHS ENDED APRIL 30,		SIX MONTHS ENDED APRIL 30,	
	2005	2004	2005	2004
	(in thousands, except per share amounts)			
Net income (loss), as reported	**$ (4,972)**	$ 28,739	**$ (19,297)**	$ 60,891
Add: Stock-based employee compensation included in net income	**560**	836	**1,137**	1,977
Deduct: Stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	**(20,298)**	(20,320)	**(40,586)**	(42,484)
Pro forma net income (loss) under SFAS 123	**$ (24,710)**	$ 9,255	**$ (58,746)**	$ 20,384
Earnings (loss) per share — basic				
As reported under APB 25	**$ (0.03)**	$ 0.19	**$ (0.13)**	$ 0.39
Pro forma under SFAS 123	**$ (0.17)**	$ 0.06	**$ (0.40)**	$ 0.13
Earnings (loss) per share — diluted				
As reported under APB 25	**$ (0.03)**	$ 0.18	**$ (0.13)**	$ 0.37
Pro forma under SFAS 123	**$ (0.17)**	$ 0.06	**$ (0.40)**	$ 0.13

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), which, under the current timetable for effectiveness, Synopsys will be required to follow beginning in its first quarter of fiscal 2006. SFAS 123R will result in the recognition of substantial compensation expense relating to the Company's employee stock options and employee stock purchase plans. As noted above, currently the Company generally does not recognize any compensation related to stock option grants the Company issues under its stock option plans or related to the discounts the Company provides under its employee stock purchase plans. Under the new rules, the Company will be required to adopt a fair-value-based method for measuring the compensation expense related to employee stock awards. The resulting substantial additional compensation expense will have a material adverse effect on the Company's reported results of operations. The Company is evaluating the requirements of SFAS 123R and expects that the adoption of SFAS 123R will have a material impact on the Company's consolidated results of operations and earnings per share. We have not yet determined the method of adoption or the effect of adopting SFAS 123R and have not determined whether the adoption will result in amounts that are different than the current pro forma disclosures under SFAS 123.The table above provides the pro forma net income (loss) and earnings (loss) per share as if the Company had used a fair-value-based method similar to one of the methods permitted under SFAS 123R to measure the compensation expense for employee stock awards during the three- and six-month periods ended April 30, 2005 and 2004.

9. 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 APRIL 30,		SIX MONTHS ENDED APRIL 30,	
	2005	2004	2005	2004
	(in thousands)			
Revenue:				
North America	**$ 129,616**	$ 156,505	**$ 261,286**	$ 316,633
Europe	**39,914**	39,817	**76,630**	88,055
Japan	**40,787**	58,704	**86,824**	97,308
Other	**34,022**	39,578	**60,903**	77,872
Consolidated	**$ 244,339**	$ 294,604	**$ 485,643**	$ 579,868

	APRIL 30, 2005	OCTOBER 31, 2004
	(in thousands)	
Property and equipment, net:		
North America	$ 152,095	$ 153,604
Other	23,530	24,551
Consolidated	$ 175,625	$ 178,155

Geographic revenue data for multi-region, multi-product transactions reflects 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 and 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 APRIL 30,		SIX MONTHS ENDED APRIL 30,	
	2005	2004	2005	2004
	(in thousands)			
Revenue:				
Galaxy Design Platform	**$ 135,125**	$ 186,993	**$ 277,654**	$ 366,388
Discovery Verification Platform	**50,619**	58,539	**102,748**	117,334
Intellectual Property	**18,703**	18,801	**34,048**	36,328
Design for Manufacturing	**25,105**	20,495	**48,563**	41,244
Professional Services & Other	**14,787**	9,776	**22,630**	18,574
Consolidated	**$ 244,339**	$ 294,604	**$ 485,643**	$ 579,868

10. RELATED PARTY TRANSACTIONS

Revenue derived from Intel Corporation and its subsidiaries in the aggregate accounted for approximately 13% of the Company's total revenue for both the three and six months ended April 30, 2005, respectively, and approximately 10% of the Company's total revenue for both the three and six months ended April 30, 2004, respectively. Andy D. Bryant, Intel Corporation's Executive Vice President and Chief Financial and Enterprise Services Officer, also served on the Company's Board of Directors between January 1999 and May 2005. Management believes all transactions between the two parties were carried out on an arm's length basis.

11. OTHER INCOME (EXPENSE)

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

	THREE MONTHS ENDED APRIL 30,		SIX MONTHS ENDED APRIL 30,	
	2005	2004	2005	2004
	(in thousands)		(in thousands)	
Interest income, net	**$ 1,980**	$ 1,615	**$ 3,773**	$ 3,082
Gain (loss) on sale of investments, net of investment write-downs	**(1,311)**	719	**(2,566)**	(641)
Foreign currency exchange gain	**91**	(23)	**2,324**	94
Correction of an error in accounting for certain hedging transactions	**—**	—	**2,958**	—
Other	**562**	(1,386)	**32**	(2,679)
Total	**$ 1,322**	$ 925	**$ 6,521**	$ (144)

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 six months ended April 30, 2005.

12. CONTINGENCIES

On August 25, 2004, a class action complaint entitled Kanekal v. Synopsys, Inc., et al., No. C-04-3580, was filed in federal district court for the Northern District of California against the Company and certain of its officers alleging violations of the Securities Exchange Act of 1934. The complaint purports to be a class action lawsuit brought on behalf of persons who acquired the Company's stock during the period December 3, 2003 through August 18, 2004. The complaint alleges that the individual defendants caused the Company to make false and misleading statements about the Company's business, forecasts and financial performance, and that certain Company officers or employees sold portions of their stock holdings while in the possession of material, adverse non-public information. The complaint does not specify the amount of damages sought. In November 2004, the Court appointed a lead plaintiff in the case. In January 2005, the lead plaintiff, the Wu Group, filed an amended complaint. The Company filed a motion to dismiss the amended complaint and a motion for sanctions in March 2005. The Court has not ruled on either motion, nor has discovery commenced in the case. In addition, no trial date has been established. While management intends to defend against these federal securities claims vigorously, and the Company does not believe that this lawsuit will have a material effect on its financial position, results of operations or cash flows, there can be no assurance as to the ultimate disposition of this lawsuit. No amount has been accrued as a loss is not considered probable or estimable.

13. SUBSEQUENT EVENTS

On May 3, 2005, Synopsys borrowed $75.0 million against its existing credit facility in connection with the acquisition of Nassda Corporation, described below. The Company repaid this amount in full as of May 27, 2005 (*See Note 5—Credit Facility*).

On May 11, 2005, the Company closed its acquisition of Nassda Corporation in an all-cash transaction for a purchase price of $7.00 per share and total payments of $200.2 million. Upon the closing date of the acquisition, Nassda had cash equivalents of $91.8 million. In addition, as required by the merger agreement, the Nassda officers, directors and employees who were defendants in the litigation between Synopsys and Nassda made settlement payments to Synopsys in the aggregate amount of $61.6 million. In approving the Nassda acquisition, the Company's Board considered a number of factors, including its opinion that the settlement of the outstanding litigation between the Company and Nassda via an acquisition on the financial terms negotiated was in the best interests of the Company and its stockholders, and that the addition of Nassda's full-chip circuit simulation and analysis software will broaden the Company's offerings of transistor level circuit simulation tools, particularly in the area of mixed-signal and memory designs.

On May 13, 2005, Steven K. Shevick, Senior Vice President and Chief Financial Officer of the Company, notified the Company that he would resign from his position with the Company to pursue an opportunity with a private company outside of the EDA industry. Mr. Shevick's resignation was not due to a disagreement with the Company known to an executive officer of the Company on any matter relating to the Company's operations, policies or practices. On May 16, 2005, the Company's Board of Directors appointed Rex S. Jackson, Senior Vice President and General Counsel of the Company, to the position of Acting Chief Financial Officer of the Company, as of the effective date of Mr. Shevick's resignation.

At the Company's Annual Meeting of Stockholders on May 23, 2005, the Company's stockholders approved the Company's 2005 Non-Employee Directors Equity Incentive Plan and the reservation of an aggregate of 300,000 shares of common stock for issuance thereunder (the Directors Plan). The Directors Plan provides for an automatic, 30,000 share option grant to each non-employee member of the Company's Board upon his or her initial appointment or election. The exercise price per share is 100% of the fair market value of the Company's common stock on the grant date and options vest in equal annual installments on the date preceding each of the first four annual meetings following the grant date, assuming continued Board service through each vesting date. In addition, upon reelection, each non-employee Board member would receive either (1) an option grant (with the number of shares determined so that the aggregate "fair value" of the grant, calculated using the option pricing model used to estimate the value of compensatory stock options in the Company's financial statements, would equal the annual cash retainer (currently $125,000) then paid to non-employee Board members) or (2) a restricted stock grant (with the number of shares subject to the award determined so that the fair market value of the restricted stock grant on the date of grant would equal the annual cash retainer then paid to non-employee Board members). The option grant or restricted stock vests in a series of 36 successive equal monthly installments from the grant date, assuming continued Board membership through each vesting date. Pursuant to the Directors Plan, the Company granted each of the six non-employee members of the Board 7,010 shares of restricted stock on May 23, 2005. The Directors Plan expires on the day immediately preceding the Company's 2007 Annual Meeting of Stockholders.

Also on May 23, 2005, the stockholders approved two amendments to the Company's Employee Stock Purchase Plan, including the international component which the Company refers to as the International Employee Stock Purchase Plan (collectively, the Purchase Plan) increasing (1) the number of common shares issuable under the Purchase Plan by 4,000,000 shares, and (2) the aggregate number of common shares purchasable on a worldwide basis by all participants on any one semi-annual purchase date from 1,000,000 shares to 2,000,000 shares. Under the Purchase Plan, 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.

In addition, on May 23, 2005, the stockholders approved an employee option exchange program by which the Company would offer to exchange stock options currently outstanding under all of its stock plans, including plans assumed in acquisitions, with exercise prices equal to or greater than $25.00 per share (the Eligible Options) for a lesser number of new options (the New Options) in accordance with specified exchange ratios. Employees are eligible to participate in the offer to exchange if they were employed by the Company or one of its subsidiaries or branches as of May 25, 2005, remain employed through the expiration date of the offer to exchange and hold Eligible Options. Our executive officers and members of our Board of Directors are not eligible to participate. The Company commenced the offer to exchange on May 25, 2005 and it is scheduled to expire on June 22, 2005, unless extended or terminated by the Company as provided in the offer materials filed with the Securities and Exchange Commission. The New Options will be accounted for using variable option accounting.

Finally, 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 (NOPA) in which the IRS claims a very large increase to our U.S. taxable income which could result in a commensurate increase in our U.S. income taxes payable. The most significant of the claimed adjustments relates to transfer pricing arrangements that we have with a foreign subsidiary. We expect to receive a Revenue Agent's Report with respect to this claim in due course in which we anticipate the IRS will assert a significant aggregate tax deficiency, plus interest and possible penalties. We believe the claimed IRS adjustments are inconsistent with applicable tax laws and that we have meritorious defenses to the proposed adjustments. Accordingly, we intend to oppose the claimed adjustments vigorously.

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 in this discussion, especially under the caption "Factors that May Affect Future Results," and elsewhere in this Form 10-Q. 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) and 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 is a world leader in electronic design automation (EDA) software 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). We also provide intellectual property (IP) and professional design services to simplify the design process and accelerate time-to-market for our customers.

Business Environment

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

Beginning in late calendar 2000, the semiconductor industry experienced its steepest and longest downturn of the past 20 years. Semiconductor industry sales dropped approximately 46% from late 2000 to early 2002 and then recovered slowly into 2003. Throughout this period, our customers took many steps to reduce their expenses, including constraining R&D and EDA expenditures, reducing the number of design engineers they employed, cutting back on their design starts, purchasing from fewer suppliers, and requiring more favorable pricing, payment and license terms from those suppliers, as well as pursuing consolidation within their own industry. Further, during this downturn, many semiconductor design companies failed or were acquired and the pace of investment in new companies declined.

The Semiconductor Industry Association (SIA) reported semiconductor industry growth of approximately 18% in 2003 and 29% in 2004. Historically, growth in semiconductor sales has been followed by growth in semiconductor R&D spending, which in turn has led to subsequent growth in EDA expenditures. We estimate R&D spending among large semiconductor companies increased approximately 10% from 2003 to 2004. However, despite expectations that prior trends would reoccur, EDA spending in 2003 and 2004 did not, in fact, track the upturn in the semiconductor industry.

We believe this occurred for a number of reasons. First, in light of the severity of the 2000-2002 downturn, we believe customers' intense focus on expense reduction continued even after the downturn ended, and that, as a result, they now generally approach spending more conservatively. Second, the consumer electronics market, where product price is a primary competitive factor, has been a key driver of the semiconductor industry's recovery. This factor has further increased pressure on our customers to control costs, including by limiting their EDA spending.

In addition to these broader trends, we believe our customers turned more cautious about their own business outlook in mid-calendar 2004 due to a number of factors, including lack of visibility into their own future results, unexpected inventory buildup in the semiconductor supply chain and concerns about the industry's growth prospects in 2005. These developments materially and adversely affected both our bookings and revenue for the third quarter and full-year fiscal 2004. Our orders for fiscal 2004 were $956 million, down from $1.37 billion in fiscal 2003. Our revenue was $1.09 billion in fiscal 2004, down from $1.18 billion in fiscal 2003, particularly impacted by our customers' increasing unwillingness to agree to the shorter payment terms we require to recognize upfront revenue and by the further license model shift described below.

Following the third quarter of fiscal 2004, we re-evaluated customer demand for upfront licenses. Recognizing our customers' increased preference for conserving cash by paying for licenses over time rather than upfront, effective in the fourth quarter of fiscal 2004 we shifted our target license mix to consist almost entirely of time-based licenses, in which customers typically pay the license fee ratably over the term of the license. As a result, upfront licenses have constituted approximately 7% or less of our license orders in each of the three quarters since this shift compared to an average of approximately 26% since the introduction of time-based licenses in August 2000 through the third quarter of fiscal 2004.

We believe this model shift meets our customers' needs, improves the predictability of our business and helps us preserve the value of our technology by reducing the need to book a given license or licenses at the end of a quarter to generate current quarter revenue. However, in the near term this shift has negatively impacted our revenue, earnings and cash flow from operations over the last three quarters, and we expect this shift will cause revenue, earnings and cash flow from operations for the third quarter and full-year fiscal 2005 to be below the comparable periods in fiscal 2004.

We continue to believe that, over the long-term, EDA spending growth will continue to depend on growth in semiconductor R&D spending and on continued growth in the overall semiconductor market. The SIA has forecasted flat semiconductor revenues in 2005 and modest growth in 2006. With this measured industry outlook, we believe EDA customers will continue to spend cautiously and focus intently on cost controls, contributing to a similarly flat environment for spending on EDA products.

Synopsys is under no obligation (and expressly disclaims 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, expect to the extent required by law.

Product Developments for the Three Months Ended April 30, 2005

During the second quarter of fiscal 2005, we announced or introduced a number of new products and related developments, including:

- We announced the beta release of our next generation physical design solution, IC Compiler, which provides concurrent physical synthesis, clock tree synthesis, routing, yield optimization and sign-off correlation for significant improvements in design performance and productivity. We expect to release IC compiler for general availability to our customers in June 2005.
- We announced Prime Rail, our comprehensive solution for timing, signal integrity and power network sign-off.
- Our DesignWare® Universal Serial Bus (USB) On-The-Go (OTG) digital core and physical interfaces IP became the first complete OTG IP solution to be certified by the USB Implementers Forum (USB-IF), helping ensure DesignWare users of interoperability with Hi-Speed USB PCs and Hi-Speed USB OTG products.
- A major Chinese foundry standardized on our Design for Manufacturing tool suite, reducing its mask turnaround time.
- Customers continued to adopt our VCS® comprehensive RTL verification solution, now including native test bench technology to offer up to 5x faster verification performance.

Financial Performance for the Three Months Ended April 30, 2005

- Our book-to-bill ratio in the second quarter of fiscal 2005 was between 1.1 and 1.2, compared to between 1.0 and 1.1 in the second quarter of fiscal 2004, driven by strong orders for our Design for Manufacturing and Verification products, through current quarter bookings were lower in absolute dollar terms.
- Revenue was $244.3 million, down 17% from $294.6 million for the three months ended April 30, 2004, primarily reflecting our fourth quarter fiscal 2004 license model shift, which significantly reduced upfront license and maintenance revenue.
- Time-based license revenue increased 8% from $162.9 million in the second quarter of fiscal 2004, to $175.8 million in the current quarter, primarily reflecting the phase-in of our further license model shift as time-based orders booked in prior periods contribute revenue to future periods.
- Upfront license revenue declined 77% from $75.8 million in the second quarter of fiscal 2004 to $17.2 million in the current quarter, reflecting our license model-driven decline in upfront license bookings from 42% in the prior quarter to 6% in the current quarter.
- For the quarter, we derived approximately 9% of our software revenue from upfront licenses and 91% from time-based licenses, versus approximately 32% and 68%, respectively, for the second quarter of fiscal 2004, reflecting our license model shift. Also as a result of this shift, for the second quarter of fiscal 2005, we derived approximately 92% of our revenue from backlog attributable to prior period time-based license bookings.
- Maintenance revenue declined by 22% from $44.5 million in the second quarter of fiscal 2004 to $34.8 million, driven by the lower level of upfront orders under our new license model (which reduces new maintenance orders since maintenance is included with the license fee in time-based licenses and not reported separately) and by non-renewal of maintenance by certain existing perpetual license customers.

- Professional service and other revenue, at $16.6 million, increased 46% from $11.4 million for the second quarter of fiscal 2004 due to the timing of formal customer acceptance of performance milestones under ongoing contracts and to the fact that our professional services staff continues to be fully booked.

- Net loss was $(5.0) million compared to net income of $28.7 million in the second quarter of fiscal 2004, primarily due to decreased upfront license revenue resulting from our further license model transition and increased sales commissions driven by higher shipments and commission rates in the current quarter, partially offset by an income tax benefit due to our loss position for the quarter.

- Net cash provided by operations for the first six months of fiscal 2005 increased to $130.6 million compared to $101.7 million for the first six months of fiscal 2004, driven primarily by a lower level of foreign income tax payments in the current period.

- We repurchased 2.6 million shares of our common stock in the second quarter for approximately $45.0 million.

Critical Accounting Policies

We base the discussion and analysis of our financial condition and results of operations upon our audited consolidated financial statements, which we prepare in accordance with accounting principles generally accepted in the United States of America. In preparing these financial statements, we must make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates based on historical experience and various other assumptions we believe are reasonable under the circumstances. Our actual results may differ from these estimates.

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

- Revenue recognition;

- Valuation of intangible assets and goodwill;

- Income taxes; and

- Allowance for doubtful accounts.

Revenue Recognition. We have designed and implemented revenue recognition policies in accordance with Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended.

With respect to software sales, we utilize three license types:

- *Technology Subscription Licenses* (TSLs) are for a finite term, on average approximately three years, and generally provide the customer limited rights to receive, or to exchange certain quantities of licensed software for, unspecified future technology. Maintenance is bundled for the term of the license and not purchased separately.

- *Term Licenses* are also for a finite term, usually three years, 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,* which 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. The annual maintenance fee for purchases under $2 million is typically calculated as a percentage of the list price of the licensed software. For purchases over $2 million, the annual maintenance fee is typically calculated as a percentage of the net license fee.

Our customers often renew their TSLs and term licenses with us prior to, and sometimes well before, expiration of the original license. In a renewal transaction, we may either replace the pre-existing arrangement with an entirely new arrangement or maintain two agreements. Where we replace the existing agreement, we supersede the original arrangement and thereafter deliver software and recognize revenue based upon the type of license reflected in the new agreement. Where we maintain two agreements, we recognize revenue on the new incremental agreement based upon the new license type purchased. If we grant extended payment terms (as discussed below), we recognize license revenue as payments become due and payable.

Customers occasionally convert their existing TSLs to perpetual licenses, paying an incremental fee which we recognize upon contract signing in accordance with AICPA Technical Practice Aid (TPA) 5100.73, assuming all other revenue recognition criteria have been met. In some situations, the contract converting the TSL to a perpetual license is modified to such an extent that a new arrangement exists. The changes to the contract may include increases or decreases in the total technology under license, changes in payment terms, changes in license terms and other pertinent factors. In these situations, we account for the entire arrangement fee as a new sale and recognize revenue when all other revenue recognition criteria have been met.

We report revenue in three categories: upfront license, time-based license and maintenance and service.

Upfront license revenue includes:

- *Perpetual licenses.* We recognize the perpetual license fee in full if, upon shipment of the software, payment terms require the customer to pay a substantial portion of the perpetual license fee within one year from shipment and all other revenue recognition criteria are met.

- *Upfront term licenses.* We recognize term license fees in full if, upon shipment of the software, payment terms require the customer to pay a substantial portion of the term license fee within one year from shipment and all other revenue recognition criteria are met.

Time-Based License (TBL) revenue includes:

- *Technology Subscription Licenses.* We typically recognize revenue from TSL license fees (which include bundled maintenance) ratably over the term of the license period. However, where we offer extended payment terms (i.e., where a substantial portion of the arrangement fee is due after one year from shipment), we recognize revenue from TSLs in an amount equal to the lesser of the ratable portion of the entire fee or customer installments as they become due and payable.

- *Term and Perpetual Licenses with Extended Payment Terms.* For term and perpetual licenses where less than a substantial portion of the term license fee is due within one year from shipment, we recognize revenue as customer installments become due and payable.

Maintenance and service revenue includes:

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

- *Professional Service Fees.* We generally recognize revenue from consulting and training services as services are performed and accepted.

We allocate revenue on software transactions (referred to as “arrangements”) involving multiple elements to each element based on the respective fair values of the elements. Our determination of fair value of each element 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 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, recognize revenue from maintenance ratably over the maintenance term and recognize consulting revenues as the related services are performed and accepted.

We make 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) our fee is fixed or determinable, and (iv) collectibility is probable. We apply these criteria as discussed below.

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

- *Delivery Has Occurred*. We deliver software to our customers physically or electronically. For physical deliveries, our 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 software.

- *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 that 75% or more of the arrangement fee be paid within one year. Where these terms apply, we regard the fee as fixed or determinable, and we recognize revenue upon delivery (assuming all other revenue recognition criteria are met). If the payment terms do not meet this standard, 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 application of other revenue accounting guidelines relating to maintenance services and arrangements that include rights to 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, 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 our credit review process or the customer's payment history, we recognize revenue on a cash-collected basis.

Description of Other Critical Accounting Policies. Other than our revenue recognition policy, which is summarized above, our critical accounting policies reflecting these estimates and judgments are described 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, 2004, filed with the SEC on January 12, 2005. We have not changed those policies since that date. Investors should therefore read this Item 2 in conjunction with that description.

Results of Operations

Revenue Background

We generate our revenue from the sale of software licenses, maintenance and professional services. Under the accounting rules and policies applicable to different kinds of licenses, *orders* we receive for software licenses and services turn into *revenue* on our income statement at varying rates. In general, our software license orders turn to revenue ratably over the license term (a "time-based license," or "TBL"; substantially all of our time-based licenses are technology subscription licenses, or "TSLs," and average approximately three years), or turn to revenue at the time the license is shipped (an "upfront license"). Maintenance orders generally turn to revenue ratably over the maintenance period. Professional service orders generally turn to revenue upon completion and customer acceptance of contractually agreed milestones. A more complete description of our revenue recognition policies can be found above under *Critical Accounting Policies.*

Our *revenue* in any fiscal quarter is equal to the sum of our time-based license, maintenance, professional service and upfront license revenue. *Time-based license* revenue in any quarter is derived almost entirely from TSL orders received and delivered in *prior* quarters; since our TSL orders generally yield revenue ratably over a typical term of three years, a TSL order contributes at most one-twelfth of its aggregate booking value into revenue in the quarter it is booked. *Maintenance* revenue in any quarter is similarly derived largely from maintenance orders received in *prior* quarters since our maintenance orders generally yield revenue ratably over a typical term of one year. *Professional Service* revenue is also derived 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. Any order or portion thereof that does not turn to revenue in the quarter in which it is received is added to our backlog and generally recognized in future periods. *Upfront license* revenue is derived directly from upfront license orders booked and shipped during the quarter.

Given the different revenue impacts of TSLs compared to upfront licenses in any given fiscal quarter, our license revenue is very sensitive to the mix of time-based and upfront licenses delivered during the quarter. A TSL order typically results in *ratable* revenue over the term of the license, yielding lower current quarter revenue. 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 shift maintenance revenue to time-based license revenue since maintenance is included in TSLs, while maintenance on upfront orders is charged and recognized 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 requested customer ship dates. Beginning in August 2000, when we adopted TSLs, we maintained a target license mix of approximately 75% TSLs and 25% upfront licenses, based on our expectations of total orders and our assessment of the demand for upfront licenses. As a result of reduced customer demand for upfront licenses as described 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.

	Q2- 2005	Q1- 2005	Q4- 2004	Q3- 2004	Q2- 2004	Q1- 2004	Q4- 2003	Q3- 2003	Q2- 2003
Upfront licenses	6%	3%	7%	20%	42%	57%	33%	21%	26%
Time-based license .	94%	97%	93%	80%	58%	43%	67%	79%	74%

In certain cases, our time-based and upfront term license agreements provide the right to re-mix a portion of the software initially licensed for other 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. However, 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 to the Company compared to licensing the individual products separately.

Total Revenue

	APRIL 30, 2005	APRIL 30, 2004	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended	$ 244.3	$ 294.6	$ (50.3)	(17)%
Six months ended	$ 485.6	$ 579.9	$ (94.3)	(16)%

The decrease in total revenue for the current periods compared to the comparable periods in fiscal 2004 was due primarily to our further license model shift begun in the fourth quarter of fiscal 2004, which significantly reduced both upfront license fees and maintenance revenue in the current periods. As a result of this shift, we expect total reported revenue under the more ratable model for the third quarter and full fiscal year 2005 to be below the comparable periods in fiscal 2004.

Time-based License Revenue

	APRIL 30, 2005	APRIL 30, 2004	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended	$ 175.8	$ 162.9	$ 12.9	8%
Percentage of total revenue................................	72%	55%		
Six months ended	$ 362.1	$ 333.5	$ 28.6	9%
Percentage of total revenue................................	75%	58%		

The increase in time-based license revenue in the three and six months ended April 30, 2005 compared to the same periods in fiscal 2004 was primarily due to our recent license model shift.

With our shift in the fourth quarter of fiscal 2004 to an almost completely ratable license model, we expect an additional phase-in period during which our TBL revenue should continue to increase in both dollar terms and as a percentage of total revenue even if the overall level of TBL orders does not grow in the near term, and could increase in the short term even if the overall level of TBL orders in any period declines. Over the long term, as we complete this further transition, we expect TBL revenue to more closely track TBL order trends.

Upfront License Revenue

	APRIL 30, 2005	APRIL 30, 2004	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended	$ 17.2	$ 75.8	$ (58.6)	(77)%
Percentage of total revenue	7%	26%		
Six months ended	$ 28.0	$ 135.3	$ (107.3)	(79)%
Percentage of total revenue	6%	23%		

The decrease in upfront license revenue, both in terms of percentage of revenue and in absolute dollar terms, for the three and six months ended April 30, 2005 compared to the same periods in fiscal 2004 was primarily due to the fact that Synopsys booked a substantially higher-than-average percentage of its orders as upfront licenses in the second quarter of fiscal 2004 and subsequently shifted to a higher ratable license mix in the fourth quarter of fiscal 2004. As a result of the license model shift, we expect upfront revenue for the third quarter and full-year fiscal 2005 to be below comparable periods in fiscal 2004 in both dollar terms and as a percentage of total revenue.

Unfilled upfront license orders were approximately $5 million at April 30, 2005 compared to $32 million as of April 30, 2004. Unfilled upfront license orders represent non-cancelable license orders that have been received from our customers for the license of our software products but were not shipped as of the end of the applicable fiscal 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; the amount of upfront software license orders received in the quarter; the amount of upfront software license orders shipped in the quarter; the degree to which upfront software license orders received are concentrated at the end of a quarter; and our operational capacity to fulfill upfront software license orders at the end of a quarter.

Service Revenue

	APRIL 30, 2005	APRIL 30, 2004	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended				
Maintenance revenue	$ 34.8	$ 44.5	$ (9.7)	(22)%
Professional service revenue	16.6	11.4	5.2	46%
Total service revenue	$ 51.4	$ 55.9	$ (4.5)	(8)%
Percentage of total revenue	21%	19%		
Six months ended				
Maintenance revenue	$ 71.0	$ 89.6	$ (18.6)	(21)%
Professional service revenue	24.6	21.4	3.2	15%
Total service revenue	$ 95.6	$ 111.0	$ (15.4)	(14)%
Percentage of total revenue	20%	19%		

Our maintenance revenue has declined due to (i) the continued shift towards TSLs, which include maintenance with the license fee and thus generate no separately recognized maintenance revenue, (ii) non-renewal of maintenance by certain customers on perpetual or other upfront licenses, and (iii) to a lesser extent, the pricing of maintenance on perpetual license transactions above $2 million, which is substantially lower than the rates on standard perpetual licenses. With our license model shift, we expect progressively more of our maintenance revenue to be included in our overall 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 adversely affect future maintenance revenue.

Professional service and other revenue increased for the three and six months ended April 30, 2005 compared to the same periods in fiscal 2004 due to timing of formal customer acceptance of performance milestones under ongoing projects and to the fact that our professional services staff continues to be fully booked. Because recognition of professional service revenue depends upon completion of contract milestones, customer schedules and other contract terms, our professional service revenue is likely to continue fluctuating quarter to quarter. Capacity constraints have limited our professional service bookings growth in the past and we expect these constraints to continue limiting our professional service bookings growth during the remainder of fiscal 2005.

Total maintenance and service revenue as a percentage of total revenue for the three and six month periods ended April 30, 2005 remained relatively stable compared to the same periods in fiscal 2004 due to the fact that total maintenance and service revenue decreased by a similar percentage as the decrease in total revenue for the current periods.

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 Service & Other.

Galaxy Design Platform. Our Galaxy Design Platform includes our logic synthesis, physical synthesis, physical design, timing analysis, signal integrity analysis and physical verification products, as well as certain analog and mixed-signal tools. Our principal products in this category are our Design Compiler® synthesis product, Physical Compiler® physical synthesis tool, IC Compiler physical design solution, Module Compiler™ data path design product, Power Compiler™ power management product, DFT Compiler™ design for test tool, JupiterXT™ design planning product, Apollo™ and Astro™ place and route products, PrimeTime®/PrimeTime® SI timing analysis products, Prime Rail timing, signal integrity and power solution, Tetra Max® test pattern generation product family, Star RXCT™ extraction product and Hercules™ physical verification tool, as well as our Milkyway™ common design data repository.

Discovery Verification Platform. Our Discovery™ Verification Platform includes our verification and simulation products. Our principal products in this category are the VCS® functional verification product, System Studio™ system level design product, Vera® testbench generator, LEDA™ design rule checker, Formality® formal verification solution, Magellan™ hybrid formal verification product, NanoSim® simulation and analysis product, HSPICE® circuit simulator and our reusable verification IP. The Discovery Platform also includes Discovery AMS, a subset of our verification technologies optimized to perform verification on analog and mixed-signal designs.

Intellectual Property. Our IP solutions include our DesignWare® Foundation Library of basic chip elements, DesignWare Verification Library of 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) and JPEG.

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

Professional Service & 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 14% and 15% of our total revenue for the three months ended April 30, 2005 and 2004, respectively, to the products to which those support services related.

	Q2-2005	Q1 2005	Q4- 2004	Q3- 2004	Q2- 2004	Q1- 2004	Q4- 2003	Q3- 2003
Galaxy Design Platform................	55%	59%	60%	61%	64%	63%	62%	64%
Discovery Verification Platform...	21	22	21	21	20	21	22	20
IP	8	6	6	7	6	6	7	8
Design for Manufacturing.............	10	10	9	7	7	7	5	5
Professional Service & Other........	6	3	4	4	3	3	4	3
Total...	100%	100%	100%	100%	100%	100%	100%	100%

For the most part, 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 revenue is recognized 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 formal customer acceptance of performance milestones under ongoing contracts.

While we expect our TSL licensing model will continue to lessen quarter-to-quarter variations in revenue in the near-term, we believe our IP and Design for Manufacturing products will, over time, account for increasing percentages of total revenue as a result of our customers' greater acceptance of and reliance upon pre-designed, pre-verified IP components and tools and technologies needed for the manufacture of very small geometry ICs.

Factors Affecting Cost of Revenues and Operating Expenses

Temporary Shutdown of Operations. During the six months ended April 30, 2005 and April 30, 2004, we temporarily shut down operations in North America for four days and three days, respectively, as a cost-saving measure, resulting in the following savings:

	SIX MONTHS ENDED APRIL 30, 2005	SIX MONTHS ENDED APRIL 30, 2004
	(in thousands)	
Cost of revenue	$ 856	$ 604
Research and development	1,889	1,372
Sales and marketing	1,169	871
General and administrative	514	423
Total	$ 4,428	$ 3,270

We did not shut down operations during the three months ended April 30, 2005 or 2004.

Functional Allocation of Operating Expenses

Historically, 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, upon a significant change in headcount (as in the case of a workforce reduction, realignment or acquisition), or as a result of other business-related factors, management reviews the allocation methodology and the expenses included in the allocation pool. Management conducted such a review with respect to the workforce realignment effective in fiscal 2004 and the ISE acquisition completed in the first quarter of fiscal 2005. The resulting expense allocations may contribute significantly to fluctuations in individual operating expenses from period to period.

Cost of Revenue

	APRIL 30 2005	APRIL 30 2004	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended				
Cost of license revenue	$ 23.2	$ 22.2	$ 1.0	5%
Cost of maintenance and service revenue	18.4	17.0	1.4	8%
Amortization of intangible assets and deferred stock compensation	28.1	25.7	2.4	9%
Total	$ 69.7	$ 64.9	$ 4.8	7%
Percentage of total revenue	29%	22%		
Six months ended				
Cost of license revenue	$ 48.0	$ 42.5	$ 5.5	13%
Cost of maintenance and service revenue	35.5	32.5	3.0	9%
Amortization of intangible assets and deferred stock compensation	56.2	51.0	5.2	10%
Total	$ 139.7	$ 126.0	$ 13.7	11%
Percentage of total revenue	29%	22%		

We divide cost of revenue into three categories: cost of license revenue, cost of maintenance and service revenue and amortization costs. In the six months ended April 30, 2005, we revised our methodology for allocating and reporting cost of revenue externally to better align costs of revenue with the appropriate revenue categories. We have reclassified cost of revenue for the six months ended April 30, 2004 to conform to the new allocation methodology. In addition, we have segregated expenses directly associated with providing consulting and training from costs of revenue associated with internal functions which provide license delivery and post-customer contract support services. Management then allocates these group costs between cost of license revenue and cost of maintenance and service revenue based on revenue reported during the quarter. In general, our total cost of revenue is relatively fixed and does 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 for providing software delivery, including 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 for 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 and Deferred Stock Compensation* below for information regarding the amount of amortization charged to cost of revenue for the relevant periods.

The dollar increases in total cost of revenue for the three and six months ended April 30, 2005 are primarily due to (i) an increase in compensation and employee benefits of $3.3 million and $6.8 million, respectively, due to our increased investment in personnel associated with our professional services organization; and (ii) an increase of $2.4 million and $5.2 million, respectively, in amortization of core/developed technology recorded as a result of our acquisitions completed during fiscal 2004 and the three and six months ended April 30, 2005. Total cost of revenue as a percentage of total revenue for the three and six months ended April 30, 2005 increased from the same periods in fiscal 2004 due to the increase in core/developed technology amortization costs and the fact that growth in costs exceeded growth in revenues, which was affected by our change to a more ratable license model in fiscal 2004.

We expect cost of revenue in total to decrease during the second half of fiscal 2005 compared to the first half primarily due to a decrease in amortization expense as amortization expenses related to core and developed technology from acquisitions completed in fiscal 2002 are completely amortized, partially offset by amortization expenses from the Nassda acquisition which will commence during the third quarter.

Operating Expenses

Research and Development

	APRIL 30, 2005	APRIL 30, 2004	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended	$ 80.0	$ 70.1	$ 9.9	14%
Percentage of total revenue	33%	24%		
Six months ended	152.9	$ 140.5	12.4	9%
Percentage of total revenue	32%	24%		

For the three months ended April 30, 2005, the increase is primarily due to (i) an increase of $4.6 million in research and development personnel and related costs as a result of acquisitions and our continued efforts to expand our investment in research and development activities, (ii) an accrual of $3.8 million in compensation expected to be due to former ISE employees now employed by Synopsys based upon probable achievement of certain sales and employee retention milestones, and (iii) an increase of $1.3 million in human resources, information technology and facilities costs reported under this line item compared to the same period in fiscal 2004 as a result of a change in allocation of certain operating expenses. See *Functional Allocation of Operating Expenses* above. This increase is moderated by a shift in hiring to lower cost geographies.

For the six months ended April 30, 2005, the increase is primarily due to (i) an increase of $8.5 million in research and development personnel and related costs as a result of acquisitions, and (ii) an accrual of $3.8 million in compensation expected to be due to former ISE employees now employed by Synopsys as described above, moderated to some extent by a shift in hiring to lower cost geographies.

The addition of research and development personnel from the Nassda acquisition will impact research and development expenses in the second half of fiscal 2005.

Sales and Marketing

	APRIL 30, 2005	APRIL 30, 2004	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended	$ 80.8	$ 74.9	$ 5.9	8%
Percentage of total revenue	33%	25%		
Six months ended	164.8	$ 145.6	$ 19.2	13%
Percentage of total revenue	34%	25%		

For the three months ended April 30, 2005, the increase is primarily due to (i) an increase of $4.2 million in sales commissions and other business performance related compensation resulting from increased shipments and meeting incentive objectives in the three months ended April 30, 2005 compared to the same period in fiscal 2004, (ii) an increase in the commission rate applied to shipments beginning in fiscal 2005, and (iii) an increase in base compensation of $3.4 million due to increased headcount when compared to the same period in fiscal 2004. These increased expenses are partially offset by a decrease of $1.7 million in employee functions and continuing cost controls applied to our marketing activities.

For the six months ended April 30, 2005, the increase is primarily due to (i) an increase of $18.0 million in sales commissions and other business performance related compensation resulting from increased shipments and meeting incentive objectives in the six months ended April 30, 2005 compared to the same period in fiscal 2004, (ii) an increase in the commission rate applied to shipments beginning in fiscal 2005 and (iii) an increase in base compensation of $3.4 million due to increased headcount when compared to the same period in fiscal 2004. This increase is partially offset by a decrease of $2.3 million in employee functions due to our decision to cancel an annual sales event in fiscal 2005 and continuing cost controls applied to our marketing activities.

General and Administrative

	APRIL 30, 2005	APRIL 30, 2004	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended	$ 25.3	$ 38.5	$ (13.2)	(34)%
Percentage of total revenue	10%	13%		
Six months ended	$ 49.5	$ 67.6	$ (18.1)	(27)%
Percentage of total revenue	10%	12%		

General and administrative expenses were higher for the three months ended April 30, 2004 than in the current quarter primarily due to (i) the $10.0 million merger termination fee paid to Monolithic System Technology, Inc. (MoSys) in the prior quarter, (ii) a net decrease of $2.0 million in bad debt expense for the current period due to successful collection efforts and changes in the provision for doubtful accounts and (iii) $1.7 million in professional services incurred in connection with the proposed acquisition of MoSys expensed in the prior quarter. The decrease in the current quarter is partially offset by an increase of $1.4 million in consulting costs related to market and internal business process analyses incurred in the second quarter of fiscal 2005.

General and administrative expenses were higher for the six months ended April 30, 2004 than the current six-month period primarily due to (i) the $10.0 million merger termination fee paid to MoSys in the prior period, (ii) a net decrease of $4.8 million in bad debt expense for the current period due to successful collection efforts and changes in the provision for doubtful accounts, (iii) $3.9 million in facilities costs in the prior period associated with the closing of facilities as planned under our workforce realignment initiated in fiscal 2003 and completed in the first quarter of fiscal 2004, and (iv) $1.7 million in professional services incurred in connection the proposed acquisition of MoSys expensed in the second quarter of fiscal 2004. The current period decrease is partially offset by (i) an increase of $2.0 million in consulting costs related to market and internal business process analyses incurred in the second quarter of fiscal 2005 and (ii) an increase of $1.1 million in depreciation expense relating to increased investment in computing infrastructure.

In-Process Research and Development. We recorded a $5.7 million in-process research and development (IPRD) charge related to our acquisition of ISE in the six months ended April 30, 2005. At the date of the ISE 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 had no IPRD charges during the three and six months ended April 30, 2004.

Amortization of Intangible Assets and Deferred Stock Compensation. Amortization of intangible assets and deferred stock compensation includes the amortization of the contract rights intangible associated with certain executory 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 and six months ended April 30, 2005. Deferred stock compensation represents the intrinsic value of unvested stock options assumed in connection with prior year acquisitions. The deferred stock compensation is amortized over the options' remaining vesting period of one to three years. Generally, amortization of deferred stock compensation will decrease over time as the assumed stock options vest. Amortization expense is included in the unaudited condensed consolidated statements of income as follows:

	APRIL 30,		**DOLLAR**	**%**
	2005	**2004**	**CHANGE**	**CHANGE**
	(dollars in millions)			
Three months ended				
Included in cost of revenue	**$ 28.1**	$ 25.7	$ 2.4	9%
Included in operating expenses	**8.8**	8.6	0.2	2%
Total	**$ 36.9**	$ 34.3	$ 2.6	8%
Percentage of total revenue	**15%**	12%		
Six months ended				
Included in cost of revenue	**$ 56.2**	$ 51.0	$ 5.2	10%
Included in operating expenses	**17.7**	17.9	(0.2)	(1)%
Total	**$ 73.9**	$ 68.9	$ 5.0	7%
Percentage of total revenue	**15%**	12%		

The increase in amortization of intangible assets and deferred compensation for the three and six months ended April 30, 2005 is primarily due to additional amortization of assets acquired in fiscal 2004 partially offset by the declining amounts of amortization related to deferred compensation recorded in prior year acquisitions. See *Note 3 to Notes to Unaudited Condensed Consolidated Financial Statements* for a schedule of future amortization amounts. Future amortization costs will be driven by future acquisitions.

Operating Margin

Our operating margin declined to approximately (8)% and (9)% in the three and six months ended April 30, 2005, respectively, compared to approximately 13% and 14% in the same periods in fiscal 2004, primarily due to (i) lower overall revenue in fiscal 2005 as a result of decreased upfront revenue following our further license model transition in the fourth quarter of fiscal 2004, (ii) higher cost of revenue to support increased field support headcount due to higher than expected utilization of our services organization, (iii) increased sales commission expense driven by higher shipments and higher commission rates in the current periods, (iv) an increase in research and development expenses primarily driven by the accrual of compensation expected to be due to former ISE employees now employed by Synopsys based upon probable achievement of certain sales and employee retention milestones, and (v) the write-off of in-process research and development expense relating to the ISE acquisition during the first quarter of fiscal 2005.

We anticipate our operating margins to improve during the second half of fiscal 2005 compared to the first half primarily due to a reduction in amortization expense for the third and fourth quarter of fiscal 2005 related to acquired intangible assets.

Other Income (Expense), Net

	APRIL 30, 2005	APRIL 30, 2004	DOLLAR CHANGE	% CHANGE
	(dollars in millions)			
Three months ended				
Interest income, net	**$ 2.0**	$ 1.6	**$ 0.4**	**25%**
Gain (loss) on sale of investments, net of write-downs	**(1.3)**	0.7	**(2.0)**	**(286)%**
Foreign Currency exchange gain/(loss)	**—**	—	**—**	**—**
Foreign Currency exchange gain from disallowed hedges	**—**	—	**—**	**—**
Other	**0.6**	(1.4)	**2.0**	**(143)%**
Total	**$ 1.3**	$ 0.9	**$ 0.4**	**44%**
Six months ended				
Interest income, net	**$ 3.8**	3.1	**0.7**	**23%**
Loss on sale of investments, net of write-downs	**(2.6)**	(0.6)	**(2.0)**	**333%**
Foreign Currency exchange gain	**2.3**	—	**2.3**	**100%**
Foreign Currency exchange gain from disallowed hedges	**3.0**	—	**3.0**	**100%**
Other	**—**	(2.7)	**2.7**	**(100)%**
Total	**$ 6.5**	(0.1)*(1)*	**6.6**	**(6600)%**

(1) May not total due to rounding.

For the six months ended April 30, 2005, the increase 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. See *Note 11* to Notes to Unaudited Condensed Consolidated Financial Statements.

Income Tax Rate

Our effective tax rate for the three and six months ended April 30, 2005 was a tax benefit rate of 73.8% and 49.4%, respectively, due to our net loss. On a quarterly basis, we estimate our annual effective tax rate at the end of the interim period. Our estimates take 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, 2005 was a tax benefit rate of 25.2% due to our net loss. Our tax benefit rate for the first quarter was lower primarily due to the recognition of a tax expense of $2.25 million arising from various state and foreign taxes which was treated as a discrete event allocable to the first quarter. In addition, changes in our estimates of annual pre-tax income (and losses) and the geographic mix of pre-tax book income (and losses) resulted in an increase in the tax benefit rate for the three months ended April 30, 2005. Our effective tax rate for the three and six months ended April 30, 2004 was a tax expense rate of 25.4% and 25.8%, respectively.

Our operations are subject to income and transaction taxes in the United States and in multiple foreign jurisdictions and to review or audit by Internal Revenue Service (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 (NOPA) in which the IRS claims a very large increase to our U.S. taxable income which could result in a commensurate increase in our U.S. income taxes payable. The most significant of the claimed adjustments relates to transfer pricing arrangements that we have with a foreign subsidiary. We expect to receive a Revenue Agent's Report with respect to this claim in due course in which we anticipate the IRS will assert a significant aggregate tax deficiency, plus interest and possible penalties. We believe the claimed IRS adjustments are inconsistent with applicable tax laws and that we have meritorious defenses to the proposed adjustments. Accordingly, we intend to oppose the claimed adjustments vigorously.

Liquidity and Capital Resources

Our source of cash, cash equivalents and short-term investments has been funds generated from our business operations, including cash on hand from companies we have acquired. Cash, cash equivalents and short-term investments decreased $54.7 million, or 9%, to $524.3 million as of April 30, 2005 from $579.0 million as of October 31, 2004.

Cash provided by operations is in part dependent upon the payment terms of our license agreements. Payment terms for time-based licenses are generally extended, with the license fee typically paid quarterly in even increments over the term of the license. Conversely, for an upfront license, we require customers pay a substantial portion of the license fee within the first year. Accordingly, we generally receive cash from time-based licenses, the primary component of our business under our now almost fully ratable license model, later than from upfront licenses.

Cash provided by operations was $130.6 million for the six months ended April 30, 2005 compared to $101.7 million for the same period in fiscal 2004. The increase of $28.9 million was driven primarily by the absence in the current period of the following payments made during the first six months of fiscal 2004: (i) tax-related cash disbursements of $32.8 million in foreign income taxes paid during the three months ended January 31, 2004, and (ii) $11.0 million in disbursements associated with foreign value added taxes receivable and maintenance contracts for our design and information systems electronic infrastructure. These reductions in disbursements were partially offset by a $16.7 million reduction in cash collections for the six months ended April 30, 2005.

Accounts receivable, net of allowances, increased $2.5 million to $134.8 million as of April 30, 2005 from $132.3 million as of October 31, 2004. Days sales outstanding, calculated based on revenue for the six months ended April 30, 2005 and accounts receivable as of April 30, 2005, decreased to 50 days as of April 30, 2005 from 53 days as of October 31, 2004.

Cash used in investing activities was $63.8 million for the six months ended April 30, 2005 compared to $48.1 million for the same period in fiscal 2004. The $15.7 million increase in cash used is due to an increase in net cash used for acquisitions of $91.3 million driven by our acquisition of ISE in the first quarter of this fiscal year, partially offset by decreases in capital expenditures of $2.7 million and net increases in sales of long and short-term investments of $34.1 million when compared to the same period of fiscal 2004.

Cash used in financing activities was $67.9 million for the six months ended April 30, 2005 compared to $120.3 million for the same period in fiscal 2004. The decrease in cash used of $52.4 million is primarily due to decreased purchases of shares of our common stock on the open market of $153.2 million, partially offset by a $100.8 million reduction 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 April 30, 2005, we held an aggregate of $158.3 million in cash, cash equivalents and short-term investments in the U.S. and an aggregate of $366.0 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 permanently 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 April 30, 2005, we had no outstanding borrowings under this credit facility and we were in compliance with all covenants. Subsequent to quarter end, on May 3, 2005, we borrowed $75.0 million under this credit facility in connection with the acquisition of Nassda Corporation described below. We repaid this amount in full as of May 27, 2005.

On May 11, 2005, we closed our acquisition of Nassda Corporation in an all-cash transaction for a purchase price of $7.00 per share and total payments of $200.2 million. Upon the closing of the acquisition, Nassda had cash and cash equivalents of $91.8 million. In addition, as required by the merger agreement, the Nassda officers, directors and employees who were defendants in the litigation between Synopsys and Nassda made settlement payments to Synopsys in the aggregate amount of $61.6 million.

We believe 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.

Factors That May Affect Future Results

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

We generate substantially all of our revenue from the semiconductor and electronics industries. Beginning in late calendar 2000, the semiconductor industry entered its steepest and longest downturn of the past 20 years. According to the Semiconductor Industry Association (SIA), the semiconductor industry grew by 18% in 2003 and 29% in 2004. Historically, growth in semiconductor sales has been followed by growth in semiconductor R&D spending, which in turn has led to growth in EDA expenditures. We estimate that R&D spending among large semiconductor companies increased approximately 10% from 2003 to 2004. However, EDA industry revenue during the semiconductor industry recovery has not tracked the growth in R&D spending. In addition, the SIA has forecasted flat revenues for the semiconductor industry in 2005 and only modest growth in 2006. These trends and forecasts could have a material adverse effect on our results of operations.

We believe that, over the long term, growth in EDA spending will continue to depend on growth in semiconductor R&D spending and of 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. In addition, 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 many customers and increased competition in the EDA industry itself. If these factors persist or 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.

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, in turn 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 result of pricing pressure on their own products and the 2000-2002 downturn, customers and potential customers are also seeking to buy more products from fewer suppliers and at reduced overall prices in an effort to reduce cost and risk. In order to succeed in this environment, we must successfully address our customers' demands for significant R&D investments by us to meet their technology requirements, while also striving to reduce their overall costs and our operating costs. Failure to manage successfully these conflicting demands would materially and adversely affect our financial condition and results of 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 2000-2002 downturn, 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. New IC design starts are a key driver of demand for EDA software.
- Fewer new companies engaged in semiconductor design are being formed or funded, and demand from existing small and medium-sized semiconductor companies has been soft. These companies have traditionally been an important source of new business for us. As a result, we have become more reliant on our established customer base for new orders.
- A number of partnerships and mergers in the semiconductor and electronics industries have occurred, and more are likely. Partnerships and 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.
- 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.

The EDA industry is highly competitive, and competition may have a material adverse effect on our business and operating results.

We compete with other EDA vendors that offer a broad range of products and services, such as Cadence Design Systems, Inc. and Mentor Graphics Corporation, and with EDA vendors that offer products focused on one or more discrete phases of the IC design process, such as Magma Design Automation, Inc., which has grown rapidly in recent years and gained a meaningful position in one of our core segments. 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:

- 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, competing technologies may reduce demand for our products and services.
- 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. Doing so requires significant engineering and development work. We can provide no assurance that we will be able to continue offering complete design flows in configurations our customers will find more attractive than our competitors' offerings or that our efforts to balance the interests of integration versus individual product performance will be successful.
- Our major initiatives face intense competition and in some cases address emerging markets. We have invested significant resources into further development of the Galaxy Design Platform, integration of the Discovery Verification Platform and enhancement of its System Verilog features and development of our Design for Manufacturing and IP portfolios. It is difficult for us to predict the success of these initiatives. If we fail to expand revenue from our new initiatives at the desired rate, our business, results of operations and financial condition would be materially and adversely affected.
- Price is an important competitive factor. Customers require a mix of price and tool performance that suits their needs; in some cases this may lead them to choose vendors based on price more than performance. In certain situations we must offer substantial discounts on our products to meet pricing set by the competition. If, as we expect, customers begin to consolidate their purchases with fewer vendors, some EDA suppliers may pursue a deep discount strategy. As a result, average prices for our products may decline. Alternatively, we may lose potential business to lower price competitors. In either case, our business, operating results and financial condition could be materially and adversely affected.

- 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, payment terms on time-based licenses lengthened compared to prior periods, negatively affecting our cash flow from operations. In addition, since cash is collected sooner on an upfront license than on a time-based license, the shift in our license mix towards more time-based licenses will adversely affect our cash flow in fiscal 2005.

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. As demonstrated following our third fiscal quarter of 2004, 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:

- Beginning in the fourth quarter of fiscal 2004, we shifted our target license mix to consist almost entirely of time-based licenses. Time-based licenses yield less current period revenue and more future period revenue than upfront licenses. The license mix shift decreased revenue for fiscal 2004 and fiscal 2005 to date and will result in lower revenue for the third quarter and full-year fiscal year 2005 compared to fiscal 2004.
- 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 customer requirements, application of accounting rules regarding revenue recognition and competitive pressures 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.
- 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 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 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.
- 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.

We expect to receive 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 (NOPA) in which the IRS claims a very large increase to our U.S. taxable income which could result in a commensurate increase in our U.S. income taxes payable. The most significant of the claimed adjustments relates to transfer pricing arrangements that we have with a foreign subsidiary. We expect to receive a Revenue Agent's Report with respect to this claim in due course in which we anticipate the IRS will assert a significant aggregate tax deficiency, plus interest and possible penalties. We believe the claimed IRS adjustments are inconsistent with applicable tax laws and that we have meritorious defenses to the proposed adjustments. Accordingly, we intend to oppose the claimed adjustments vigorously. However, there can be no assurance that we will prevail, and, if this matter is decided adversely to us and we are required to pay a significant amount of additional U.S. taxes (and applicable interest and potentially penalties) for these and subsequent tax years, our results of operations and financial condition would be materially and adversely affected.

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 three in fiscal 2005 to date, six transactions during fiscal 2004 and three transactions in fiscal 2003, and, as part of our efforts to expand our product and services offerings, we expect to acquire additional companies.

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

- Potential dilution of our earnings per share;
- Problems in integrating the acquired products with our products;
- Difficulties in retaining key employees and integrating them into our company;
- Challenges in ensuring acquired products meet our quality standards;
- Failure to realize expected synergies or cost savings;
- Failure of acquired products to achieve projected sales;
- Drain on management time for acquisition-related activities;
- Adverse effects on customer buying patterns or relationships; and
- Assumption of unknown liabilities.

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 have a positive effect on 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.

Stagnation of foreign economies, foreign exchange rate fluctuations or other international issues could adversely affect our performance.

During fiscal 2004 and the six months ended April 30, 2005, we derived 45% and 46%, respectively, of our revenue from outside North America; going forward, we expect our overall orders and revenue targets will continue to depend on substantial contributions from outside North America. 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 could adversely affect our performance by reducing the amount of revenue derived from outside North America.

Our operating results are also affected by fluctuations in foreign currency exchange rates. Our results of operations can be adversely affected when, as has been the case recently, the U.S. dollar weakens relative to other currencies, particularly the Euro, the Japanese yen and, to a lesser extent, 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, we can provide no assurance that our hedging transactions will be effective.

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

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, including employees who have joined Synopsys in connection with acquisitions, 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 generally to reduce the rate at which companies, including Synopsys, issue stock options to employees. We expect that the implementation of accounting rules that will require us to recognize on our income statement compensation expense from employee stock options and our employee stock purchase plan and which we will be required to adopt in the first quarter of fiscal 2006, will increase stockholder pressure to limit future option grants.

In addition, a substantial portion of the outstanding stock options held by employees have exercise prices above the market price of our stock (i.e., they are “underwater”), which has decreased the value of these options as an employee retention tool. Although our stockholders have approved, and we have launched, an employee stock option exchange program by which significantly underwater options may be exchanged for a lesser number of new options priced at current fair market value and with a new vesting period, the failure to obtain stockholder approval to issue new options in the future could lead to higher employee turnover and it will make it more difficult to attract, retain and motivate employees, any of which could materially and adversely affect our business, results of operations and financial condition.

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. 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 and expensive 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 the licensed 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 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.

We are subject to changes in financial accounting standards, which may adversely affect our reported financial results or the way we conduct business.

Accounting policies affecting software revenue recognition have been the subject of frequent interpretations, significantly affecting the way we license our products. Future changes in financial accounting standards, including pronouncements relating to revenue recognition, may have a significant effect on our reported results, including reporting of transactions completed before the effective date of the changes.

In December 2004, the FASB issued statement of Financial Accounting standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), which, under the current timetable for effectiveness, will be effective in our first quarter of fiscal 2006. SFAS 123R will result in our recognition of substantial compensation expense relating to our employee stock options and employee stock purchase plans. Synopsys currently uses the intrinsic value method to measure compensation expense for stock-based awards to our employees. Under this standard, we generally do not recognize any compensation related to stock option grants we issue under our stock option plans or the discounts we provide under our employee stock purchase plans. Under the new rules, we are required to adopt a fair value-based method for measuring the compensation expense related to employee stock awards; this will lead to substantial additional compensation expense and will have a material adverse effect on our reported results of operations. *Note 8 to our Unaudited Condensed Consolidated Financial Statements* in this report provides our pro forma net income and earnings per share as if we had used a fair value-based method similar to the methods required under SFAS 123R to measure the compensation expense for employee stock awards during the periods presented.

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, which monitors the accounting practices of public companies. 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 report for our fiscal year ending October 31, 2005. This effort has required, and continues to require, the commitment of significant financial and managerial resources. Although we believe that our ongoing review of our internal controls will enable us to provide a favorable assessment of our internal controls and for our external auditors to provide their attestation as of October 31, 2005, as required by Section 404, we can give no assurance that these efforts will be completed on a timely and successful basis. 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.

Computer viruses, intrusion attempts on our information technology infrastructure and "denial of service" attacks could seriously disrupt our business operations.

"Hackers" and others have in the past created a number of computer viruses or otherwise initiated "denial of service" attacks on computer networks and systems. Our information technology infrastructure is regularly subject to various attacks and intrusion efforts of differing seriousness and sophistication. While we diligently maintain our information technology infrastructure and continuously implement protections against such viruses or intrusions, if our defensive measures fail or should similar defensive measures by our customers fail, our business could be materially and adversely affected.

If export controls affecting our products are expanded, our business will be adversely affected.

The U.S. Department of Commerce regulates the sale and shipment of certain technologies by U.S. companies to foreign countries. To date, we believe we have successfully complied with applicable export regulations. However, if the Department of Commerce places significant export controls on our existing, future or acquired products, our business would be materially and adversely affected.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk. Our exposure to market risk for changes in interest rates relates primarily to our short-term investment portfolio. The primary objective of our investment activities is to preserve the principal while at the same time maximizing yields without significantly increasing the risk. To achieve this objective, we maintain our portfolio of cash equivalents and investments in a mix of tax-exempt and taxable instruments that meet high credit quality standards, as specified in our investment policy. None of our investments are held for trading purposes. Our policy also limits the amount of credit exposure to any one issue, issuer and type of instrument.

The following table presents the carrying value and related weighted-average total return for our investment portfolio. The carrying value approximates fair value as of April 30, 2005.

	FAIR VALUE	WEIGHTED AVERAGE TOTAL RETURN
	(in thousands)	
Short term investments — US	$ 91,651	0.62%
Money market funds — US	65,394	1.36
Short term investments — International	89,541	2.31
Cash equivalent investments — International	16,698	2.31
Cash deposits and money market funds — International	220,951	2.53
Total interest bearing instruments	$ 484,235	1.96%

As of April 30, 2005, the stated maturities of our current short-term investments are $87.3 million within one year, $46.1 million within one to five years, $1.8 million within five to ten years and $46.0 million after ten years. This compares to the stated maturities of our current short-term investments and cash equivalents as of October 31, 2004, which were $99.9 million within one year, $93.1 million within one to five years, $10.3 million within five to ten years and $44.9 million after ten years. However, in accordance with our investment policy, the weighted-average effective duration of our total invested funds does not exceed one year. These investments are classified as available-for-sale and are recorded on the balance sheet at fair market value with unrealized gains or losses reported as a separate component of accumulated other comprehensive income (loss), net of tax.

The following table presents the amounts of our cash equivalents and investments that are subject to interest rate risk by calendar year of expected maturity and average interest rates:

April 30, 2005 (in thousands)	2005	2006	2007	2008	Total	Fair Value
Cash equivalents (variable rate)	$ 303,043				$ 303,043	$ 303,043
Average interest rate	2.49%					
Short-term investments (variable rate)	$ 44,059	$ 6,094	$ 10,130	$ 949	$ 61,232	$ 61,232
Average interest rate	2.96%	2.98%	3.00%	3.32%		
Short-term investments (fixed rate)	$ 68,899	$ 39,464	$ 11,597		$ 119,960	$ 119,960
Average interest rate	1.75%	2.06%	3.22%			

Foreign Currency Risk. The functional currency of each of Synopsys' foreign subsidiaries is the foreign subsidiary's local currency, except for our principal Irish, Bermuda and Swiss subsidiaries whose functional currencies are the U.S. dollar. We engage in programs to hedge (i) those currency exposures associated with certain assets and liabilities denominated in non-functional currencies, and (ii) forecasted intercompany and third party accounts receivable, backlog and accounts payable denominated in non-functional currencies. Our hedging activities are intended to offset the impact of currency fluctuations on the value of these balances and expenses.

We designate a portion of our forward contracts as cash flow hedges under FAS133 and record unrealized gains and losses on these contracts in accumulated other comprehensive income until the forecasted exposure is recognized on the balance sheet. The ineffective portion of our cash flow hedges is measured each period and recognized currently in earnings.

In the first quarter of fiscal 2005, Synopsys 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 Synopsys' hedging program. To correct the error, Synopsys reclassified the remaining $3.0 million related to the disallowed hedges from accumulated other comprehensive income to other income in the three months ended January 31, 2005.

The success of our hedging activities depends upon the accuracy of our estimates. Looking forward, to the extent our estimates of various balances denominated in non-functional currencies proves inaccurate, we will not be completely hedged, and we will record a gain or loss, depending upon the nature and extent of such inaccuracy. We can provide no assurance that our hedging transactions will be effective.

Foreign currency contracts entered into in connection with our hedging activities contain credit risk in that the counterparty may be unable to meet the terms of the agreements. We have limited these agreements to major financial institutions to reduce this credit risk. Furthermore, we monitor the potential risk of loss with any one financial institution. We do not enter into forward contracts for speculative purposes.

The following table provides information about our foreign currency contracts as of April 30, 2005. None of our forward contracts has duration longer than one year. As of April 30, 2005, the fair value of our forward contracts was $(0.26) million.

	AMOUNT IN U.S. DOLLARS (in thousands)	WEIGHTED AVERAGE CONTRACT RATE
Notional Forward Contract Values:		
Japanese yen	50,996	105.39
Euro	34,469	0.7629
Canadian dollar	13,466	1.23809
Chinese renminbi	3,405	8.2235
Israeli shekel	2,815	4.3678
Singapore dollar	2,804	1.64452
British pound sterling	1,511	0.52408
Taiwan dollar	940	31.1126
Swiss Franc	887	1.18638
Indian Rupee	771	43.75
Sweden Korna	648	7.0358
Korean Won	481	999.50
TOTAL	$ 113,193	

Net unrealized gains of approximately $3.2 million and $9.6 million, net of tax, as of April 30, 2005 and October 31, 2004, respectively, are included in accumulated other comprehensive income (loss) on our unaudited condensed consolidated balance sheet. Net cash outflows on maturing forward contracts during the three months ended April 30, 2005 were $0.8 million.

Equity Risk. Our strategic investment portfolio consists at April 30, 2005 of approximately $11.0 million of minority equity investments in publicly traded and privately held companies. The securities of publicly traded companies are classified as available-for-sale securities accounted for under Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and are reported at fair value, with unrealized gains or losses, net of tax, recorded as a component of other comprehensive income (loss) in stockholders' equity. The cost basis of securities sold is based on the specific identification method. The securities of privately held companies are reported at the lower of cost or fair value. During the three and six months ended April 30, 2005, we reduced the value of our strategic investment portfolio by $1.0 and $2.6 million, respectively, for certain investments we determined were impaired. Our accounting policies covering our strategic investments are described 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, 2004.

ITEM 4. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures.* As of April 30, 2005 (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. Subject to these limitations, the Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, the disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the reports Synopsys files and submits under the Exchange Act is recorded, processed, summarized and reported as and when required.

(b) *Changes in Internal Controls.* There were no changes in Synopsys' internal control over financial reporting during the three months ended April 30, 2005 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

On August 25, 2004, a class action complaint entitled Kanekal v. Synopsys, Inc., et al., No. C-04-3580, was filed in federal district court for the Northern District of California against Synopsys and certain of our officers alleging violations of the Exchange Act. The complaint purports to be a class action lawsuit brought on behalf of persons who acquired Synopsys stock during the period of December 3, 2003 through August 18, 2004. The complaint alleges that the individual defendants caused Synopsys to make false and misleading statements about Synopsys' business, forecasts, and financial performance, and that certain Synopsys officers or employees sold portions of their stock holdings while in the possession of adverse, non-public information. The complaint does not specify the amount of damages sought. In November 2004, the Court appointed a lead plaintiff in the case. In January 2005, the lead plaintiff, the Wu Group, filed an amended complaint. Synopsys filed a motion to dismiss the amended complaint and a motion for sanctions in March 2005. The Court has not ruled on either motion, nor has discovery commenced in the case. In addition, no trial date has been established. While management intends to defend against these federal securities claims vigorously, and Synopsys does not believe that this lawsuit will have a material effect on Synopsys' financial position, results of operations or cash flows, there can be no assurance as to the ultimate disposition of this lawsuit.

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 fiscal quarter ended April 30, 2005.

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				
January 30, 2005 through March 5, 2005	1,133,572	$ 17.6433	1,133,572	$ 464,842,812
Month #2				
March 6, 2005 through April 2, 2005	—		—	464,842,812
Month #3				
April 3, 2005 through April 30, 2005	1,464,000	17.0641	1,464,000	439,860,971
Total	2,597,572	$ 17.3169	2,597,572	$ 439,860,971

(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 renewed in December 2002, December 2003 and December 2004, the latest renewal of which was effective and announced on December 1, 2004. Funds are available until expended or until the program is suspended by the Chief Financial Officer or the Board of Directors.

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.

10.1 Form of Indemnification Agreement for directors and executive officers.

10.2 Synopsys Executive Incentive Plan dated April 20, 2005(3)

10.3	FY05 Individual Compensation Plan for Principal Sales Officer dated April 20, 2005(3)(4)
10.4	Employee Stock Purchase Plan, as amended(3)(5)
10.5	International Employee Stock Purchase Plan, as amended(5)
10.6	2005 Non-Employee Director Equity Incentive Plan(3)(5)
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. (6)

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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) Compensatory plan or agreement in which an executive officer or director participates.

(4) Incorporated by reference from exhibit to Current Report on Form 8-K filed with the Securities and Exchange Commission on May 27, 2005.

(5) Incorporated by reference from exhibit to Registration Statement on Form S-8 filed with the Securities and Exchange Commission on May 25, 2005.

(6) 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/ Steven K. Shevick

Steven K. Shevick
Senior Vice President, Finance
and Chief Financial Officer
(Principal Financial Officer)

Date: May 27, 2005

EXHIBIT INDEX

Exhibit No.	Description
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.
10.1	Form of Indemnification Agreement for directors and executive officers.
10.2	Synopsys Executive Incentive Plan dated April 20, 2005(3)
10.3	FY05 Individual Compensation Plan for Principal Sales Officer dated April 20, 2005(3)(4)
10.4	Employee Stock Purchase Plan, as amended(3)(5)
10.5	International Employee Stock Purchase Plan, as amended(5)
10.6	2005 Non-Employee Director Equity Incentive Plan(3)(5)
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. (6)

---

(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) Compensatory plan or agreement in which an executive officer or director participates.

(4) Incorporated by reference from exhibit to Current Report on Form 8-K filed with the Securities and Exchange Commission on May 27, 2005.

(5) Incorporated by reference from exhibit to Registration Statement on Form S-8 filed with the Securities and Exchange Commission on May 25, 2005.

(6) 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.

Exhibit 10.1

SYNOPSYS, INC.

INDEMNIFICATION AGREEMENT

THIS INDEMNIFICATION AGREEMENT ("Agreement") is made and entered into as of ______________, ________ by and between **SYNOPSYS, INC.,** a Delaware corporation (the "Company"), and ___________________________ ("Indemnitee").

RECITALS

WHEREAS, Indemnitee performs a valuable service to the Company in his or her capacity as a director of the Company;

WHEREAS, the stockholders of the Company have adopted bylaws (the "Bylaws") providing for the indemnification of the officers, directors, employees and other agents of the Company, including persons serving at the request of the Company in such capacities with other companies or enterprises, to the maximum extent authorized by the Delaware General Company Law, as amended (the "Code");

WHEREAS, the Bylaws and the Code, by their non-exclusive nature, permit contracts between the Company and the members of its Board of Directors, officers, employees and other agents with respect to indemnification of such persons; and

WHEREAS, in order to induce Indemnitee to continue to serve as a director of the Company, the Company has determined and agreed to enter into this Agreement with Indemnitee.

NOW, THEREFORE, in consideration of Indemnitee's continued service as a director after the date hereof, and for other good and valid consideration, the receipt and adequacy of which is hereby acknowledged, the parties hereto agree as follows:

AGREEMENT

1. Services to the Company. Indemnitee will serve as a director of the Company or as a director, officer or other fiduciary of a Subsidiary of the Company (including any employee benefit plan of the Company) (as defined below) faithfully and to the best of his or her ability so long as he or she is duly elected and qualified in accordance with the provisions of the Bylaws or other applicable charter documents of the Company or such Subsidiary; *provided, however,* that Indemnitee may at any time and for any reason resign from such position (subject to any contractual obligation that Indemnitee may have assumed apart from this Agreement). For purposes of this Agreement, "Subsidiary" means any corporation of which more than 50% of the outstanding voting securities are owned directly or indirectly by the Company, by the Company and one or more other subsidiaries, or by one or more other subsidiaries.

2. Indemnification of Indemnitee. The Company hereby agrees to hold harmless and indemnify Indemnitee to the fullest extent authorized or permitted by the provisions of the Bylaws and the Code, as the same may be amended from time to time (but, only to the extent that such amendment permits the Company to provide broader indemnification rights than the Bylaws or the Code permitted prior to adoption of such amendment).

3. Additional Indemnity. In addition to and not in limitation of the indemnification otherwise provided for herein, and subject only to the exclusions set forth in Section 4 hereof, the Company hereby further agrees to hold harmless and indemnify Indemnitee:

(a) against any and all expenses (including attorneys' fees), witness fees, damages, judgments, fines and amounts paid in settlement actually and reasonably incurred by Indemnitee and any other amounts that Indemnitee becomes legally obligated to pay because of any claim or claims made against or by him or her in connection with any threatened, pending or completed action, suit or proceeding, whether civil, criminal, arbitrational, administrative or investigative (including an action by or in the right of the Company) to which Indemnitee is, was or at any time becomes a party, or is threatened to be made a party, by reason of the fact that Indemnitee is, was or at any time becomes a director, officer, employee or other agent of Company or a Subsidiary, or is or was serving or at any time serves at the request of the Company as a director, officer, employee or other agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise; and

(b) otherwise to the fullest extent as may be provided to Indemnitee by the Company under the non-exclusivity provisions of the Code and the Bylaws.

4. Limitations on Additional Indemnity. No indemnity pursuant to Section 3 hereof shall be paid by the Company:

(a) in respect to remuneration paid to Indemnitee if it shall be determined by a final judgment or other final adjudication that such remuneration was in violation of law;

(b) on account of any claim against Indemnitee for an accounting of profits made from the purchase or sale by Indemnitee of securities of the Company pursuant to the provisions of Section 16(b) of the Securities Exchange Act of 1934 and amendments thereto or similar provisions of any federal, state or local statutory law;

(c) on account of Indemnitee's conduct that is established by a final judgment as knowingly fraudulent or deliberately dishonest or that constituted willful misconduct;

(d) on account of Indemnitee's conduct that is established by a final judgment as constituting a breach of Indemnitee's duty of loyalty to the Company or resulting in any personal profit or advantage to which Indemnitee was not legally entitled;

(e) for which payment is actually made to Indemnitee under a valid and collectible insurance policy or under any valid and enforceable non-Company indemnity clause, bylaw or agreement, except in respect of any excess beyond payment under such insurance, clause, bylaw or agreement;

(f) if indemnification is not lawful (and, in this respect, both the Company and Indemnitee have been advised that the Securities and Exchange Commission believes that indemnification for liabilities arising under the federal securities laws is against public policy and is, therefore, unenforceable and that claims for indemnification should be submitted to appropriate courts for adjudication);

(g) if the action, suit or proceeding with respect to which a claim for indemnity hereunder is made arose from or is based upon any of the following:

(i) any solicitation of proxies by Indemnitee, or by a group of which he or she was or became a member consisting of two or more persons that had agreed (whether formally or informally and whether or not in writing) to act together for the purpose of soliciting proxies, in opposition to any solicitation of proxies approved by the Board of Directors; or

(ii) any activities by Indemnitee that constitute a breach of or default under any agreement between Indemnitee and the Company; or

(h) in connection with any proceeding (or part thereof) initiated by Indemnitee, or any proceeding by Indemnitee against the Company or any Subsidiary or the directors, officers, employees or other agents of the Company or any Subsidiary, including, but not limited to, an action described under Section 8(c)(ii) herein, unless (i) such indemnification is expressly required to be made by law, (ii) the proceeding was authorized by the Board of Directors of the Company, (iii) such indemnification is provided by the Company, in its sole discretion, pursuant to the powers vested in the Company under the Code, or (iv) the proceeding is initiated pursuant to Section 9 hereof.

5. Contribution. If the indemnification provided in Sections 2 and 3 hereof is unavailable by reason of a court decision described in Section 4(f) hereof based on grounds other than any of those set forth in Sections 4(a), (b), (c), (d), (e), (g) or (h) hereof, then in respect of any threatened, pending or completed action, suit or proceeding in which the Company is jointly liable with Indemnitee (or would be if joined in such action, suit or proceeding), the Company shall contribute to the amount of expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred and paid or payable by Indemnitee in such proportion as is appropriate to reflect (i) the relative benefits received by the Company on the one hand and Indemnitee on the other hand from the transaction from which such action, suit or proceeding arose, and (ii) the relative fault of the Company on the one hand and of Indemnitee on the other in connection with the events which resulted in such expenses, judgments, fines or settlement amounts, as well as any other relevant equitable considerations. The relative fault of the Company on the one hand and of Indemnitee on the other shall be determined by reference to, among other things, the parties' relative intent, knowledge, access to information and opportunity to correct or prevent the circumstances resulting in such expenses, judgments, fines or settlement amounts. The Company agrees that it would not be just and equitable if contribution pursuant to this Section 6 were determined by pro rata allocation or any other method of allocation, which does not take account of the foregoing equitable considerations.

6. Notification and Defense of Claim. Not later than thirty (30) days after receipt by Indemnitee of notice of the commencement of any action, suit or proceeding, Indemnitee will, if a claim in respect thereof is to be made against the Company under this Agreement, notify the Company of the commencement thereof; but Indemnitee's omission so to notify the Company will not relieve the Company from any liability which the Company may have to Indemnitee otherwise than under this Agreement. With respect to any such action, suit or proceeding as to which Indemnitee notifies the Company of the commencement thereof:

(a) the Company will be entitled to participate therein at its own expense;

(b) except as otherwise provided below, the Company may, at its option and jointly with any other indemnifying party similarly notified and electing to assume such defense, assume the defense thereof, with counsel reasonably satisfactory to Indemnitee. After notice from the Company to Indemnitee of its election to assume the defense thereof, the Company will not be liable to Indemnitee under this Agreement for any legal or other expenses subsequently incurred by Indemnitee in connection with the defense thereof except for reasonable costs of investigation or otherwise as provided below. Indemnitee shall have the right to employ separate counsel in such action, suit or proceeding but the fees and expenses of such counsel incurred after notice from the Company of its assumption of the defense thereof shall be at the expense of Indemnitee unless (i) the employment of counsel by Indemnitee has been authorized by the Company, (ii) Indemnitee shall have reasonably concluded, and so notified the Company, that there may be a conflict of interest between the Company and Indemnitee in the conduct of the defense of such action or (iii) the Company shall not in fact have employed counsel to assume the defense of such action, in each of which cases the fees and expenses of Indemnitee's separate counsel shall be at the expense of the Company. The Company shall not be entitled to assume the defense of any action, suit or proceeding brought by or on behalf of the Company or as to which Indemnitee shall have made the conclusion provided for in clause (ii) above; and

(c) the Company shall not be liable to indemnify Indemnitee under this Agreement for any amounts paid in settlement of any action or claim effected without its written consent. The Company shall be permitted to settle any action except that it shall not settle any action or claim in any manner which would impose any penalty or limitation on Indemnitee without Indemnitee's written consent.

7. Advancement and Repayment of Expenses.

(a) In the event that Indemnitee employs his or her own counsel pursuant to Sections 7(b) above, the Company shall advance to Indemnitee, prior to any final disposition of any threatened or pending action, suit or proceeding, whether civil, criminal, administrative or investigative, any and all reasonable expenses (including legal fees and expenses) incurred in investigating or defending any such action, suit or proceeding within ten (10) days after receiving from Indemnitee copies of invoices presented to Indemnitee for such expenses.

(b) Indemnitee agrees that Indemnitee will reimburse the Company for all reasonable expenses paid by the Company in investigating or defending any civil or criminal action, suit or proceeding against Indemnitee in the event and only to the extent it shall be ultimately determined by a final judicial decision (from which there is no right of appeal) that Indemnitee is not entitled, under the provisions of the Code, the Bylaws, this Agreement or otherwise, to be indemnified by the Company for such expenses.

(c) Notwithstanding the foregoing, the Company shall not be required to advance such expenses to Indemnitee in respect of any action arising from or based upon any of the matters set forth in subsection (h) of Section 4 or if Indemnitee (i) commences any action, suit or proceeding as a plaintiff unless such advance is specifically approved by a majority of the Board of Directors or (ii) is a party to an action, suit or proceeding brought by the Company and approved by a majority of the Board which alleges willful misappropriation of corporate assets by Indemnitee, disclosure of confidential information in violation of Indemnitee's fiduciary or contractual obligations to the Company, or any other willful and deliberate breach in bad faith of Indemnitee's duty to the Company or its shareholders.

8. Enforcement. Any right to indemnification or advances granted by this Agreement to Indemnitee shall be enforceable by or on behalf of Indemnitee in any court of competent jurisdiction if (i) the claim for indemnification or advances is denied, in whole or in part, or (ii) no disposition of such claim is made within ninety (90) days of request therefor. Indemnitee, in such enforcement action, if successful in whole or in part, shall be entitled to be paid also the expense of prosecuting his or her claim. It shall be a defense to any action for which a claim for indemnification is made under Sections 2 and 3 hereof (other than an action brought to enforce a claim for expenses pursuant to Section 8 hereof, *provided that* the required undertaking has been tendered to the Company) that Indemnitee is not entitled to indemnification because of the limitations set forth in Section 4 hereof. Neither the failure of the Company (including its Board of Directors or its stockholders) to have made a determination prior to the commencement of such enforcement action that indemnification of Indemnitee is proper in the circumstances, nor an actual determination by the Company (including its Board of Directors or its stockholders) that such indemnification is improper shall be a defense to the action or create a presumption that Indemnitee is not entitled to indemnification under this Agreement or otherwise.

9. **Subrogation.** In the event of payment under this Agreement, the Company shall be subrogated to the extent of such payment to all of the rights of recovery of Indemnitee, who shall execute all documents required and shall do all acts that may be necessary to secure such rights and to enable the Company effectively to bring suit to enforce such rights.

10. **Continuation of Obligations.** All agreements and obligations of the Company contained herein shall commence upon the date that Indemnitee first became a member of the Board of Directors or an officer, employee or agent of the Company or any Subsidiary, as the case may be, and shall continue during the period Indemnitee is a director, officer, employee or agent of the Company or any Subsidiary (or is or was serving at the request of the Company as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise) and shall continue thereafter so long as Indemnitee shall be subject to any possible claim or threatened, pending or completed action, suit or proceeding, whether civil, criminal or investigative, by reason of the fact that Indemnitee was a director, officer, employee or agent of the Company or any Subsidiary or serving in any other capacity referred to herein.

11. **Non-Exclusivity of Rights.** The rights conferred on Indemnitee by this Agreement shall not be exclusive of any other right which Indemnitee may have or hereafter acquire under any statute, provision of the Company's Certificate of Incorporation or Bylaws, agreement, vote of stockholders or directors, or otherwise, both as to action in his or her official capacity and as to action in another capacity while holding office; provided, however, that this Agreement shall supersede and replace any prior indemnification agreements entered into by and between the Company and Indemnitee and that any such prior indemnification agreement shall be terminated upon the execution of this Agreement.

12. **Separability.** Each of the provisions of this Agreement is a separate and distinct agreement and independent of the others, so that if any provision hereof shall be held to be invalid or unenforceable for any reason, such invalidity or unenforceability shall not affect the validity or enforceability of the other provisions hereof. Furthermore, if this Agreement shall be invalidated in its entirety on any ground, then the Company shall nevertheless indemnify Indemnitee to the fullest extent provided by the Bylaws, the Code or any other applicable law.

13. **Governing Law.** This Agreement shall be interpreted and enforced in accordance with the laws of the State of Delaware.

14. **Binding Effect.** This Agreement shall be binding upon Indemnitee and upon the Company, its successors and assigns, and shall inure to the benefit of Indemnitee, his or her heirs, personal representatives and assigns and to the benefit of the Company, its successors and assigns.

15. **Amendment and Termination.** No amendment, modification, termination or cancellation of this Agreement shall be effective unless it is in writing and is signed by both parties hereto.

16. **Counterparts.** This Agreement may be executed in one or more counterparts, each of which shall for all purposes be deemed to be an original but all of which together shall constitute but one and the same Agreement. Only one such counterpart need be produced to evidence the existence of this Agreement.

17. **Headings.** The headings of the sections of this Agreement are inserted for convenience only and shall not be deemed to constitute part of this Agreement or to affect the construction hereof.

18. **Notices.** All notices, requests, demands and other communications hereunder shall be in writing and shall be deemed to have been duly given (i) upon delivery if delivered by hand to the party to whom such communication was directed or (ii) upon the third business day after the date on which such communication was mailed if mailed by certified or registered mail with postage prepaid:

(a) If to Indemnitee, at the address indicated on the signature page hereof.

(b) If to the Company, to:

Vice President and General Counsel
Synopsys, Inc.
700 East Middlefield Road
Building C
Mountain View, CA 94043-4033

or to such other address as may have been furnished to Indemnitee by the Company.

IN WITNESS WHEREOF, the parties hereto have executed this Indemnification Agreement on and as of the day and year first above written.

SYNOPSYS, INC.,
a Delaware corporation

By: ______________________________

Name: ______________________________

Title: ______________________________

INDEMNITEE

By: ______________________________

Name: ______________________________

Address: ______________________________

* Represents specific quantitative or qualitative performance-related factors, or factors or criteria involving confidential commercial or business information, the disclosure of which would have an adverse effect on the Registrant.

SYNOPSYS®

Title: Executive Incentive Plan
Effective Date: March 15, 2005

Document Owner: **Human Resources Compensation**

Approvals:

Jan Collinson
Sr. VP of Human Resources and Facilities

Aart de Geus
Chairman and CEO

Chi-Foon Chan
President and COO

Date	Author	Revision History
March 15, 2005	J. Cleveland	Initial plan document

This Synopsys Executive Incentive Plan ("EIP" or the "Plan") provides members of the Company's senior management the potential to earn variable compensation linked directly to attainment of the Company's fiscal year objectives, Business Group performance (as applicable), and individual performance and contribution.

ELIGIBILITY

To be eligible to receive an award under this Plan, an executive must have been designated by the Board of Directors as an "officer" of the Company pursuant to rule 16(b) of the Securities Exchange Act of 1934 and must be:

- a regular employee scheduled to work at least 20 hours per week;
- employed by Synopsys as of the first work day of the fourth quarter in the fiscal year;
- actively employed through the last day of the fiscal year (or on an approved leave of absence);

and

- not participating in a commission or any other incentive plan (including, but not limited to, a sales or applications consulting compensation plan, CIP, or a special incentive plan in connection with an acquisition).

TARGETED PERCENTAGE OF FISCAL YEAR ELIGIBLE EARNINGS

The targeted incentive percentage for each eligible executive is set by the Compensation Committee of the Board of Directors. An executive's actual award may be substantially different than his or her targeted bonus based on Company and Business Group (if applicable) achievement and individual performance and contribution, as assessed by the executive's management and approved by the Compensation Committee.

The targeted incentive is expressed as a percentage of eligible earnings. Eligible earnings include base salary, flexible time off (FTO) pay, and disability benefits (if applicable) actually paid through Synopsys Payroll during the fiscal year. All other types of compensation such as spot bonuses, employee referral bonuses, and amounts realized from the exercise of stock options or upon purchase or sale of shares under the Company's Employee Stock Purchase Plan do not count as eligible earnings.

If an executive has participated in a commission plan or other incentive bonus plan for part of the fiscal year, only earnings received during the portion of the year the executive was eligible for EIP will be included as eligible earnings. For eligible executives who join the Company pursuant to an acquisition, only qualifying compensation as described above paid by Synopsys following the closing date of the acquisition will be counted.

FUNDING THE PLAN

When determining EIP pool funding, Synopsys measures 1) overall corporate performance, and 2) business group performance (if applicable).

For executives in product Business Groups, the incentive pool is funded [*]% based on the Company performance and [*]% based on the executive's Business Group performance. For executives in infrastructure or corporate services/support groups (Corporate Marketing, Finance/Legal/Operations, Human Resources/Facilities, Technology & Information Systems (CTO), and the Office of the President), the incentive pool is solely funded 100% based on Company performance. In the event an eligible executive transfers from a business group to a corporate infrastructure group or vice versa during the fiscal year, appropriate pool funding will be determined by the executive's management, subject to the approval of the Compensation Committee.

CORPORATE PERFORMANCE

Synopsys must achieve in aggregate at least 90% of its fiscal year plan for accepted orders, revenue and expenses for any pool funding to occur, regardless of individual Business Group performance. Corporate pool funding increases or decreases based on Synopsys' actual performance against the fiscal year plan. Pool funding rates based on actual performance are set forth in Exhibit A to this Plan. For example, if aggregate performance is 99%, 97% of the targeted pool will be funded. In calculating corporate orders achievement, accepted orders may be adjusted (up or down) based on the six quarter revenue signature of the orders (excluding upfront orders) accepted each quarter compared to a benchmark that is consistent with the Company's long term financial plan (the "Orders Quality Modifier").

The relative weighting of orders (as adjusted by the OQM), revenue and expenses is as follows:

THE MEASUREMENTS

Corporate Performance (100%):
Measure Weighting
Accepted Orders (OQM adjusted) [*]%
Revenue [*]%
Expenses [*]%

BUSINESS GROUP PERFORMANCE

Each product Business Group must achieve at least 90% of its fiscal year plan for accepted orders and expenses in aggregate, in order for the Business Group portion ([*]%) of the incentive pool to fund. If the Business Group does not achieve at least 90% of its plan, only the portion of the incentive pool based on Company performance ([*]%), if funded, will be available for payout to Business Group employees.

The pool increases or decreases based on the product Business Group's actual performance against its fiscal year plan similar to the Corporate performance scale above. In calculating BG orders achievement, accepted orders may be adjusted (up or down) based on the OQM.

The maximum pool funding for the Business Group component is [*]%, unless Synopsys as a whole exceeds 100% of the corporate plan, in which case the maximum pool funding is [*]%.

THE BG MEASUREMENTS

Corporate Performance ([*]%):	Business Group Performance ([*]%):
Measure Weighting	**Measure Weighting**
Accepted Orders (as adjusted by OQM) [*]%	Accepted Orders (as adjusted by OQM) [*]%
Revenue [*]%	Expenses [*]%
Expenses [*]%	

INDIVIDUAL PAYOUT

An eligible executive's individual performance and contribution during the fiscal year largely determines his or her EIP award. Fifty percent of an eligible executive's bonus will be based on the financial performance of the Company and Business Group, as applicable. The remaining 50% will be based on an assessment of achievement of business objectives and impact to the Company, as determined by the executive's management and the Compensation Committee.

IMPORTANT NOTES ABOUT THE PLAN

This Plan supersedes and replaces all prior corporate incentive plans. The Company may amend or terminate the Plan at any time, with or without notice. The Company may likewise terminate an individual's participation in the Plan at any time, with or without notice. Nothing in this Plan shall be construed to be a guarantee that any participant will receive all or part of an incentive award or to imply a contract between the Company and any participant. Eligibility for and determination of incentive awards under the Plan are within the sole discretion of the Company, and prior to actual distribution, incentive awards may be increased, reduced or eliminated.

Approvals:

/s/ Jan Collinson	April 20, 2005
Jan Collinson	**Date**
Senior Vice President – HR/FAC	
/s/ Aart de Geus	April 20, 2005
Aart de Geus	**Date**
Chairman and CEO	
/s/ Chi-Foon Chan	April 20, 2005
Chi-Foon Chan	**Date**
President and COO	

Exhibit A

Corporate or Business Group Pool Funding

% Performance to Plan	Performance Factor %
[*]%	167% (Maximum)
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
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[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
[*]%	[*]%
Under 90%	0%

The maximum pool funding for the Business Group component is [*]%, unless Synopsys as a whole exceeds 100% of the corporate plan, in which case the maximum funding is [*]%.

---

* Represents specific quantitative or qualitative performance-related factors, or factors or criteria involving confidential commercial or business information, the disclosure of which would have an adverse effect on the Registrant.

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)) 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) 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

(c) 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: May 27, 2005

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

EXHIBIT 31.2

CERTIFICATION

I, Steven K. Shevick, 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)) 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) 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

(c) 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: May 27, 2005

/s/ Steven K. Shevick
Steven K. Shevick
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 Steven K. Shevick, the 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 April 30, 2005 (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 27th day of May, 2005.

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

/s/ Steven K. Shevick
Steven K. Shevick
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 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 the Form 10-Q), irrespective of any general incorporation language contained in such filing.