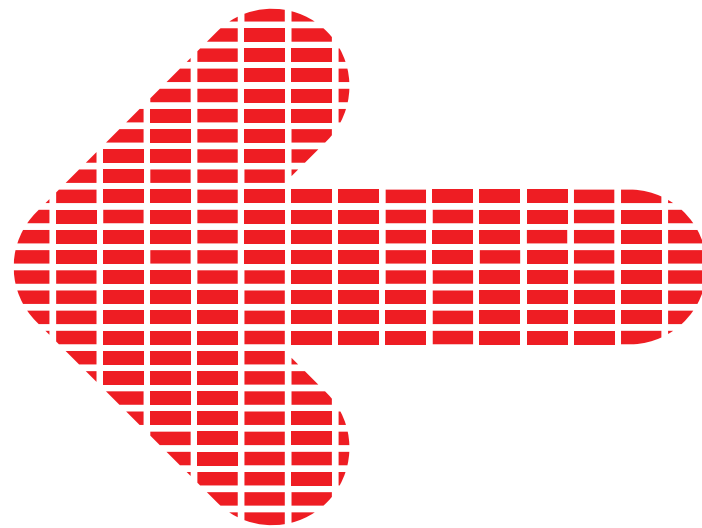
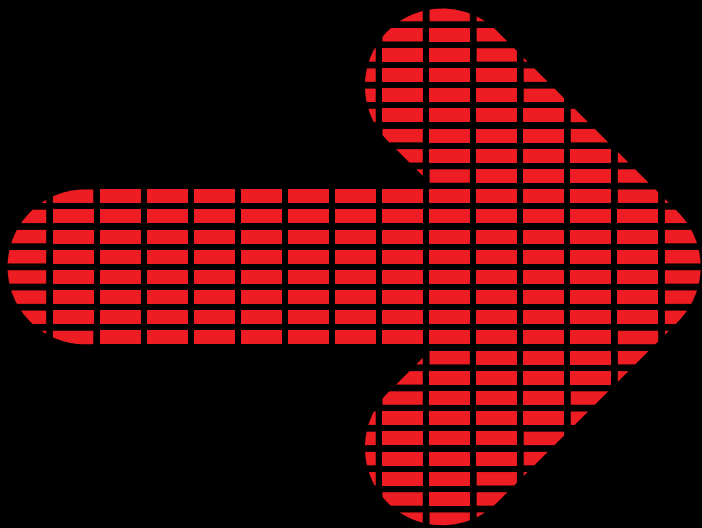


CADENCE THE WHOLE POINT



AN UNPRECEDENTED CONVERGENCE OF FORCES IS RESHAPING ELECTRONICS. CADENCE HELPS ITS CUSTOMERS PROFIT FROM IT.



HOW WILL OUR CUSTOMERS THRIVE FROM GROWING DEMAND WHEN THEY'RE ALREADY WORKING AT CAPACITY? →

CADENCE REMOVES LIMITATIONS

WE INCREASE CAPACITY BY DELIVERING INTEGRATED TECHNOLOGY THAT ENABLES UNPARALLELED PRODUCTIVITY. BY PROVIDING EXPERTISE AND SERVICES TO POWER OUR CUSTOMERS' DESIGN TEAMS. AND BY CREATING CONNECTIONS BETWEEN TECHNOLOGY, BUSINESSES AND MARKETS.

Just a few years ago the electronics industry was focused almost entirely on computers. Today is different. The need for advanced electronics is growing. You'll find the results in smart phones, game consoles, PDAs, MP3 players, web pads, and more. These are the products that are changing the way we live, work, and play. And you'll find them everywhere. In the workplace. In our cars and in our homes. The demand for these and even newer electronic devices continues to grow, driven by innovations in technology and the convergence of communications, audio, video, and computing technologies in a single product. The value, flexibility, and performance these products deliver is fueling the demand for more innovative electronic designs. And the problem is that this demand—driven by technology complexity—arrives at a time when the shortage of electronic design talent and the need to get products to market faster inhibit our customers from making the most of this immense opportunity.

Cadence® solutions unleash the creativity and productivity of our customers, helping them bring this new generation of electronic products to market. By removing limitations, we are an essential ingredient in helping our customers thrive. We're able to do this because our electronic design technology encompasses every aspect of the process. From semiconductor (IC) design, to printed circuit board (PCB) design, and complete system design. Our technology is a key element in helping our customers tame the accelerating pace of technology advancement and the complexities associated with the convergence of multiple capabilities coming together in a single system.

The intensity of demand has revealed a critical shortage of design engineering talent. And the race to market has revealed that the old tools and old methodologies simply aren't good enough. So, our customers' challenge is twofold. To succeed, they must build

the right team and equip them with a world-class product development process.

Cadence answers both challenges. We remove the limitations created by the shortage of design talent, giving our customers access to a deep, experienced product development partner. Tality™ Corporation, our electronic design subsidiary, is already the world's largest resource for outsourcing electronic product development. And our integrated technology combined with our electronic design methodology services, helps our customers create a design process that speeds their pipeline of new products from idea to reality. Fast. Which fuels their growth.

We go a step further. By partnering with our customers we ensure that our design technology, our services, and our relationships with key supply chain partners, all work together with one goal in mind—the success of our customers.



HOW CAN OUR CUSTOMERS MANAGE GROWING TECHNOLOGY COMPLEXITY AND STILL BE FIRST TO MARKET? →

**CADENCE INCREASES THE
SPEED OF BUSINESS**

WE PROVIDE **COMPREHENSIVE SOLUTIONS** THAT HELP OUR CUSTOMERS **HARNESS THE POWER** OF GROWING TECHNOLOGY COMPLEXITY, FAST.

The hot new electronic products that you're using today, and the breakthroughs you'll rely on tomorrow, are the result of technology convergence. And convergence is the watchword in the electronics industry. Convergence is the force that is creating these new, intelligent devices that offer you computing, communications, audio and video capabilities, all together in one easy-to-use device. In some cases, all this technology comes together on a single chip. You'll find convergence in the underlying technologies that make all this convenience and capability possible.

To deliver the performance their customers expect, things that were never compatible—even things that were done in separate stages—must now be combined. It means that analog and digital and radio frequency capabilities must come together. It means hardware and

software development must progress in lock step. It means that silicon packaging and PCB design must follow the same integrated path. And, to get all this together on a single chip, the silicon process geometries that enable even more capability continue to shrink. The net result is escalating complexity.

Growing complexity creates opportunities for developing innovative electronic products with more capability than ever before. It also creates the need for more powerful, more integrated tools and services to make the most of every new technology. At a time when the market demands a pace that's faster than ever, complexity slows the design process, creating new problems and making our customers' core technology challenges even tougher to solve. Those core challenges are our focus. We help our customers tame technology and complexity and harness the power complexity offers.

Cadence solutions transform complexity into an advantage that lets them deliver new features and new capabilities to their markets. And, as we continue integrating our world class technology and services into ever more comprehensive design solutions, Cadence will further reduce time to market.

We help our customers accomplish this because our focus is on providing comprehensive solutions. So that no step within the design process is left unaddressed. Redundancies are reduced or eliminated. Processes are streamlined. New design efforts can move forward on multiple fronts, simultaneously. Instead of one step after another. Our solutions ensure that all the elements of creating a successful new design are integrated, compatible, and pointed at delivering the product, finding the right connections in the supply chain, and being first to market. Time and time again.



HOW CAN OUR CUSTOMERS LEVERAGE THE ELECTRONICS DESIGN CHAIN TO KEEP WINNING? →

TALK TO CADENCE

**WE ARE A STRATEGIC PARTNER, EXTENDING OUR
RELATIONSHIPS BEYOND PROVIDING POWERFUL TECHNOLOGY
TO CREATING AND IMPLEMENTING SOLUTIONS THAT
EXPAND AND REVOLUTIONIZE OUR CUSTOMERS' MARKETS.**

To succeed in this new environment, our customers are looking for something beyond the traditional vendor relationship. They need strategic partners. Partners that are focused on their success in getting their ideas to market. They understand that, to transform their business they'll need marketplace alliances, collaboration with customers, and the insights to know what's coming. To remain competitive they'll need to reduce development costs, cycle times, and time to market. To build their business, more direct access to the right elements of the supply chain will be essential. The need for a new approach is obvious everywhere in the electronics industry.

Which means the need for Cadence is just as obvious. Our view of the world matches theirs. To really transform our industry, we're working with customers,

to develop and implement the products and services they really need. We work together to further integrate with their customers and their vendors, to optimize productivity throughout the supply chain. More and more, Cadence is embarking on marketplace alliances with our customers, developing solutions together, and jointly taking them to our mutual customers, creating major strategic and competitive advantages.

So it's no surprise that our customers are at the center of everything we do. We look at the world from their perspective. The problems they face are our problems. By approaching our business as a partnership with our customers, we know that when we help enhance their success, our own success is enhanced. It must be the right approach. Because today, most of the world's leading electronics companies rely on Cadence technology and Cadence

people to deliver their products. They rely on the broadest portfolio of electronic design technology and services, our strategic partnerships with industry leaders, and our ability to look at their problems, see the solution, and enhance their productivity.

No one can solve all these issues alone. But because we work in collaboration with our customers, we know that our approach is the one capable of meeting the challenges they face in the real world. By developing strategic partnerships, sharing ideas and cooperating throughout design and production cycles, we enhance our customers' ability to win. Cadence is now the focal point for connecting and integrating technology and services, talent and ideas, customers and vendors, and helping to bring great new products to new and growing markets.



RAY BINGHAM PRESIDENT AND CHIEF EXECUTIVE OFFICER

TO OUR STOCKHOLDERS

In 2000, Cadence delivered an outstanding performance marked by many tangible successes—from exceeding our financial goals to strengthening our business model to developing a powerful portfolio of innovative new electronic design solutions. But even more important, it was a performance that advanced the Cadence mission of being the indispensable partner to our customers, who are competing in the largest and fastest growing market on earth—the electronics industry.

PRODUCING EXCELLENT RESULTS

Cadence revenue in 2000 reached \$1.3 billion, a 17 percent increase over 1999, and we capped off 2000 with our best quarter ever. Fourth quarter revenue was \$391 million, up 46 percent compared with the fourth quarter of 1999. Product revenue for the year was \$627 million, up 24 percent over 1999, outpacing our electronic design competitors and extending our market leadership.

In addition to posting solid revenue growth, we transitioned our software business to a subscription license model that gives Cadence far more visibility—revenue is recognized over time, rather than at the time of initial sale. During 2000, we booked more than 40 percent of our

software business under the new subscription license, significantly exceeding our own 30 percent target. For the last six quarters we built more than \$400 million of subscription backlog, most of which will be recognized as revenue ratably over the next eight to ten quarters. During 2001, we expect one-third of our product revenue to come from this subscription backlog, improving our revenue visibility.

In the second half of 2000, we also began a contract renewal cycle—renewals of three-year contracts signed with many of our major customers. Our initial renewals, including those with Philips Semiconductors, Texas Instruments, and a large Japanese semiconductor company, were at significantly higher values than their original orders, driven by the adoption of our new technology and our customers' need to equip even more engineers.

Our strong financial results, the shift to the subscription model, and our renewal cycle give us powerful momentum heading into the future.

CONVERGING FORCES RESHAPING ELECTRONICS

Electronic products are literally changing the way we live—from the Internet, its infrastructure and the explosion of devices

connected to it, to electronics in the home and in our cars, new breeds of entertainment devices, and the computing and communications systems that are powering our businesses. The electronics industry is in the midst of radical transformations— incredible technology advances, fierce competition, talent scarcity, and reshaping supply chains.

This electronics revolution creates exciting new opportunities for Cadence to take on a larger, more valuable role with our customers. Opportunities for us to expand from our position as the leader in electronic design solutions to becoming an essential force in helping our customers transform the way they innovate and bring products to market. An opportunity to equip our customers and their partners with a common, world-class design infrastructure. Enabling them to streamline their total design process and gain business flexibility in partnering with the thousands of other companies using Cadence solutions. The result will be a networked design chain that's more efficient than ever. This is how we see the emerging electronics supply chain, and how we can leverage it to our customers' advantage. We have the scope, the scale, and the technology to make it happen.

CADENCE CORE VALUES

INTEGRITY above all else

Integrity means keeping commitments, maintaining high ethical standards and principles, and building shared goals and visions. This overriding value guides everything we do.

Respect and develop PEOPLE

At Cadence, our people are our most critical asset. And they deserve to be treated with utmost respect—to have the opportunity to develop their skills and experience. Our leaders are committed to inspiring and empowering others—to showing trust, delegating important responsibilities, and fostering an environment of mutual support.

Commit to CUSTOMER success

Customers are at the core of everything we do. We are committed to their success and measure our own success by theirs. We work on our customers' behalf by understanding the challenges they face and by putting their success first.

LEAD with courage and commitment

Leadership means inspiring and energizing others. It means having the courage to challenge the status quo and make tough decisions. It takes commitment to transform strategy into results. That's why we focus on developing and nurturing an environment where leaders are free to create. Free to organize, achieve, and succeed.

INNOVATE to create value

In the world of electronics, innovation is everything. With a market filled with competitors, and customer product cycles as short as six months, the willingness and ability to invent time after time becomes critical. That means we must continually provide innovative business concepts, technologies, products, services, partnerships, and processes—all to create new value for customers.

Toward that end, 2000 was a pivotal year. We made great strides in strengthening our foundation, with a vigorous focus on deepening relationships with our customers and adopting a values-based culture. In fact, at the center of everything we do are our five core values—Integrity above all else, respect and develop People, commit to Customer success, Lead with courage and commitment, and Innovate to create value.

These core values are changing the way we work and define success. From collaborating with customers and measuring our success by theirs, to delivering innovative solutions in virtually every segment of our business. From leading the way to a more predictable business model, to focusing our energy on the people who develop electronics. The values are an integral part of who we are and a powerful strategic advantage going forward.

We are ready to take Cadence to the next phase of our transformation—a future in which we are at the center of our customers' business and an essential ingredient in their success.

DELIVERING INNOVATIVE ELECTRONIC DESIGN SOLUTIONS

We're helping our customers cope with immense challenges posed by the unprecedented convergence of forces reshaping

the electronics industry by delivering innovative solutions—with technology, services, and partnerships—focused on getting their products to market. Fast. This means continuously extending our solutions, and in many cases pioneering new design methodologies, in collaboration with our customers and partners.

Cadence solutions encompass system, integrated circuit (IC), and printed circuit board (PCB) design, providing us the opportunity to serve every company that develops electronic products and become their total design infrastructure partner.

2000 was a banner year. We successfully delivered against our aggressive technology roadmap, innovating in virtually every area of electronic design and creating solutions with our customers. One highlight was our pioneering work in system-level design, where we collaborated with a number of our key semiconductor and systems customers, including BMW, Hitachi, Ericsson, Motorola, Philips Semiconductors, and STMicroelectronics.

In IC design, our customers are facing dramatic complexity increases, shrinking semiconductor process geometries, and the

need to bring analog and digital together on the same chip. To address these challenges, our customers will need to shift to a new generation of technology that addresses timing and signal integrity closure, and integrates Synthesis, Placement and Routing (SP&R) into a unified solution for digital design. During 2000 we shipped the industry's first and only integrated front-to-back solution. We gained the leadership position, booking more than \$110 million and shipping hundreds of seats, making SP&R what we believe to be the fastest growing product family in EDA history. We saw major adoptions by Ericsson, Fujitsu, Hewlett-Packard, Philips Semiconductors, Texas Instruments, and Toshiba America Electronic Components. In the area of custom analog and mixed signal design, we delivered a number of new innovations including Virtuoso® Custom Designer (VCD), which provides powerful new automation technology and methodology services that help designers increase productivity fivefold.

As chip designs grow in complexity, the problems of packaging the silicon and integrating these devices in PCB systems rise dramatically. Our SPECCTRAQuest™ high-speed interconnect design solution helped fuel record PCB performance.

We also embarked on a bold, new technology roadmap with select customers—called the SuperChip Initiative—designed to help solve our customers’ problems across all domains, from system to IC to PCB design. It will enable design convergence. Bringing together hardware and software. Bringing together analog, radio frequency (RF), and digital. Bringing together silicon, package, and PCB design. We believe that the SuperChip Initiative will help our customers solve some of their most difficult design challenges, deliver more complex chips to market faster, and further our technology advantage. We’re innovating to create value for our customers.

**OUR WORLD-CLASS PEOPLE—
AN INTEGRAL PART OF THE SOLUTION**

The daunting challenges our customers face can’t be solved with innovative technology alone. Cadence realized this years ago, and began the transformation of our business from a software-only supplier to that of a solutions provider—adding our expertise, in the form of powerful service capabilities, to our unmatched technology portfolio. Now, more than ever, this is a key advantage for Cadence, as we expand our role as a strategic partner. We have built a team

of more than 1,000 applications engineers, who are a powerful force in delivering customer success. They are also a competitive differentiator for Cadence. Added to the innovations emanating from our more than 1,200 R&D professionals, it’s clear that our world-class people are an integral part of the solutions we deliver to our customers. Our people make customer success real, which is why they are a key component of our core values.

**TALITY CORPORATION—
PIONEERING DESIGN SERVICES**

Fueled by the shortage of design engineering talent and the move to product development outsourcing, Cadence pioneered the electronic design services business. This business provides a compelling offering to help customers get their products to market. During 2000 we launched Tality Corporation as a separate company to provide these market-leading design services. Although our plans to take part of Tality public were delayed because of overall stock market dynamics, we continued to see many successes during the year.

During 2000, Tality’s business continued to evolve from purely project-oriented work to more strategic multi-year, multi-project relationships with customers like

Nokia and Vitesse. This is a trend that will only accelerate as more and more customers turn to outsourcing their product development. Such relationships make Tality an integral part of our customers’ product development processes—a testament to the expertise of our 1,100 design engineers. With the addition of significant intellectual property (IP) to our portfolio, Tality further enhances our ability to provide strategic design capacity to our customers.

Tality also opened a design center in Dallas to support its strategic relationship with Nokia, and I was honored to be present when Her Majesty The Queen officially opened our Livingston Design Center in Scotland—part of Scottish Enterprise’s Alba Centre.

LEADERSHIP AS COMPETITIVE ADVANTAGE

As the market leader, Cadence is afforded tremendous opportunities. Our business leadership allows us to invest more in R&D than the rest of the industry. It allows us to field an unmatched portfolio of solutions that span from system to IC to PCB design. Our leadership in pioneering the services business provides us with unparalleled resources and expertise to dedicate to the success of our customers. The marketplace leadership of our solutions means that more electronic products are designed on

NEW WAYS OF DOING BUSINESS

TSMC / ANDLEY CHANG DESIGN SERVICE MARKETING

"With process geometries headed into very deep-submicron territories, it is imperative to more tightly link tools to specific foundry processes to fulfill the system-on-chip potential that these process technologies offer. TSMC has consecutively led the industry, launching the first commercial availability of 0.18, 0.15, and 0.13 micron SoC process technologies. This joint development effort with Cadence is part of our overall strategy to allow designers to quickly ramp to these new processes."

CADENCE DESIGN SYSTEMS / KEVIN BUSHBY / SENIOR VICE PRESIDENT WORLDWIDE FIELD OPERATIONS

"Cadence meets customer challenges around the globe through the unique product development model we employ. By participating in our product roadmap decisions, our customers are driving us to build the most comprehensive design technology suite and methodologies that span the design of the next generation of systems, ICs, and printed circuit boards (PCBs)."

TEXAS INSTRUMENTS / DR. KEH-SHEW LU SENIOR VICE PRESIDENT WW MIXED SIGNAL AND LOGIC PRODUCTS

"With Cadence, TI is collaborating with a world-class company that has the electronic design solutions, the ready-for-market expertise, and the commitment to the convergence that is so critical to system-on-chip (SoC) design. Our collaboration underscores our belief that Cadence delivers one of the most comprehensive, powerful packages of EDA solutions available today."

CADENCE DESIGN SYSTEMS / JAKE BUURMA / SENIOR VICE PRESIDENT WORLDWIDE RESEARCH AND DEVELOPMENT

"Our biggest challenges at Cadence are staying ahead of the design and technology needs of our customers, ensuring that our products exceed expectations. Our Integration Ensemble solution and SuperChip Initiative show Cadence's willingness to rise to meet the needs of converging markets and to empower the design chain with innovative solutions."

STMICROELECTRONICS / PHILIPPE MAGARSHACK GROUP VICE PRESIDENT

"We are impressed with the true-language interoperability and other advantages of the Cadence NC-Sim environment. With the NC technology, best in class performance and a very efficient memory utilization, we can deliver a truly effective way to reduce design cycles to our customers using 0.18 micron and 0.25 micron HCMOS processes. The Cadence toolset offers the capabilities of a mixed-language, NC-based approach and our confidence is reflected in our own choice to use NC-Verilog as our golden simulator."

CADENCE DESIGN SYSTEMS / MATTHEW CHAN PRESIDENT, ASIA PACIFIC

"We believe our position as the world's leading supplier of EDA products and services is simply an outcome of being extremely focused on customer success. Our focus on helping customers get their ideas to market more quickly, efficiently, and at lower costs is resulting in a loyalty that is strengthening our ability to help solve the most difficult design challenges."

PHILIPS SEMICONDUCTORS / LAMBERT VAN DEN HOVEN VICE PRESIDENT, DESIGN TECHNOLOGY

"In the system-on-a-chip arena, maximizing designer productivity is the key to mastering our time-to-market challenges. After reviewing current market offerings, Philips Semiconductors is convinced that Cadence remains a world-class partner for electronic design. The company's ongoing investment in its solutions makes Cadence a natural partner to aid Philips Semiconductors in continuing to provide customers with the world's most advanced capabilities."

CADENCE DESIGN SYSTEMS / GLEN S. FUKUSHIMA / PRESIDENT AND CHIEF EXECUTIVE OFFICER, JAPAN

"Our strong market position uniquely qualifies us to face customers' continuously evolving design challenges. Customers want to partner with a supplier who can help meet the growing time-to-market pressures, increasingly complex chip designs, shrinking gate sizes, and the need for both analog and digital capabilities on the same chip. We believe Cadence is the company customers will trust to meet these challenges."

HEWLETT-PACKARD / CARLY FIORINA CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER

"Momentum in the EDA market is accelerating as chips make their way into all kinds of appliances and devices. Cadence and HP will work together to optimize solutions that meet the increasing engineering demands for greater performance and next-generation architectures. This symbiotic relationship will significantly accelerate delivery to customers of higher quality products with innovative functionality."

CADENCE DESIGN SYSTEMS / JIM HOGAN / SENIOR VICE PRESIDENT BUSINESS DEVELOPMENT

"As the essential link in the global design chain, we are transforming the way business is done. We are accomplishing this by equipping customers with a world-class design infrastructure, and also by equipping their partners with a compatible infrastructure. This networked design chain we're building gives customers the ability to streamline their total design process and gain more business flexibility in partnering with the thousands of other companies standardizing on Cadence. It also offers customers predictability in time to market, thus assuring their success."

AMKOR / NOZAD KARIM DIRECTOR OF SYSTEM IN PACKAGE DESIGN AND TEST

"The strategic importance of selecting a supplier who could perform electrical modeling and analysis at the packaging level was paramount. Cadence's Advanced Package Designer software's tight integration with schematic captures, electrical parameter extractions, signal integrity and RF design tools are essential for Amkor needs."

ALTEON WEBSYSTEMS / SHIRISH SATHAYE VICE PRESIDENT OF ENGINEERING AND CHIEF TECHNOLOGY OFFICER

"We felt that the combination of CoBALT™ RTL verification technology, Quickturn's networking solutions, and the QuickCycles program, made Quickturn the right choice for Alteon's flagship product development."

the Cadence design infrastructure than any other platform in the world. It also means that we're able to attract the best partners in the world to serve our customers even better.

We're excited about taking our leadership to the next level, about building on the great strengths of this company. The unprecedented convergence of forces that is reshaping the electronics industry is opening up rewarding new opportunities for Cadence. Opportunities for us to provide the electronic product design infrastructure to our customers and assist in connecting the entire supply chain. To help them transform the way they innovate and bring new products to market. To be an essential part of their success. An opportunity to continue to lead with courage and commitment.

**DEEPENING CUSTOMER RELATIONSHIPS,
COMMITTING TO CUSTOMER SUCCESS**

Customers are clearly the lifeblood of our business, which is why their success is the true measure of ours. This view of our success is all the more crucial as our role elevates to an even more valued business partner.

We have made a number of tangible changes to help us better serve our customers and open new channels of communication and collaboration. Every

part of our organization is addressing—and is accountable to—customer needs. And we're doing it in several ways. In 1999, I created the Office of Customer Advocacy, an unfiltered channel for customer issues to be brought to my attention and resolved. We measure our success by our customers' success, and we do it in a way that proves our commitment—all our employee incentive compensation programs are tied directly to the results of our customer satisfaction survey.

Collaboration with customers on every major product development is a key element in realizing our strategic objective. As part of the SuperChip Initiative, we're collaborating with Texas Instruments to solve the daunting problems of bringing analog content together with increasingly complex digital circuits on a single chip. Our Integration Ensemble product for hierarchical design of complex ICs was developed in collaboration with Hitachi, STMicroelectronics, and others. And we've pioneered new system design techniques with the world's leading system design companies.

To better support our customers, we're forming and strengthening a number of strategic partnerships that span the ecosystem of the electronics industry. Think of

the electronics industry as a chain of participants—each one dependent on another. Many of our customers are also customers of each other. For example, many of our systems customers depend on our semiconductor customers for part of their product design. With more and more disaggregation occurring, this chain becomes more fragmented and complex. Cadence's goal is to be the essential link in this supply chain—adding value by making it easier for each member of the chain to connect with each other.

Our extended network of partnerships throughout the electronics industry ecosystem is a critical element in our strategy—placing Cadence at the center of the industry and our customers' businesses. Our value proposition is the ability to equip our customers with a world-class design infrastructure, while we equip their partners with compatible infrastructures—streamlining the total design process and enabling greater business flexibility. The result is a networked design chain that's more efficient than ever.

TAKING THE NEXT STEP

Going forward, the strong foundation we built in 2000 positions us to play an even larger role in our customers' businesses.

Given the broad economic weakness we saw during the first several months of 2001, we believe we can add even more value to our customers as they continue to focus on their core business and look to partners like Cadence for help. Why are we confident of that strength going forward? It's the combination of industry growth, rapid technology change, a more predictable business model, and a unique ability to assist in our customers' success.

Growth

Electronics companies are in the business of designing new products, and have continued to do so even during cyclical slowdowns. Research and development focus is critical to our customers' ability to succeed in the marketplace, and our solutions are instrumental in this R&D process. In addition, significant technology changes, such as the move to deep submicron design and increasing chip complexity, are requiring customers to buy new and different solutions. This retooling cycle is just the first of two significant cycles over the next several years—the second being the move to tools that enable design of analog and digital functions on a single chip. Cadence is positioned to benefit from both.

Increased Visibility

Our transition to a subscription license model creates an environment of visibility uncommon in the software industry. Looking ahead, we begin 2001 with a significant subscription backlog. We are also at the beginning of a contract renewal cycle that will last through the next two years, and then repeat itself.

Competitive Advantage

Our market leadership provides us tremendous opportunities. Our technology portfolio, being developed with our customers, is getting stronger and yielding breakthrough products in all major segments. Our unique portfolio of solutions—software technology, methodology services, design services, and key industry partnerships—offers customers unparalleled design capability.

We are passionate about the opportunities that lie ahead for Cadence. The opportunities to help our customers transform electronic product design and to become an indispensable partner to the largest and fastest growing market on earth—the electronics industry.

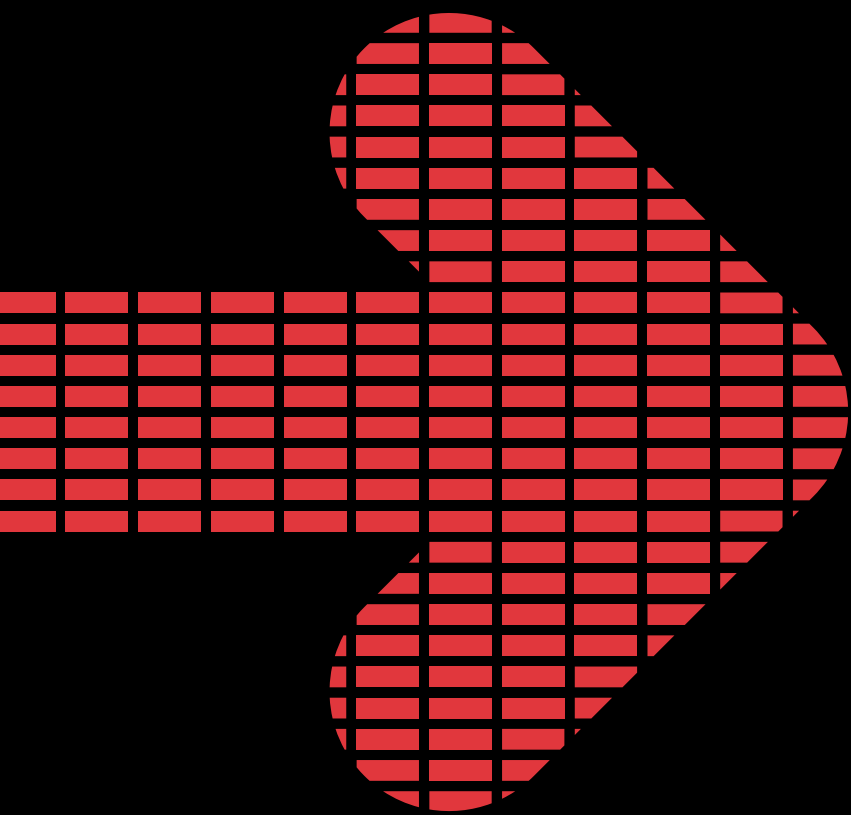
The deepening relationships with our customers and the core values that each

and every one of us has embraced—Integrity, People, Customer, Leadership, Innovation—are the key elements in creating an even more successful Cadence.

I am very proud of our employees—not only for the results that they achieved during 2000, but also for their immense effort and uncompromising focus on our customers. And I'm very excited about the opportunities in the years to come. Thank you for your continued support, and I look forward to a very successful 2001.



RAY BINGHAM
PRESIDENT AND CHIEF EXECUTIVE OFFICER



CADENCE FORM 10-K

SELECTED FINANCIAL DATA

(In thousands except per share amounts)

	2000	1999	1998
Revenue	\$1,279,550	\$1,093,303	\$1,320,180
Net income ¹	\$ 122,532	\$ 78,396	\$ 275,206
Net income per share—assuming dilution ¹	\$ 0.47	\$ 0.31	\$ 1.07
Net income (loss)	\$ 49,977	\$ (14,075)	\$ 25,124
Net income (loss) per share—assuming dilution	\$ 0.19	\$ (0.06)	\$ 0.10
Cash, cash equivalents, and short-term investments	\$ 136,969	\$ 118,758	\$ 249,477
Total assets	\$1,477,321	\$1,459,659	\$1,481,916
Stockholders' equity	\$ 909,465	\$ 986,149	\$ 947,830

¹ Excludes unusual items, amortization of acquired intangibles, and amortization of deferred stock compensation

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 30, 2000

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 1-10606

CADENCE DESIGN SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

77-0148231
(I.R.S. Employer
Identification No.)

2655 Seely Avenue, Building 5, San Jose, California 95134
(Address of Principal Executive Offices, including Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$.01 par value per share
(Title of Each Class)

New York Stock Exchange
(Names of Each Exchange on which Registered)

Securities registered pursuant to Section 12(g) of the Act:
None

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Aggregate market value of the voting stock held on March 3, 2001 by non-affiliates of the registrant: \$6,081,210,144

Number of shares of common stock outstanding at March 3, 2001: 244,716,706

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement for the 2001 Annual Meeting to be held on May 16, 2001, are incorporated by reference into Part III hereof.

CADENCE DESIGN SYSTEMS, INC.
2000 FORM 10-K ANNUAL REPORT

Table of Contents

PART I

	<u>Page</u>
Item 1. Business	3
Item 2. Properties	21
Item 3. Legal Proceedings	21
Item 4. Submission of Matters to a Vote of Security Holders	24

PART II

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters	26
Item 6. Selected Financial Data	27
Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations ..	28
Item 7A. Quantitative and Qualitative Disclosures About Market Risk	45
Item 8. Financial Statements and Supplementary Data	46
Item 9. Changes and Disagreements with Accountants on Accounting and Financial Disclosure ..	46

PART III

Item 10. Directors and Executive Officers of the Registrant	47
Item 11. Executive Compensation	47
Item 12. Security Ownership of Certain Beneficial Owners and Management	47
Item 13. Certain Relationships and Related Transactions	47

PART IV

Item 14. Exhibits, Financial Statements, Schedules, and Reports on Form 8-K	48
Signatures	93

PART I.

Item 1. Business

Certain statements contained in this Annual Report on Form 10-K, including, without limitation, statements containing the words “believes,” “anticipate,” “estimates,” “expects,” “intends,” and words of similar import, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results could vary materially from those expressed in these statements. Readers are referred to “Marketing and Sales,” “Research and Development,” “Competition,” “Proprietary Technology,” “Manufacturing,” and “Factors That May Affect Future Results” sections contained in this Annual Report on Form 10-K, which identify important risk factors that could cause actual results to differ from those contained in the forward-looking statements.

Overview

Cadence Design Systems, Inc., provides comprehensive software and other technology and offers design and methodology services for the product development requirements of the world’s leading electronics companies. Cadence licenses its leading-edge electronic design automation, or EDA, software and hardware technology and provides a range of services to companies throughout the world to help optimize their product development processes. Cadence is a supplier of end-to-end products and services which are used by companies to design and develop complex chips and electronic systems, including semiconductors, computer systems and peripherals, telecommunications and networking equipment, mobile and wireless devices, automotive electronics, consumer products, and other advanced electronics.

Cadence was formed as a Delaware corporation as a result of the merger of SDA Systems, Inc. into ECAD, Inc. in May 1988. Cadence’s headquarters are located at 2655 Seely Avenue, Building 5, San Jose, California 95134. Its telephone number at that location is (408) 943-1234.

Factors Driving Electronic Design Automation Industry

The worldwide electronics industry has experienced expansion driven primarily by the communications (networking and wireless) markets. The rise in Internet and cell phone use pressures electronics suppliers to provide equipment that meets the ever-increasing demand for bandwidth. The advent of technologies such as third generation cellular, wireless networking, and optical networking are converging the Internet and the cell phone. The next step, pervasive connection of consumer electronic devices, appears closer to becoming reality. On the electronics production side, ever-decreasing silicon manufacturing process geometries coupled with the move to 300mm wafer production is driving integrated circuit, or IC, costs, volumes, and increasingly higher complexities. These market and technology forces pose major challenges for the global electronics design community, and consequently create significant opportunities and challenges for EDA tools and services providers.

The electronics industry is faced with increasing complexity of electronic devices. Design teams face two major challenges in deep submicron design and system-on-chip, or SOC, design.

Deep submicron design refers to the design of integrated circuits that will have feature sizes smaller than ½ micron. IC feature sizes for wires, transistors, and contacts decrease with each advance in the semiconductor manufacturing process. Each successive move to a smaller feature size (e.g., decreasing from .25 microns to .18 microns and smaller) requires introducing new capabilities throughout the entire design and manufacturing flow to account for new physical effects that emerge from the decrease in size. Deep submicron design represents a major challenge for the entire semiconductor industry.

SOC design refers to implementing an entire electronics sub-system on a single IC. Smaller feature sizes make it more economical to put additional circuitry on a single die. The chips fabricated with these dies include one or more processors (microprocessors and digital signal processors), a high-performance bus, numerous memory devices and peripherals, custom digital logic, custom analog logic, and millions of lines of software code. Such devices offer huge benefits in terms of price, performance, power, and size. However, they

are extremely difficult to design, and it is even more difficult to ensure that they exhibit the correct behavior under all circumstances, a process known as functional verification.

These trends pose significant new challenges for electronic design teams. Deep submicron design requires designers to take into account many physical effects they previously ignored. SOC design requires new approaches to managing complexity and its related risks. The industry addresses these challenges in a number of ways, including utilizing new EDA tools, and upgrading design methodologies.

Electronic Design

The electronic design process involves describing the behavioral, architectural, functional, and structural attributes of an IC or electronic system. The process is one of successive refinement where the design team adds a level of detail to the design and verifies the results of the addition before proceeding to add each next level of detail. Design teams begin with very abstract behavioral models of their system and end with a physical description of millions of transistors and their interconnections. Semiconductor foundries use the physical description to create the masks and test programs needed to manufacture the ICs. EDA tools aid the design team in capturing its design intent, creating the next level of detail, and verifying the results. Problems are often found at one level that can only be resolved by revising a previous level of description. These iterations introduce delay and risk into the design process.

System Level Design

Decisions made during system level design, including behavioral, algorithmic, and architectural definition, determine a substantial majority of an electronic system's final performance and cost. The behavioral definition specifies which functions the system needs to perform. The algorithmic definition is a mathematical model that describes any signal processing necessary to condition video and audio data streams. The architectural definition specifies the high-level structure of the design's implementation. This includes hardware/software partitioning, a process which specifies whether each behavioral and algorithmic function is to be implemented in hardware or software.

Many companies are adopting a platform-based design approach to address the complexity of SOC design. Platform-based design defines a robust, flexible platform of pre-verified virtual components including processors, memories, and peripherals tuned for a particular application or set of applications (e.g., digital video or cellular communications). Once established, design teams create a new SOC rapidly using mostly existing virtual components and complete the design without requiring much new circuitry or new software. This approach can reduce time-to-market and risk dramatically, but also poses a series of new methodology and automation challenges.

Functional Verification

The first step in digital hardware design is to create a detailed functional specification using a hardware description language, or HDL, generally using VERILOG[®] or VHDL[®]. The functional specification does not include physical attributes such as timing, power, and size. Both Verilog and VHDL specify functionality at various levels of abstraction, from behavioral (most abstract) to gate-level (most detailed). Many design teams begin with a behavior specification, as it can be written and functionally verified quickly. Afterwards, these teams manually rewrite the specification at the register-transfer-level, or RTL, of abstraction, which specifies the functionality between each of the individual storage elements, also known as registers, within the design. Many design teams skip the behavioral design and verification phase and begin with RTL.

To verify their designs, teams create elaborate testbenches. Testbenches are tests that simulate the inputs a design will likely experience in its actual application. Testbenches often include environmental models (e.g., channel distortion effects for wireless designs), processor models running representative software, models for other hardware in the system, and checks that determine whether or not the design exhibits the appropriate behavior. Teams perform functional verification by simulating their design and its testbench, thus identifying logical errors to be corrected. Design teams can proceed to implement the design using automated digital or custom design techniques after extensive, error-free RTL functional verification. Any undetected functional

error potentially requires a very expensive design change that requires discarding any silicon manufactured to date and manufacturing new silicon with the change. Since even the fastest software-based simulation runs many orders of magnitude slower than the eventual silicon implementation, design teams increasingly employ specialized hardware to increase the process speed by up to a few orders of magnitude.

Automated Digital IC Design

Most design teams use an automated digital methodology for the majority of their digital hardware design. Although designers write the RTL and specify the design's physical constraints, they use tools to automatically create the detailed implementation. Digital design flows let teams gain better time-to-market than full-custom design, but sacrifices silicon performance, power, and size.

The first step in an automated digital methodology (i.e., mostly automated) is the use of a logic synthesis tool to create a gate-level version of the design. At the gate level, the functionality between registers is elaborated to logic gates, or standard cells. At this point the design is a network of interconnected standard cells and hard cores, or previously implemented logic. Both the standard cells and the cores are based on a specific manufacturing process technology for a specific foundry. Design teams verify that the gate-level description is functionally equivalent to the original RTL specification to identify any potential problems that occurred during this logic synthesis.

The next step in automated digital design is the design layout. Designers determine where the major blocks of circuitry should be located on the physical die to provide the lowest cost chips meeting the requisite performance requirements. They use this floorplan to guide an automated placement and routing tool to determine the precise location for every cell, and then connect the cells. This step is commonly referred to as place-and-route. Since the precise physical implementation is unknown prior to layout, it is impossible to accurately predict the IC's physical characteristics before this stage. Rough estimates are available at the gate level, but with deep submicron physical effects, these estimates are not sufficiently accurate to ensure the design will work properly in silicon. At the level of approximately 0.18 micron, logic synthesis tools must take placement and routing into account and place-and-route tools must be able to re-optimize the logic to converge on the design's performance requirements.

Physical verification and analysis is the final step before release of a design to manufacturing. Physical verification ensures that the design abides by all of the detailed rules and parameters that the foundry specifies for its manufacturing process. Violating a single foundry rule can result in silicon that does not work. Physical analysis is a set of capabilities, such as cross-talk analysis, that guard against new physical effects that are important to consider in deep submicron design.

Custom IC (Analog and Mixed-Signal) Design

In general, it is possible to achieve considerably higher-performance, lower-cost digital circuits by designing them directly at the layout level. This approach is known as custom design because designers can craft every cell by hand and every interconnection between cells. For a design with millions of cells, this process is extremely time-consuming and risks of error are significant. Automated custom physical design techniques considerably speed the process by automating many common layout tasks and by making intelligent, incremental implementation decisions the designer can accept or reject. Design teams generally use this custom design approach for designs that are very performance and cost-sensitive, such as microprocessors, memories, and field-programmable gate arrays. Even in these cases, teams often use automated digital techniques where possible.

Analog design is a form of custom design for analog circuits which requires specialized tools and techniques. Analog designers use a "bottom-up" approach rather than the "top-down" approach automated digital designers use. They handcraft each analog component based on very detailed, process-specific analysis, then repeat the process when they combine the components into an analog circuit. Unlike digital designs, in which signals are clearly either on or off beyond a specified threshold, the exact value of a signal is almost always critical in analog design. Analog circuits are extremely sensitive to any variation in the surrounding circuitry and environment (e.g., heat, power, and electromagnetic effects). Despite these problems, design

teams are combining more and more analog and digital circuitry on the same design, known as mixed-signal design, to take advantage of the performance, cost, reliability, size, and power advantages inherent in mixed signal designs.

Printed Circuit Board Design and IC Packaging

Electronic systems invariably consist of one or more printed circuit boards, or PCBs. In addition to their mechanical role, PCBs interconnect and provide power to individual ICs. As IC performance and complexity increase, designing the board that interconnects the ICs becomes increasingly difficult. The challenge starts with the IC package itself. As IC input/output densities and speeds increase, IC packages become an integral part of system-level performance. High-speed package design is no longer just a mechanical task, but involves precise layout, modeling, and analysis. Likewise, high-speed PCB design involves more than layout. It requires analysis to ensure each signal reaches its destination on time and to identify potential signal integrity problems.

Cadence Electronic Design Automation Tools

Cadence offers the most comprehensive set of EDA tools in its industry. Cadence tools improve designer productivity and design quality throughout the electronic design process.

System-level Design Tools

Cadence system-level design tools help design teams optimize their designs and provide a smooth path to detailed hardware design. The CADENCE® Virtual Component Co-design, or VCC, toolset lets designers capture and verify system behavior independent of the hardware and software implementation. Designers can then map the behavior to a variety of architectural implementations and analyze the results of each. Using this rapid exploration, teams can optimize their overall system level design including critical hardware/software partitioning. VCC is also an ideal environment for platform-based design. For those portions of the behavior that are algorithmic in nature, Cadence's SPW® toolset provides a specialized environment for capturing and analyzing floating-point and fixed-point algorithms. It also serves as an excellent system-level testbench environment, especially for communications and multimedia applications.

Functional Verification Tools

Design teams need a range of simulation and hardware-based acceleration tools to verify the functionality of their designs. Cadence offers the industry's most complete set of simulators and emulators for behavioral, register-transfer-level, and gate-level functional verification. The Cadence lineup of digital simulators includes the NC-VERILOG® simulator for the VERILOG language, NC-VHDL for the VHDL language, and NC-Sim that simultaneously supports both languages. These simulators provide designers with the simulation performance and capacity they need to verify the functionality of today's most complex designs.

For teams that require hardware-accelerated verification, the Cadence Quickturn division offers the industry's most mature solutions. MERCURYPLUS™ and COBALT™ provide FPGA-based emulation and custom processor-based acceleration, respectively. Cadence also offers specialized kits that provide a complete verification environment for popular applications such as 3G wireless communication and Gigabit Ethernet networking. Most recently, Cadence introduced the Quickturn Rapid Prototyping System, or RPS, for rapidly prototyping platform-based designs. Each of these systems enable design teams to identify hardware and software problems that they would otherwise not find until the design is implemented in silicon.

Automated Digital IC Design Tools

Our unified synthesis, placement-and-routing system, or SP&R, provides a complete implementation path from RTL through final layout for the most advanced designs. The SP&R system consists of Physically Knowledgeable Synthesis, or PKS, physical synthesis for front-end logic design and SILICON ENSEMBLE® PKS, optimization-place-and-route for back-end physical design. PKS provides simultaneous logic synthesis, placement, and global routing. SILICON ENSEMBLE PKS provides a complete place-and-route environment, including the ability to re-optimize a design's logic to meet new physical constraints. These tools

have common timing, optimization, placement, and routing engines to ensure single-pass accuracy as the design progresses from RTL to final layout. Cadence recently introduced power optimization, test synthesis, and datapath compilation capabilities for automated digital design. For leading-edge physical verification, Cadence offers the ASSURA™ physical verification toolset created specifically for deep submicron designs.

Cadence also offers traditional logic synthesis with its BUILDGATES® software, SILICON ENSEMBLE place-and-route software, and DRACULA® physical verification tools that are highly effective for designs to about 0.25 micron.

Custom and Analog Design Tools

Cadence is the leader in custom design, analog design, and mixed-signal design. Cadence's VIRTUOSO® Custom Designer, or CD, toolset is based on its flagship VIRTUOSO custom layout tool. The VIRTUOSO CD toolset is a highly integrated custom design environment that includes layout editing, placement, routing, and physical verification. By automating many aspects of custom design, designers become more productive than those using previous generation custom layout tools. The VIRTUOSO CD toolset includes Cadence ASSURA physical verification, which offers automated, interactive physical and batch IC layout verification, extraction, and layout enhancements for manufacturing. The ASSURA tools utilize patented hierarchical processing techniques to significantly reduce verification cycle times and provide effective debugging capabilities.

Cadence also offers a complete line of analog and mixed-signal design tools. Cadence Analog Design Environment is the industry's only complete front-to-back analog design automation solution for full-custom analog and digital, mixed-signal, and radio frequency, or RF, IC design. Within that environment, designers can choose SPECTRE® Circuit Simulator solutions. The SPECTRE Circuit Simulator utilizes state-of-the-art direct method circuit simulation to provide increased speed, accuracy, and capacity over SPICE simulators. The SPECTRE RF simulator is the first RF simulator with the speed and capacity to handle full-chip, transistor-level circuit simulation of RF designs with 5,000+ devices on desktop workstations. Design teams can use the Cadence Accelerated Transistor-Level Simulator, or ATS, for full chip, transistor-level simulation of either pure digital or mixed analog and digital designs.

For years analog/mixed-signal design teams have been seeking to move to a top-down approach. The Cadence AMS designer enables them to do so. It is a mixed-signal environment and analog/mixed-signal simulator, the latter of which is based on Cadence's popular NC-Sim and SPECTRE simulators.

Printed Circuit Board Design Tools

Cadence offers a range of tools to address the wide variety of PCB designs. The OrCAD product line delivers personal productivity for individual engineers. OrCAD products include capture, layout, and board-level simulation capabilities. For teams creating state-of-the-art designs, Cadence offers software under the ALLEGRO®, SPECCTRA®, and SPECCTRAQUEST™ brands. The ALLEGRO program is a correct-by-design system for physical design and analysis of printed circuit boards, multi-chip modules, hybrids, and Multiwire™ board designs. The SPECCTRA product line provides placement editing, automatic shape-based routing and a route editor. SPECCTRAQUEST software provides advanced system design and analysis capabilities. Using SPECCTRAQUEST software, designers can explore and make choices between timing, signal integrity, crosstalk, power delivery and EMI, to optimize electrical performance and reliability before manufacturing. The Cadence Advanced Packaging Ensemble provides package layout and analysis so design teams can ensure quality interconnects between IC dies.

Third-Party Tool Support

Cadence supports the integration of third-party and in-house proprietary tools through its ALANZA™ services. The ALANZA engineers work with customers, foundries, application-specific integrated circuit, or ASIC, vendors, and other EDA companies to ensure that Cadence tools work well in any design environment. To date, more than 125 companies have integrated their tools with Cadence software.

Electronic Design Automation Services

To complement its tools, Cadence provides a range of EDA services that keep electronic design teams as productive as possible. These include educational services, support services, design services, and methodology services. The company's educational services include Internet, classroom, and custom courses that teach everything from how to use the most recent tool features to the latest design techniques. Support services include product maintenance and updates, and telephone and Internet-based technical support. Cadence also offers custom support services, which may include one or more of its standard support services plus account technical management, application and educational services, and metrics reporting. Maintenance and support agreements are offered to customers either as part of our product license agreement or under a separate maintenance agreement.

Design Services (Tality)

On July 17, 2000, Cadence announced its plan to separate its electronics design services group into a new company named Tality Corporation, or Tality. Tality's separation from Cadence was substantially completed on October 4, 2000, and accordingly the electronic design services business now operates as a majority-owned subsidiary of Cadence. Tality filed a registration statement with the Securities and Exchange Commission for Tality's initial public offering, or IPO. On October 9, 2000, Cadence announced the postponement of Tality's IPO due to unfavorable market conditions. Therefore, the financial statements and financial information in this Annual Report on Form 10-K do not give effect to the IPO.

Tality is a leading global provider of engineering services for the design of complex electronic systems and integrated circuits. Tality focuses its offerings primarily on the growing communications market. Targeted segments of this market include wireline and wireless communications infrastructure, high-speed data access equipment and consumer communication products. Tality provides engineering services that extend from product concept through manufacturing to help communications companies realize their product visions.

- **Concept**
Tality assists clients in refining a product concept and mapping technology options.
- **Specification**
Tality maps its clients' product concept into technology, partitions it into software and hardware, and defines how each component will operate.
- **Implementation**
Tality physically implements specifications into advanced integrated circuits, complex printed circuit boards and complete systems.
- **Prototype**
Tality works with third-party manufacturers to develop and deliver product prototypes for testing to identify and resolve remaining design issues.
- **Manufacturing support**
Tality assists clients through the process of moving to volume manufacturing.

Tality has over 1,000 engineers located at 14 design sites in the United States, Canada, the United Kingdom, and India. Since the beginning of 1998, Tality has completed over 500 design projects. Its clients include both leading and emerging electronic systems companies and integrated circuit manufacturers.

Tality's design solutions enable customers to address the pressures of increasing business and technological complexity, growing competition, resource constraints and the need to decrease time-to-market. Its engineering team has expertise in targeted segments of the communications market. Tality also has experience in systems design, embedded software and firmware design, printed circuit board and chip-level design and full systems integration. In addition, through its internal research and development efforts and its design projects, Tality has accumulated a growing portfolio of intellectual property that it may offer customers as part of its

electronics design services. To every design engagement, Tality brings an established design infrastructure comprised of the design automation tools, computing infrastructure and laboratory environments necessary for the development of clients' products. Tality also assists customers by providing project management services to address the growing complexities of the design phase of product development and offers assistance in the management of clients' supply chains through the application of its in-depth knowledge of and experience in technical and business management processes.

Methodology Services

Cadence's methodology services group offers a variety of services to help customers address electronic design challenges. It leverages Cadence's cumulative experience and knowledge of industry best practices to improve design productivity.

Marketing and Sales

Cadence generally uses a direct sales force consisting of sales people and applications engineers to license its products and market its consulting and design services to prospective customers. Applications engineers provide technical pre-sales as well as post-sales support for software products. The Cadence Methodology Services group provides on-site capabilities to help customers improve productivity with Cadence and other EDA products. Tality offers complete design services to its customers. Due to the complexity of EDA products and the electronic design process in general, the sales cycle is generally long (three to six months or more). During the sales cycle, the Cadence direct sales force generally provides technical presentations, product demonstrations, and on-site customer evaluations of Cadence software. Cadence also uses traditional marketing approaches to promote its products and services, including advertising, direct mail, telemarketing, trade shows, public relations, and the Internet.

Cadence markets and supports its products and services internationally (except in Japan) through its subsidiaries and various distributors. Cadence markets its consulting and design services in Japan through a wholly-owned subsidiary. Since the reorganization of Cadence's distribution channel in Japan in 1997, Cadence has licensed its products through Innotech Corporation, in which Cadence is an approximately 15% stockholder as of December 30, 2000.

A summary of Cadence's net revenue and long-lived assets by geographic area is set forth in the "Segment Reporting" note to the Consolidated Financial Statements, which information is incorporated herein by reference. Prices for international customers are quoted in a local currency from an international price list. The list is prepared based on the U.S. dollar price list but reflects the higher cost of doing business outside the United States. International customers are invoiced in the local currency or U.S. dollars using current exchange rates.

Cadence expects that revenue from its international operations will continue to account for a significant portion of its total revenue.

Exposure to foreign currency transaction risk can arise when transactions are conducted in a currency different from the functional currency of a Cadence subsidiary. Cadence uses foreign currency forward exchange contracts and purchases foreign currency put options to help protect against currency exchange risks. Although Cadence attempts to reduce the impact of foreign currency fluctuations, significant exchange rate movements may hurt Cadence's results of operations as expressed in U.S. dollars. Exchange rate gains and losses on the translation into U.S. dollars of amounts denominated in foreign currencies are included as a separate component of stockholders' equity and reflected losses of \$4.7 million in 2000, \$2.5 million in 1999, and \$1.4 million in 1998.

On January 1, 1999, 11 member countries of the European Union adopted the euro as their common legal currency and established fixed conversion rates between their sovereign currencies and the euro. Transactions can be made in either the sovereign currencies or the euro until January 1, 2002, when the euro must be used exclusively. Currently, only electronic transactions may be conducted using the euro. Cadence is in the process of upgrading its internal systems and believes that its financial institution vendors are capable of handling the

euro conversion and Cadence is in the process of examining current marketing and pricing policies and strategies that may be affected by conversion to the euro. The cost of this effort is not expected to materially harm Cadence's results of operations or financial condition. However, Cadence cannot assure you that all issues related to the euro conversion have been identified and that any additional issues would not materially harm Cadence's results of operations or financial condition. For example, the conversion to the euro may have competitive implications on Cadence's pricing and marketing strategies and Cadence may be at risk to the extent its principal European suppliers and customers are unable to deal effectively with the impact of the euro conversion. Cadence has not yet completed its evaluation of the impact of the euro conversion on its functional currency designations.

Cadence's international operations may also be subject to other risks, including:

- The adoption and expansion of government trade restrictions;
- Limitations on repatriation of earnings;
- Reduced protection of intellectual property rights in some countries;
- Recessions in foreign economies;
- Longer receivables collection periods and greater difficulty in collecting accounts receivable;
- Difficulties in managing foreign operations;
- Political and economic instability;
- Unexpected changes in regulatory requirements;
- Tariffs and other trade barriers; and
- U.S. government licensing requirements for export, as licenses can be difficult to obtain.

Research and Development

Cadence's investment in research and development was \$292.4 million in 2000, \$244.9 million in 1999, and \$224.5 million in 1998, prior to capitalizing software development costs of \$28.4 million, \$25.7 million, and \$21.7 million, respectively. See "Notes to Consolidated Financial Statements" for a more complete description of Cadence's capitalization of certain software development costs.

The primary areas of research include SOC design, the design of silicon devices in the deep submicron range, high-speed board design, architectural-level design, high-performance logic verification technology, and hardware/software co-design. The industries in which Cadence competes experience rapid technology developments, changes in industry standards, changes in customer requirements, and frequent new product introductions and improvements. If Cadence is unable to respond quickly and successfully to these developments and changes, Cadence may lose its competitive position and its products or technologies may become non-competitive or obsolete, in which case, revenues would be materially and adversely affected. In order to compete successfully, Cadence must develop or acquire new products and improve its existing products and processes on a schedule that keeps pace with technological developments in its industries. Cadence must also be able to support a range of changing computer software, hardware platforms, and customer preferences. There is no guarantee that Cadence will be successful in this respect.

Cadence's advanced research and development group, Cadence Laboratories, is committed to new technological development. This group is chartered with identifying and developing prototype technologies in emerging design areas that will offer substantially improved alternatives to current EDA solutions.

Competition

The electronic design automation product market and the commercial electronic design and methodology services industries are highly competitive. If Cadence is unable to compete successfully in these industries, it could seriously harm Cadence's business, operating results, and financial condition. To compete in these

industries, Cadence must identify and develop innovative and cost-competitive EDA products and market them in a timely manner. It must also gain industry acceptance for its design and methodology services and offer better strategic concepts, technical solutions, prices and response time, or a combination of these benefits, than those of other design companies and the internal design departments of electronics manufacturers. Cadence cannot assure you that it will be able to compete successfully in these industries. Factors that could affect Cadence's ability to succeed include:

- The development of competitive EDA products and design and methodology services could result in a shift of customer preferences away from Cadence's products and services and significantly decrease revenue;
- The electronics design and methodology services industries are relatively new and electronics design companies and manufacturers are only beginning to purchase these services from outside vendors;
- The pace of technology change demands continuous technological development to meet the requirements of next-generation design challenges; and
- There are a significant number of current and potential competitors in the EDA industry and the cost of entry is low.

In the EDA products industry, Cadence currently competes with three large companies, Avant! Corporation, Mentor Graphics Corporation, and Synopsys, Inc., and numerous smaller companies. Cadence also competes with manufacturers of electronic devices that have developed or have the capability to internally develop their own EDA products. In the electronics design and methodology services industries, Cadence competes with numerous electronic design and consulting companies as well as with the internal design capabilities of electronics manufacturers. Many manufacturers of electronic devices may be reluctant to purchase services from independent vendors such as Cadence because they wish to promote their own internal design departments. Electronics companies and management consulting firms continue to enter the electronics design and methodology services industries.

Proprietary Technology

Cadence's success depends, in part, upon its proprietary technology. Many Cadence products include software or other intellectual property licensed from third parties. Cadence generally relies on patents, copyrights, trademarks, and trade secret laws to establish and protect its proprietary rights in technology and products. Despite precautions Cadence may take to protect its intellectual property, Cadence cannot assure you that third parties will not try to challenge, invalidate or circumvent these patents. Cadence also cannot assure you that the rights granted under its patents will provide it with any competitive advantages, patents will be issued on any of its pending applications, or future patents will be sufficiently broad to protect Cadence's technology. Furthermore, the laws of foreign countries may not protect Cadence's proprietary rights in those countries to the same extent as U.S. law protects these rights in the U.S. Cadence may have to seek new or renew existing licenses for this software and other intellectual property in the future. The Cadence design services business also requires it to license the software or other intellectual property of third parties. Cadence's failure to obtain for its use software or other intellectual property licenses or other intellectual property rights on favorable terms, or the need to engage in litigation over these licenses or rights, could seriously harm Cadence's business, operating results, and financial condition.

Cadence cannot assure you that its reliance on licenses from or to third parties, or patent, copyright, trademark, and trade secret protection, will be enough to be successful and profitable in the industries in which Cadence competes. There are numerous patents in the EDA industry and new patents are being issued at a rapid rate. It is not always economically practicable to determine in advance whether a product or any of its components infringes the patent rights of others. As a result, Cadence may be forced to respond to or prosecute intellectual property infringement claims to protect its rights or defend a customer's rights. These claims, regardless of merit, could consume valuable management time, result in costly litigation, or cause product shipment delays, all of which could seriously harm Cadence's business, operating results, and financial condition. In settling these claims, Cadence may be required to enter into royalty or licensing agreements with

the third parties claiming infringement. These royalty or licensing agreements, if available, may not have terms acceptable to Cadence. Being forced to enter into a license agreement with unfavorable terms could seriously harm Cadence's business, operating results, and financial condition.

Manufacturing

Cadence software production operations consist of configuring the proper version of a product, outsourcing the recording of the product on magnetic tape or CD-ROM, and producing customer-unique access keys allowing customers to use licensed products. User manuals and other documentation are generally available on CD-ROM, but are occasionally supplied in hard copy format. Software and documentation are also made available to selected customers by electronic distribution over the Internet.

Cadence performs final assembly and test of its emulation products in San Jose, California. Subcontractors manufacture all major subassemblies, including all individual printed circuit boards and custom integrated circuits, and supply them to Cadence for qualification and testing prior to their incorporation into the assembled product.

Cadence has generally been able to obtain adequate manufacturing supplies in a timely manner from existing sources or, where necessary, from alternative sources of supply. However, a reduction or interruption in supply or a significant increase in the price of one or more components would adversely affect Cadence's business, operating results, and financial condition and could damage customer relationships.

Employees

As of February 28, 2001, Cadence employed approximately 5,650 persons, with approximately 3,250 in sales, services, marketing, support and manufacturing activities, 1,600 in product development and 800 in management, administration and finance. None of Cadence's employees is represented by a labor union, and Cadence has experienced no work stoppages. Cadence believes that its employee relations are good.

Factors That May Affect Future Results

The following risk factors and other information included in this Annual Report on Form 10-K should be carefully considered. The risks and uncertainties described below are not the only ones Cadence faces. Additional risks and uncertainties not currently known to Cadence or that Cadence currently deems immaterial also may impair Cadence's business operations. If any of the following risks actually occurs, Cadence's business, operating results, and financial condition could be materially harmed. The risk factors affecting Tality Corporation which is, and immediately after its initial public offering will remain, a subsidiary of Cadence, are described in detail in the Registration Statement on Form S-1 filed by Tality Corporation with the Securities and Exchange Commission on July 17, 2000, as amended. Unless specifically noted, references to Cadence in the discussion below are references to Cadence and its subsidiaries, including Tality Corporation and its subsidiaries.

Cadence is subject to the cyclical nature of the integrated circuit industry and the electronics systems industry, and the current downturn or any future downturns may reduce our revenue

Purchases of our products and services are highly dependent upon the commencement of new design projects by integrated circuit manufacturers and electronics systems companies. The integrated circuit industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles, and wide fluctuations in product supply and demand. The integrated circuit and electronics systems industries have experienced significant downturns, often connected with, or in anticipation of, maturing product cycles of both these companies' and their customers' products and a decline in general economic conditions. These downturns have been characterized by diminished product demand, production over capacity, high inventory levels and accelerated erosion of average selling prices. During these downturns, the number of new design projects may decrease. Certain integrated circuit manufacturers and electronics systems companies have recently announced a

slowdown of demand and production. The current slowdown and any future downturns may reduce our revenue and harm our results of operations.

Cadence has reorganized its design services group as a separate company, which may impact its financial results

Since 1995, Cadence has operated an internal electronics design services group. On July 17, 2000, Cadence announced its plan to separate its design services group into a separate company focused on providing design solutions and proprietary technology to electronics product companies and integrated circuit manufacturers, and announced the planned initial public offering of the separate company. The separation was substantially completed on October 4, 2000. On October 9, 2000, Cadence announced that it had postponed Tality's initial public offering due to unfavorable market conditions. Upon completion of the planned initial public offering of Tality, Cadence expects that it will hold approximately 80% of the voting power of Tality. While Cadence does not currently plan to distribute to Cadence stockholders its equity interests in Tality Corporation or Tality's subsidiaries, it will have the right at any time to sell some or all of these equity interests. Cadence has agreed with the underwriters not to transfer its equity interests in Tality Corporation and limited partnership units in Tality, LP for 180 days after the date of the initial public offering of Tality Corporation, except with the prior written consent of Goldman, Sachs & Co. After the expiration of this 180-day period, Cadence will no longer be restricted from transferring any of its common stock of Tality Corporation or limited partnership units in Tality, LP to the public or its stockholders. Cadence currently expects that the principal factors that it would consider in determining whether and when to exchange, convert, sell or distribute to its stockholders any of its shares or partnership units include:

- The relative market prices of Tality's common stock and Cadence's common stock;
- The ability of an affiliate of Tality to make sales under Rule 144 of the Securities Act of 1933 or under an effective registration statement covering Cadence's shares of Tality's common stock;
- The absence of any court order or other regulation prohibiting or restricting such sales; and
- Other conditions affecting Tality's business or Cadence's other businesses.

Cadence has agreed to grant certain rights and provide certain services to Tality on terms that are more favorable to Tality than terms that would be offered to an unrelated party

In connection with the separation of Tality, Cadence entered into a number of agreements governing its business relationships with Tality and Cadence's provision of certain services to Tality, including provision of certain facilities, and accounting, finance, legal, human resources, and other administrative services, on terms that are more favorable to Tality than terms that would be offered to an unrelated entity. As a result, Cadence is obligated to provide certain services to Tality for the periods defined in the various agreements, some of which have long or unspecified terms, which may impact our financial results.

Cadence has historically suffered losses in its electronics design and methodology services business

The market for electronics design and methodology services is relatively new and rapidly evolving. Cadence's expenses of the design services business increased substantially in connection with the completion of Tality's separation from Cadence and its expenses may continue to increase as it seeks to expand its business. The rate of growth of Tality's revenue over prior periods may not continue or increase at all, and its separation and expansion may prove more expensive than Cadence anticipates. If Tality fails to increase its revenue to offset its expenses, Tality will continue to experience losses. Cadence's or Tality's failure to succeed in these services businesses may seriously harm Cadence's business, operating results, and financial condition.

The success of Cadence's electronic design and methodology services businesses depend on many factors that are beyond its control

In order to be successful with its electronics design and methodology services, Cadence must overcome several factors that are beyond its control, including the following:

- *Cadence's cost of services personnel is high and reduces gross margin.* Gross margin represents the difference between the amount of revenue from the sale of services and Cadence's cost of providing those services. Cadence must pay high salaries to attract and retain professional services personnel. This results in a lower gross margin than the gross margin in Cadence's software business. In addition, the high cost of training new services personnel or not fully utilizing these personnel can significantly lower gross margin.
- *A substantial portion of these services contracts are fixed-price contracts.* This means that the customer pays a fixed price that has been agreed upon ahead of time, no matter how much time or how many resources Cadence must devote to perform the contract. If Cadence's cost in performing the services consistently and significantly exceeds the amount the customer has agreed to pay, it could seriously harm Cadence's business, operating results, and financial condition.

Cadence's failure to respond quickly to technological developments could make its products uncompetitive and obsolete

The industries in which Cadence competes experience rapid technology developments, changes in industry standards, changes in customer requirements and frequent new product introductions and improvements. Currently, the electronic chip design industry is experiencing several revolutionary trends:

- The size of features such as wires, transistors, and contacts on chips is shrinking due to advances in semiconductor manufacturing processes. Process feature sizes refer to the width of the transistors and the width and spacing of the interconnect on the chip. Feature size is normally identified by the headline transistor length, which is shrinking from 0.35 microns to 0.18 microns and smaller. This is commonly referred to in the semiconductor industry as the migration to deep submicron and it represents a major challenge for all levels of the semiconductor industry from chip design and design automation to design of manufacturing equipment and the manufacturing process itself. Shrinkage of transistor length to such infinitesimal proportions (for reference, the diameter of the period at the end of this sentence is approximately 400 microns) is challenging fundamental laws of physics and chemistry.
- The ability to design very large chips, in particular integration of entire electronic systems onto a single chip instead of a circuit board (a process that is referred to in the industry as "SOC"), increases the complexity of managing a design that at the lowest level is represented by billions of shapes on the fabrication mask. In addition, systems typically incorporate microprocessors and digital signal processors that are programmed with software, requiring simultaneous design of the silicon chip and the related embedded software on the chip.

If Cadence is unable to respond quickly and successfully to these developments and changes, Cadence may lose its competitive position and its products or technologies may become uncompetitive or obsolete. In order to compete successfully, Cadence must develop or acquire new products and improve its existing products and processes on a schedule that keeps pace with technological developments in its industries. Cadence must also be able to support a range of changing computer software, hardware platforms and customer preferences. There is no guarantee that Cadence will be successful in this regard.

Cadence's failure to obtain software or other intellectual property licenses or adequately protect its proprietary rights could seriously harm its business

Cadence's success depends, in part, upon its proprietary technology. Many of Cadence's products include software or other intellectual property licensed from third parties, and Cadence may have to seek new or renew existing licenses for this software and other intellectual property in the future. Cadence's design services

business also requires it to license software or other intellectual property of third parties. Cadence's failure to obtain for its use software or other intellectual property licenses or other intellectual property rights on favorable terms, or the need to engage in litigation over these licenses or rights, could seriously harm Cadence's business, operating results, and financial condition.

Also, Cadence generally relies on patents, copyrights, trademarks and trade secret laws to establish and protect its proprietary rights in technology and products. Despite precautions Cadence may take to protect its intellectual property, Cadence cannot assure you that third parties will not try to challenge, invalidate, or circumvent these patents. Cadence also cannot assure you that the rights granted under its patents will provide it with any competitive advantages, patents will be issued on any of its pending applications, or future patents will be sufficiently broad to protect Cadence's technology. Furthermore, the laws of foreign countries may not protect Cadence's proprietary rights in those countries to the same extent as U.S. law protects these rights in the U.S.

Cadence cannot assure you that its reliance on licenses from or to third parties, or that patent, copyright, trademark, and trade secret protections, will be enough to be successful and profitable in the industries in which Cadence competes.

Intellectual property infringement by or against Cadence could seriously harm its business

There are numerous patents in the EDA industry and new patents are being issued at a rapid rate. It is not always economically practicable to determine in advance whether a product or any of its components infringes the patent rights of others. As a result, from time to time, Cadence may be forced to respond to or prosecute intellectual property infringement claims to protect its rights or defend a customer's rights. These claims, regardless of merit, could consume valuable management time, result in costly litigation, or cause product shipment delays, all of which could seriously harm Cadence's business, operating results, and financial condition. In settling these claims, Cadence may be required to enter into royalty or licensing agreements with the third parties claiming infringement. These royalty or licensing agreements, if available, may not have terms acceptable to Cadence. Being forced to enter into a license agreement with unfavorable terms could seriously harm Cadence's business, operating results, and financial condition. Any potential intellectual property litigation could force us to do one or more of the following:

- Pay damages to the party claiming infringement;
- Stop licensing, or providing services that use, the challenged intellectual property;
- Obtain a license from the owner of the infringed intellectual property to sell or use the relevant technology, which license may not be available on reasonable terms, or at all; or
- Redesign the challenged technology, which could be time-consuming and costly.

If we were forced to take any of these actions, our business and results of operations may be harmed.

Cadence obtains key components for its hardware products from a limited number of suppliers

Cadence depends on several suppliers for certain key components and board assemblies used in its hardware-based verification products. Cadence's inability to develop alternative sources or to obtain sufficient quantities of these components or board assemblies could result in delays or reductions in product shipments. In particular, Cadence currently relies on Taiwan Semiconductor Manufacturing Corporation for the supply of key integrated circuits and on IBM for the hardware components for both Cadence's COBALT™ product and MERCURYPLUS™. Other disruptions in supply may also occur. If there were such a reduction or interruption, Cadence's results of operations would be seriously harmed. Even if Cadence can eventually obtain these components from alternative sources, a significant delay in Cadence's ability to deliver products would result.

Fluctuations in quarterly results of operations could hurt Cadence's business and the market price of its stock

Cadence has experienced, and may continue to experience, varied quarterly operating results. Various factors affect Cadence's quarterly operating results and some of them are not within Cadence's control, including the mix of products and services sold, the mix of licenses used to sell products and the timing of significant orders for its software products and services by customers. Quarterly operating results are affected by the mix of products and services sold because there are significant differences in margins from the sale of hardware and software products and services. For example, based on a three-year average in 1999, Cadence had realized gross margins on software product sales of approximately 87% but realized gross margins of approximately 64% on hardware product sales and 30% on its performance of services. In 2000, realized gross margins decreased to approximately 78% for software products, remained flat at 64% for hardware products and increased to approximately 31% for services. In addition, Cadence's quarterly operating results are affected by the mix of licenses entered into in connection with the sale of software products. Cadence has three basic licensing models: perpetual, fixed-term, and subscription. Perpetual and fixed-term licenses recognize a larger portion of the revenue at the beginning of the license period and subscription licenses recognize revenue ratably over each quarter of the term of the license. As Cadence customers purchase more software products pursuant to subscription agreements, future operating results may be lower than that of comparable quarters in which perpetual and fixed-term licenses were in greater use for software product transactions. Finally, Cadence's quarterly operating results are affected by the timing of significant orders for its software products because a significant number of contracts for software products are in excess of \$5 million. The failure to close a contract for the sale of one or more orders of Cadence's software products could seriously harm its quarterly operating results.

Sales of Cadence's hardware products depend, in significant part, upon the decision of the prospective customer to commence a project for the design and development of complex computer chips and systems. These projects often require significant commitments of time and capital. Cadence's hardware sales may be delayed if customers delay commencement of projects. Lengthy hardware sales cycles subject Cadence to a number of significant risks over which Cadence has little or no control, including insufficient, excess or obsolescent inventory, variations in inventory valuation and fluctuations in quarterly operating results.

In addition, Cadence bases its expense budgets partially on its expectations of future revenue. However, it is difficult to predict revenue levels or growth. Revenue levels that are below Cadence's expectations could seriously hurt Cadence's business, operating results, and financial condition. If revenue or operating results fall short of the levels expected by public market analysts and investors, the trading price of Cadence common stock could decline dramatically. Also, because of the timing of large orders and its customers' buying patterns, Cadence may not learn of revenue shortfalls, earnings shortfalls or other failures to meet market expectations until late in a fiscal quarter, which could cause even more immediate and serious harm to the trading price of Cadence common stock.

Cadence believes that quarter-to-quarter comparisons of the results of operations of its services business segments may not be meaningful. Therefore, stockholders should not view Cadence's historical results of operations as reliable indicators of its future performance. In addition, many of our services engagements are terminable with little or no advance notice and without penalty. Since a significant portion of our costs is fixed, we may not be able to reduce our costs in a timely manner in connection with the unanticipated revenue loss when one or more projects is terminated.

The lengthy sales cycle of Cadence's products and services makes the timing of its revenue difficult to predict and may cause its operating results to fluctuate unexpectedly

Cadence has a lengthy sales cycle that generally extends at least three to six months. The length of our sales cycle may cause our revenue and operating results to vary unexpectedly from quarter to quarter. The complexity and expense associated with our business generally requires a lengthy customer education and approval process. Consequently, we may incur substantial expenses and devote significant management effort and expense to develop potential relationships that do not result in agreements or revenue and may prevent us from pursuing other opportunities.

In addition, sales of our products and services may be delayed if customers delay approval or commencement of projects because of:

- Customers' budgetary constraints and internal acceptance review procedures;
- The timing of customers' budget cycles; and
- The timing of customers' competitive evaluation processes.

If customers experience delays in their approval or project commencement activities, we may not learn of, and therefore be able to communicate to the public, revenue or earnings shortfalls until late in a fiscal quarter.

Cadence expects to acquire other companies and may not successfully integrate them or the companies it has recently acquired

Cadence has acquired other businesses before and is likely to do so again. While Cadence expects to analyze carefully all potential transactions before committing to them, Cadence cannot assure you that any transaction that is completed will result in long-term benefits to Cadence or its stockholders, or that Cadence's management will be able to manage the acquired businesses effectively. In addition, growth through acquisition involves a number of risks. If any of the following events occurs after Cadence acquires another business, it could seriously harm Cadence's business, operating results, and financial condition:

- Difficulties in combining previously separate businesses into a single unit;
- The substantial diversion of management's attention from day-to-day business when negotiating these transactions and then integrating an acquired business;
- The discovery after the acquisition has been completed of liabilities assumed from the acquired business;
- The failure to realize anticipated benefits such as cost savings and revenue enhancements;
- The failure to retain key personnel of the acquired business;
- Difficulties related to assimilating the products of an acquired business in, for example, distribution, engineering, and customer support areas;
- Unanticipated costs;
- Adverse effects on existing relationships with suppliers and customers; and
- Failure to understand and compete effectively in markets in which we have limited previous experience.

Cadence's international operations may seriously harm its financial condition because of several weak foreign economies and the effect of foreign exchange rate fluctuations

Cadence has significant operations outside the United States. Cadence's revenue from international operations as a percentage of total revenue was approximately 44% for fiscal 2000 and 52% for fiscal 1999. Cadence also transacts business in various foreign currencies. Recent economic uncertainty and the volatility of foreign currencies in certain parts of the Asia-Pacific region, has had, and may continue to have, a seriously harmful effect on Cadence's revenue and operating results.

Fluctuations in the rate of exchange between the U.S. dollar and the currencies of countries other than the U.S. in which Cadence conducts business could seriously harm its business, operating results, and financial condition. For example, if there is an increase in the rate at which a foreign currency exchanges into U.S. dollars, it will take more of the foreign currency to equal a specified amount of U.S. dollars than before the rate increase. If Cadence prices its products and services in the foreign currency, it will receive less in U.S. dollars than it did before the rate increase went into effect. If Cadence prices its products and services in U.S. dollars, an increase in the exchange rate will result in an increase in the price for Cadence's products and services compared to those products of its competitors that are priced in local currency. This could result in

Cadence's prices being uncompetitive in markets where business is transacted in the local currency. Cadence's international operations may also be subject to other risks, including:

- The adoption and expansion of government trade restrictions;
- Volatile foreign exchange rates and currency conversion risks;
- Limitations on repatriation of earnings;
- Reduced protection of intellectual property rights in some countries;
- Recessions in foreign economies;
- Longer receivables collection periods and greater difficulty in collecting accounts receivable;
- Difficulties in managing foreign operations;
- Political and economic instability;
- Unexpected changes in regulatory requirements;
- Tariffs and other trade barriers; and
- U.S. government licensing requirements for export which make licenses difficult to obtain.

Cadence expects that revenue from its international operations will continue to account for a significant portion of its total revenue.

Exposure to foreign currency transaction risk can arise when transactions are conducted in a currency different from the functional currency of a Cadence subsidiary. A subsidiary's functional currency is the currency in which it primarily conducts its operations, including product pricing, expenses and borrowings. Cadence uses foreign currency forward exchange contracts and purchases foreign currency put options to help protect against currency exchange risks. These forward contracts and put options allow Cadence to buy or sell specific foreign currencies at specific prices on specific dates. Increases or decreases in the value of Cadence's foreign currency transactions are partially offset by gains and losses on these forward contracts and put options. Although Cadence attempts to reduce the impact of foreign currency fluctuations, significant exchange rate movements may hurt Cadence's results of operations as expressed in U.S. dollars.

Foreign currency exchange risk occurs for some of Cadence's foreign operations whose functional currency is the local currency. The primary effect of foreign currency translation on Cadence's results of operations is a reduction in revenue from a strengthening U.S. dollar, offset by a smaller reduction in expenses. Exchange rate gains and losses on the translation into U.S. dollars of amounts denominated in foreign currencies are included as a separate component of stockholders' equity.

Failure to obtain export licenses could harm Cadence's business

Cadence must comply with U.S. Department of Commerce regulations in shipping its software products and other technologies outside the U.S. Although Cadence has not had any significant difficulty complying with these regulations so far, any significant future difficulty in complying could harm Cadence's business, operating results, and financial condition.

Cadence's inability to compete in its industries could seriously harm its business

The EDA market and the commercial electronics design and methodology services industries are highly competitive. If Cadence is unable to compete successfully in these industries, it could seriously harm Cadence's business, operating results, and financial condition. To compete in these industries, Cadence must identify and develop innovative and cost competitive electronic design automation software products and market them in a timely manner. It must also gain industry acceptance for its design and methodology services and offer better strategic concepts, technical solutions, prices and response time, or a combination of these factors, than those of other design companies and the internal design departments of electronics manufactur-

ers. Cadence cannot assure you that it will be able to compete successfully in these industries. Factors that could affect Cadence's ability to succeed include:

- The development of competitive EDA products and design and methodology services could result in a shift of customer preferences away from Cadence's products and services and significantly decrease revenue;
- The electronics design and methodology services industries are relatively new and electronics design companies and manufacturers are only beginning to purchase these services from outside vendors;
- The pace of the technology change demands continuous technological development to meet the requirements of next-generation design challenges; and
- There are a significant number of current and potential competitors in the EDA industry and the cost of entry is low.

In the EDA products industry, Cadence currently competes with three large companies, Avant! Corporation, Mentor Graphics Corporation, and Synopsys, Inc., and numerous smaller companies. Cadence also competes with manufacturers of electronic devices that have developed or have the capability to develop their own EDA products. Many manufacturers of electronic devices may be reluctant to purchase services from independent vendors such as Cadence because they wish to promote their own internal design departments. In the electronics design and methodology services industries, Cadence competes with numerous electronic design and consulting companies as well as with the internal design capabilities of electronics manufacturers. Other electronics companies and management consulting firms continue to enter the electronic design and methodology services industries.

Cadence's failure to attract, train, motivate, and retain key employees may harm its business

Competition for highly skilled employees is very intense. Cadence's business depends on the efforts and abilities of its senior management, its research and development staff, and a number of other key management, sales, support, technical, and services personnel. The high cost of training new personnel, not fully utilizing these personnel, or losing trained personnel to competing employers could reduce our gross margins and harm our business and operating results. Competition for these personnel is intense, particularly in geographic areas recognized as high technology centers such as the Silicon Valley area, where our principal offices are located, and the other locations where we maintain large facilities. To attract and retain individuals with the requisite expertise, we may be required to grant large numbers of stock options or other stock-based incentive awards, which may be dilutive to existing stockholders. We may also be required to pay significant base salaries and cash bonuses, which could harm our operating results. If we do not succeed in hiring and retaining candidates with appropriate qualifications, we will not be able to grow our business and our operating results will suffer. Cadence's failure to attract, train, motivate, and retain key employees would impair its development of new products, its ability to provide design and methodology services and the management of its businesses. This would seriously harm Cadence's business, operating results, and financial condition.

If Cadence become subject to unfair hiring claims, Cadence could be prevented from hiring needed personnel, incur liability for damages and incur substantial costs in defending itself

Companies in Cadence's industry whose employees accept positions with competitors frequently claim that these competitors have engaged in unfair hiring practices or that the employment of these persons would involve the disclosure or use of trade secrets. These claims could prevent us from hiring personnel or cause us to incur liability for damages. Cadence could also incur substantial costs in defending ourselves or its employees against these claims, regardless of their merits. Defending ourselves from these claims could also divert the attention of Cadence's management away from its operations.

Errors or defects in Cadence designs could expose it to liability and harm our reputation

Cadence's customers use its products and services in designing and developing products that involve a high degree of technological complexity, each of which has its own specifications and is based on various

industry standards. Because of the complexity of the systems and products with which Cadence works, some of its products and designs can be adequately tested only when put to full use in the marketplace. As a result, its customers or their end users may discover errors or defects in Cadence's software or the systems Cadence designs, or the products or systems incorporating its design and intellectual property may not operate as expected. Errors or defects could result in:

- Loss of current customers and loss of or delay in revenue and loss of market share;
- Failure to attract new customers or achieve market acceptance;
- Diversion of development resources to resolving the problem;
- Increased service costs; and
- Liability for damages.

We rely on a continuous power supply to conduct our operations, and California's current energy crisis could disrupt our operations and increase our expenses.

California is in the midst of an energy crisis that could disrupt our operations and increase our expenses. In the event of an acute power shortage, that is, when power reserves for the State of California fall below 1.5%, California has on some occasions implemented, and may in the future continue to implement, rolling blackouts throughout California. We currently have backup generators or alternate sources of power for critical operations in the event of a blackout. If blackouts interrupt our power supply, however, we may be temporarily unable to continue operations at our facilities. Any such interruption in our ability to continue operations at our facilities could damage our reputation, harm our ability to retain existing customers and to obtain new customers, and could result in lost revenue, any of which could substantially harm our business and results of operations. Our current insurance does not provide coverage for any damages we or our customers may suffer as a result of any interruption in our power supply.

Anti-takeover defenses in Cadence's charter, by-laws, and under Delaware law could prevent an acquisition of Cadence or limit the price that investors might be willing to pay for Cadence common stock

Provisions of the Delaware General Corporation Law that apply to Cadence and its Certificate of Incorporation could make it difficult for another company to acquire control of Cadence. For example:

- Section 203 of the Delaware General Corporation Law generally prohibits a Delaware corporation from engaging in any business combination with a person owning 15% or more of its voting stock, or who is affiliated with the corporation and owned 15% or more of its voting stock at any time within three years prior to the proposed business combination, for a period of three years from the date the person became a 15% owner, unless specified conditions are met.
- Cadence's Certificate of Incorporation allows Cadence's Board of Directors to issue, at any time and without stockholder approval, preferred stock with such terms as it may determine. No shares of preferred stock are currently outstanding. However, the rights of holders of any Cadence preferred stock that may be issued in the future may be superior to the rights of holders of its common stock.
- Cadence has a rights plan, commonly known as a "poison pill," which would make it difficult for someone to acquire Cadence without the approval of Cadence's Board of Directors.

All or any one of these factors could limit the price that certain investors would be willing to pay for shares of Cadence common stock and could delay, prevent or allow Cadence's Board of Directors to resist an acquisition of Cadence, even if the proposed transaction was favored by a majority of Cadence's independent stockholders.

Item 2. Properties

Cadence's headquarters are located in San Jose, California, and Cadence owns the related land and buildings. Additionally, Cadence owns buildings in India and land and buildings in Scotland. The total square footage of Cadence's owned buildings is approximately 984,000 square feet.

Cadence leases additional facilities for its sales offices in the U.S. and various foreign countries, and its research and development and design services facilities in California and other states and in foreign countries including Scotland, India, Canada, England, and Japan.

Cadence believes that these facilities and the undeveloped land it owns adjacent to its current headquarters are adequate for its current needs and that suitable additional or substitute space will be available as needed to accommodate any expansion of Cadence's operations.

Item 3. Legal Proceedings

From time to time Cadence is involved in various disputes and litigation matters that arise in the ordinary course of business. These include disputes and lawsuits related to intellectual property, mergers and acquisitions, licensing, contract law, distribution arrangements, and employee relations matters.

Cadence filed a complaint in the U.S. District Court for the Northern District of California on December 6, 1995 against Avant! Corporation and certain of its employees for misappropriation of trade secrets, copyright infringement, conspiracy, and other illegal acts.

On January 16, 1996, Avant! filed various counterclaims against Cadence and Joseph B. Costello, Cadence's former President and Chief Executive Officer, and with leave of the court, on January 29, 1998, filed a second amended counterclaim. The second amended counterclaim alleges, *inter alia*, that Cadence and Mr. Costello had cooperated with the Santa Clara County, California, District Attorney and initiated and pursued its complaint against Avant! for anti-competitive reasons, engaged in wrongful activity in an attempt to manipulate Avant!'s stock price, and utilized certain pricing policies and other acts to unfairly compete against Avant! in the marketplace. The second amended counterclaim also alleges that certain Cadence insiders engaged in illegal insider trading with respect to Avant!'s stock. Cadence and Mr. Costello believe that they have meritorious defenses to Avant!'s claims, and each intends to defend such action vigorously. By an order dated July 13, 1996, the court bifurcated Avant!'s counterclaim from Cadence's complaint and stayed the counterclaim pending resolution of Cadence's complaint. The counterclaim remains stayed.

In an order issued on December 19, 1997, as modified on January 26, 1998, the District Court entered a preliminary injunction barring Avant! from any further infringement of Cadence's copyrights in DESIGN FRAMEWORKII® software, or selling, licensing or copying such product derived from DESIGN FRAMEWORK II, including, but not limited to, Avant!'s ArcCell products. On December 7, 1998, the District Court issued a further preliminary injunction, which enjoined Avant! from selling its Aquarius product line. Cadence posted a \$10 million bond in connection with the issuance of the preliminary injunction. On July 30, 1999, the U.S. Court of Appeals for the Ninth Circuit affirmed the preliminary injunction.

By an order dated July 22, 1997, the District Court stayed most activity in the case pending in that court and ordered Avant! to post a \$5 million bond in light of related criminal proceedings pending against Avant! and several of its executives.

On September 7, 1999, the District Court ruled on the parties' Motions for Summary Adjudication, and granted in part, and denied in part, each party's motion regarding the scope of a June 6, 1994 Release Agreement between the parties. The court held that Cadence's copyright infringement claim against Avant! is not barred by the release and that Cadence may proceed on that claim. The court also held that Cadence's trade secret claim based on Avant!'s use of Cadence's DESIGN FRAMEWORK II source code is barred by the release. The Ninth Circuit has agreed to hear both parties' appeal from the District Court's order. The trial date has been vacated pending a decision on the appeal and the outcome of the criminal case, for which the trial is scheduled to begin in April 2001.

In February 1998, Aptix Corporation and Meta Systems, Inc. filed a lawsuit against Quickturn Design Systems, Inc. in the U.S. District Court for the Northern District of California. In this lawsuit, entitled *Aptix Corporation and Meta Systems, Inc. v. Quickturn Design Systems*, Civil Action No. C 98-00762 WHA, Aptix and Meta Systems alleged that Quickturn infringed a U.S. patent owned by Aptix and licensed to Meta. Quickturn filed a counterclaim requesting the District Court to declare the Aptix patent invalid in view of the prior art and unenforceable based on inequitable conduct during the prosecution of the patent. In June 2000 the District Court entered judgment in favor of Quickturn, dismissing the complaint and declaring the patent unenforceable. On September 8, 2000 the Court ordered Aptix to pay \$4.2 million to Quickturn as reimbursement to Quickturn of the attorneys' fees and costs it incurred in the litigation. Aptix has appealed the District's Court's judgment and, in the meantime, has agreed to post a \$2 million bond to secure the judgment.

On January 7, 1999, in the suit captioned *Mentor Graphics Corporation, et. al. v. Lobo, et. al.*, Delaware Chancery Court, New Castle County, Civ. Action No. 16843-NC ("*Mentor v. Lobo*"), an amended complaint was filed and served by Mentor asserting claims against Cadence, Quickturn Design Systems, Inc. and its Board of Directors for declaratory and injunctive relief for various alleged breaches of fiduciary duty purportedly owned by Quickturn and its Board of Directors to Quickturn's shareholders in connection with the merger between Quickturn and Cadence. Mentor alleged that Cadence aided and abetted Quickturn and its Board of Directors in those purported breaches. Mentor has not prosecuted the matter since January 1999. In May 2000, Mentor advised the Delaware Chancery Court of its objection to the settlement of a companion action brought on behalf of certain Quickturn shareholders. Mentor further advised the court that it would seek an award of attorneys' fees related to its prosecution of the *Mentor v. Lobo* action. At the request of the court, on July 28, 2000, Mentor filed its brief in support of its standing to seek such an award. Cadence, Quickturn and the individual defendants have opposed Mentor's request. A hearing on the matter was held on February 1, 2001. The court has taken the matter under submission.

On April 30, 1999, Cadence and several of its officers and directors were named as defendants in a lawsuit filed in the U.S. District Court for the Northern District of California, entitled *Spett v. Cadence Design Systems, et al.*, civil action no. C 99-2082. The action was brought on behalf of a class of stockholders who purchased Cadence common stock between November 4, 1998 and April 20, 1999, and alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The lawsuit arises out of Cadence's announcement of its first quarter 1999 financial results. On September 18, 2000 the District Court granted Cadence's Motion to Dismiss Plaintiffs' Claims with leave to amend. To date, no amended complaint has been filed. Should an amended complaint be filed, Cadence and the individual defendants intend to continue their vigorous defense of the allegations.

In early 1999, Cadence entered into negotiations with Intellect Communications, Inc., and Intellect's wholly-owned subsidiary, DNA Enterprises, Inc., with respect to a potential purchase of substantially all the assets of DNA. The transaction was not consummated and, in July 1999, Intellect and DNA filed suit against Cadence in a Texas state court alleging breach of contract, fraud, negligent misrepresentation and breach of fiduciary duty, seeking unspecified compensatory and punitive damages. Cadence has answered, denying liability, and discovery has commenced. A trial date has been schedule for October 2001. Cadence believes that it has defenses to and disputes the allegations made by Intellect and DNA, including the allegation that a purchase contract was entered into, and intends to defend the action vigorously.

On July 21, 1999, Mentor filed suit against Quickturn in the U.S. District Court for the District of Delaware, alleging that Quickturn's MERCURY™ hardware emulation systems infringe U.S. Patent Nos. 5,777,489 and 5,790,832 allegedly assigned to Mentor. At Quickturn's request, Cadence was added as a party defendant. Mentor has since asserted that Quickturn's MERCURYPLUS™ emulation systems also infringe U.S. Patent Nos. 5,777,489 and 5,790,832. The complaint seeks a permanent injunction and unspecified damages. Cadence intends to vigorously defend itself against these claims. On December 14, 1999, this action was transferred to the U.S. District Court for the Northern District of California, and renumbered Civil Action No. C 99-5464 SI.

On February 25, 2000, Cadence and several of its officers were named as defendants in a lawsuit filed in the U.S. District Court for the Northern District of California, entitled *Maxick v. Cadence Design Systems, Inc.*, File No. C 00 0658PJH. The action was brought on behalf of a class of shareholders of OrCAD, Inc., and alleges violations of Section 14(d) (7) of the Securities Exchange Act of 1934, as amended, and Rule 14d-10 thereunder. The lawsuit arises out of Cadence's acquisition of OrCAD, which was completed in August 1999. Cadence's Motion to Dismiss plaintiffs' claims was denied. Discovery is continuing. The defendants believe the complaint is without merit and intend to continue their vigorous defense of the allegations.

On March 24, 2000, Mentor and Meta and several founders of Meta filed suit against Quickturn and Cadence and a former Quickturn employee in the U.S. District Court for the Northern District of California, Civil Action No. C 00-01030 WHA. The suit alleges patent infringement of a U.S. Patent allegedly assigned to Mentor, misappropriation of trade secrets and breach of confidence, and seeks unspecified damages, injunctive relief and the assignment to Mentor of a patent previously issued to Quickturn. Cadence intends to vigorously defend itself against these claims, and has filed a counterclaim for declaratory judgment of invalidity of several patents allegedly assigned to Mentor. Following a motion by Cadence, the former Quickturn employee was dismissed as a party to the action. Discovery in the action has subsequently been consolidated with discovery in Civil Action No. C 99-5464, the *Mentor v. Quickturn* suit transferred from Delaware.

In April 2000, Cadence filed suit against a former design services customer, IMI Telecommunications, Inc., for breach of contract relating to IMI Telecommunications' failure to make payments due and fulfill its obligations under a services agreement. Damages claimed by Cadence are approximately \$1 million. The defendant countersued, alleging breach of oral contract, rescission, negligent misrepresentation and fraud by Cadence and claiming damages exceeding \$100 million and seeking punitive damages exceeding \$500 million. Cadence filed a motion to dismiss the defendant's counterclaims, and a hearing on this motion was held on October 2, 2000. A ruling has not yet been issued. Cadence believes that it has defenses to and disputes the allegations made by IMI Telecommunications and intends to defend the action vigorously.

On September 11, 2000, Mentor filed a complaint against Quickturn and Cadence in the U.S. District Court for the Northern District of California (Case No. C-00-03291) accusing Quickturn and Cadence of infringing U.S. Patent No. 5,574,388, purportedly owned by Mentor and seeking unspecified damages and injunctive relief. Quickturn and Cadence believe the complaint filed by Mentor is without substance and that the patent that is the subject of this suit is invalid and not infringed. Cadence and Quickturn are vigorously defending the claim. On November 3, 2000, Mentor filed a motion for preliminary injunction, asking the Court to prohibit the sale of Quickturn's MERCURYPLUS emulation systems prior to trial of this action. The hearing on that motion is scheduled for March 30, 2001. The parties have agreed to consolidate this action with Civil Action Nos. C 99-5464 and C 00-01030 WHA, described above, for purposes of discovery and pre-trial motions. A trial date of October 7, 2002 has been set for all three actions.

On November 2, 2000, Mentor and Meta filed a complaint for declaratory judgment against Quickturn and Cadence in the U.S. District Court for the District of Oregon (Case No. C-00-1489) seeking a ruling that Mentor's proposed design verification approach (in which chip designers would use U.S.-based computer terminals to operate SimExpress emulation systems located overseas) will not infringe Quickturn's patents and will not violate the permanent injunction entered by the Oregon District Court on July 7, 1999 in Civil Action No. C-96-00342. On January 5, 2001, Quickturn and Cadence answered the complaint. In their answer, Quickturn and Cadence denied Mentor and Meta's contention, and asserted that Mentor and Meta's complaint lacks subject matter jurisdiction and is barred by *res judicata* and collateral estoppel. Quickturn and Cadence intend to vigorously contest this action.

On November 22, 2000, a former design services customer, Uniden Corporation, filed an action for fraud, negligent misrepresentation and breach of contract in the State Court of Texas against Cadence, and alleged those causes of action as well as others against Intel Corporation and entities related to Intel. Uniden seeks compensatory and punitive damages in an unspecified amount. The suit was filed after Cadence demanded payment of approximately \$1 million for design services rendered to Uniden. Cadence since has filed a counterclaim to recover the approximate \$1 million owed for services rendered. Intel has filed a motion for

forum non conviens requesting that the action be moved to California. Cadence has joined in that motion. Cadence intends to vigorously defend the action brought by Uniden.

Management believes that the ultimate resolution of the disputes and litigation matters discussed above will not have a material adverse effect on Cadence's business, operating results or financial condition. However, were an unfavorable ruling to occur in any specific period, there exists the possibility of a material adverse impact on the result of operations.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Executive Officers of Cadence

The executive officers of Cadence are as follows:

<u>Name</u>	<u>Age</u>	<u>Positions and Offices</u>
H. Raymond Bingham.....	55	President, Chief Executive Officer, and Director
Ronald R. Barris	58	Senior Vice President, Services
Kevin Bushby	45	Senior Vice President, Worldwide Field Operations
R.L. Smith McKeithen	57	Senior Vice President, General Counsel, and Secretary
William Porter	46	Senior Vice President and Chief Financial Officer
Robert P. Wiederhold	41	President and Chief Executive Officer of Tality Corporation
Robert A. Promm	49	Vice President and Corporate Controller

Executive officers are appointed by the Board of Directors and serve at the discretion of the Board.

H. RAYMOND BINGHAM has served as President and Chief Executive Officer of Cadence since April 1999. Mr. Bingham has been a director of Cadence since November 1997. From 1993 to April 1999, Mr. Bingham served as Executive Vice President and Chief Financial Officer of Cadence. Prior to joining Cadence, Mr. Bingham was Executive Vice President and Chief Financial Officer of Red Lion Hotels and Inns, an owner operator of a chain of hotels, for eight years. Mr. Bingham is a director of Legato Systems, Inc., Onyx Software Corporation, TenFold Corporation, and KLA-Tencor Corporation.

RONALD R. BARRIS joined Cadence in December 1999 as Senior Vice President, Strategy and became Senior Vice President, Services in August 2000. From 1993 to 1999 Mr. Barris served as a partner for Coopers & Lybrand in its high technology practice and subsequently in PricewaterhouseCoopers as the managing partner of its semiconductor practice. Mr. Barris previously worked at General Electric, FMC, Union Metal and Alliance Automation.

KEVIN BUSHBY joined Cadence in 1995 as Vice President and General Manager, European Operations and became Senior Vice President, Worldwide Field Operations in 2000. From 1990 to 1995 Mr. Bushby held several positions with Unisys Corporation, most recently as Vice President Sales and Marketing, Client Server Systems Division. Prior to this Mr. Bushby held positions in Convergent Technologies and Hewlett-Packard.

R.L. SMITH McKEITHEN joined Cadence in 1996 as Vice President, General Counsel, and Secretary and became Senior Vice President, General Counsel, and Secretary in 1998. From 1994 to 1996, he served as Vice President, General Counsel, and Secretary of Strategic Mapping, Inc. From 1988 to 1994, he served as Vice President, General Counsel, and Secretary of Silicon Graphics, Inc.

WILLIAM PORTER joined Cadence in 1994 as Vice President, Corporate Controller, and Assistant Secretary and became Senior Vice President and Chief Financial Officer in May 1999. From 1988 to 1994, Mr. Porter served as Technical Accounting and Reporting Manager and most recently as Controller of Cupertino Operations with Apple Computer, Inc., a personal computer company.

ROBERT P. WIEDERHOLD joined Cadence in 1996 as Vice President and General Manager of the Deep Submicron Business Unit and became Senior Vice President of Cadence Worldwide Design Services

Group in July 1998. In July 2000, Mr. Wiederhold became President and Chief Executive Officer of Tality Corporation, a subsidiary of Cadence. From 1994 to 1996, he served as Executive Vice President, Chief Operating Officer, and Director of High Level Design Systems, Inc. From 1985 to 1994, he held various positions with Cadence Design Systems, Inc., most recently as Vice President, Marketing for the Systems Division.

ROBERT A. PROMM joined Cadence in December 1999 as Vice President and Corporate Controller. From November 1997 to December 1999, Mr. Promm served as Vice President, Corporate Controller of Kaiser Foundation Health Plan, Inc. Prior to November 1997, Mr. Promm held several positions with Apple Computer, Inc., most recently as Vice President and Financial Controller.

PART II.

Item 5. Market for the Registrant's Common Equity and Related Stockholder Matters

Cadence common stock is traded on the New York Stock Exchange under the symbol CDN. Cadence has never declared or paid any cash dividends on its common stock in the past, and does not plan to pay cash dividends in the foreseeable future. As of March 6, 2001, Cadence had approximately 1,464 registered stockholders and estimates that it had approximately 42,007 beneficial owners of its common stock.

The following table sets forth the high and low sales price for Cadence common stock for each calendar quarter in the two-year period ended December 30, 2000:

	<u>High</u>	<u>Low</u>
<u>2000:</u>		
First Quarter	\$24.00	\$18.13
Second Quarter	\$20.81	\$13.50
Third Quarter	\$27.13	\$19.50
Fourth Quarter	\$28.69	\$21.25
<u>1999:</u>		
First Quarter	\$34.13	\$21.63
Second Quarter	\$26.63	\$10.63
Third Quarter	\$16.75	\$ 9.19
Fourth Quarter	\$24.06	\$13.31

Item 6. Selected Financial Data

The following selected consolidated financial data should be read in conjunction with the consolidated financial statements and the notes thereto and the information contained herein in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation." Historical results are not necessarily indicative of future results.

	Five Fiscal Years Ended December 30, 2000				
	2000	1999	1998	1997	1996
	(In thousands, except per share amounts)				
Revenue	\$1,279,550	\$1,093,303	\$1,320,180	\$1,036,773	\$888,642
Net income (loss)	\$ 49,977	\$ (14,075)	\$ 25,124	\$ 165,122	\$ 48,441
Net income (loss) per share — assuming dilution	\$ 0.19	\$ (0.06)	\$ 0.10	\$ 0.68	\$ 0.21
Total assets	\$1,477,321	\$1,459,659	\$1,481,916	\$1,153,247	\$875,754
Long-term obligations	\$ 3,298	\$ 25,024	\$ 136,380	\$ 1,599	\$ 20,292
Stockholders' equity	\$ 909,465	\$ 986,149	\$ 947,830	\$ 821,363	\$552,083

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the five-year summary of selected financial data and the Consolidated Financial Statements and notes thereto included elsewhere in this Annual Report on Form 10-K. All references to years represent fiscal years unless otherwise noted. Except for the historical information contained in this Annual Report on Form 10-K, the following discussion contains forward-looking statements based on current expectations that involve certain risks and uncertainties. Cadence's actual results could differ materially from those discussed herein. Factors that could cause actual results or performance to differ materially or contribute to such differences include, but are not limited to, those discussed below in "Disclosures about Market Risk", and "Liquidity and Capital Resources".

Overview

Cadence provides comprehensive software and other technology and offers design and methodology services for the product development requirements of the world's leading electronics companies. Cadence licenses its leading-edge electronic design automation, or EDA, software and hardware technology and provides a range of services to companies throughout the world to help its customers optimize their product development processes. Cadence is a supplier of end-to-end products and services, which are used by companies to design and develop complex chips and electronic systems including semiconductors, computer systems and peripherals, telecommunications and networking equipment, mobile and wireless devices, automotive electronics, consumer products, and other advanced electronics.

The worldwide electronics industry has experienced expansion driven primarily by the communications (networking and wireless) markets. However, the industry recently experienced a slowdown commencing in late 2000 and the severity of which has increased in early 2001. The electronics industry slowdown, especially in the semiconductor industry, may reduce our revenue and harm our results of operations.

On July 17, 2000, Cadence announced its plan to separate its electronics design services group into a new company named Tality Corporation, or Tality. Tality's separation from Cadence was substantially completed on October 4, 2000, and accordingly the electronic design services business now operates as a majority-owned subsidiary of Cadence. Tality filed a registration statement with the Securities and Exchange Commission for Tality's initial public offering, or IPO. On October 9, 2000, Cadence announced the postponement of Tality's IPO due to unfavorable market conditions. The financial statements and financial information in this Annual Report on Form 10-K do not give effect to the IPO.

On December 29, 2000, Cadence entered into a definitive agreement to acquire CadMOS Design Technology, Inc., a privately held design tools firm headquartered in San Jose. CadMOS provides solutions to the noise problems experienced in ultra-deep submicron, or UDSM, processes. Its noise-analysis solutions are targeted at both digital and mixed signal designers working in microprocessors, DRAMs, mixed-signal SOC, and ASICs. The acquisition was completed on February 28, 2001, in which Cadence acquired all of the outstanding stock of CadMOS and assumed all outstanding stock options. The acquisition will be accounted for as a purchase.

In December 1999, Cadence acquired all of the outstanding stock of Diablo Research Company LLC for cash and assumed all outstanding stock options of Diablo. Diablo was a high-technology engineering services firm with expertise in wireless communication, global positioning satellite solutions, and data transfer and home automation markets. The total purchase price was \$39.9 million and the acquisition was accounted for as a purchase.

In August 1999, Cadence acquired OrCAD, Inc., a supplier of computer-aided engineering and computer-aided design software and services for the printed circuit board industry, for cash. Cadence acquired all of the outstanding stock of OrCAD and assumed all outstanding stock options. The purchase price was \$131.4 million and the acquisition was accounted for as a purchase.

In May 1999, Cadence completed its merger with Quickturn Design Systems, Inc. Quickturn designed, manufactured, sold, and supported hardware and software products that verify the design of computer chips and electronic systems. Cadence acquired all of the outstanding shares of Quickturn common stock in a tax-

free, stock-for-stock transaction for approximately 24.6 million shares of Cadence common stock. The acquisition was accounted for as a pooling-of-interests. In addition, Cadence assumed all outstanding stock options and warrants of Quickturn. All prior period consolidated financial statements were restated as if the merger took place at the beginning of such periods, in accordance with required pooling of interests accounting and disclosures.

In January 1999, Cadence acquired Design Acceleration, Inc., or DAI, a supplier of design verification technology used in system-on-a-chip, or SOC, design. Cadence acquired all of the outstanding stock of DAI for approximately 0.6 million shares of Cadence common stock and \$2.9 million of cash. The total purchase price was \$25.7 million and the acquisition was accounted for as a purchase.

In September 1998, Cadence acquired all of the outstanding stock of Ambit Design Systems, Inc. for cash. Ambit was a leading developer of design automation technology used in SOC design. The total purchase price was \$255 million and the acquisition was accounted for as a purchase.

In September 1998, Cadence acquired the Bell Labs' Integrated Circuit Design Automation Group of Lucent Technologies Inc., or BLDA, for cash. BLDA was a design automation development organization that focused on the complex verification challenges companies face when designing integrated circuits and next-generation SOC. The total purchase price was \$58 million and the acquisition was accounted for as a purchase.

In March 1998, Cadence acquired all of the outstanding stock of Excellent Design, Inc., or EXD, for cash. EXD provided ASIC and SOC design and library development. The total purchase price was \$40.9 million and the acquisition was accounted for as a purchase.

In February 1998, Cadence acquired all of the outstanding stock of Symbionics Group Limited for approximately 1 million shares of Cadence common stock and \$21.3 million of cash. Symbionics provided product development design services to leading electronics manufacturers. The total purchase price was \$56.1 million and the acquisition was accounted for as a purchase.

Results of Operations

Revenue

	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>% Change</u>	
	(In millions)			<u>00/99</u>	<u>99/98</u>
Product	\$ 627.4	\$ 505.4	\$ 760.5	24%	(34)%
Services	336.0	294.9	265.2	14%	11%
Maintenance	<u>316.2</u>	<u>293.0</u>	<u>294.5</u>	8%	(1)%
Total revenue	<u>\$1,279.6</u>	<u>\$1,093.3</u>	<u>\$1,320.2</u>	17%	(17)%

Sources of Revenue as a Percent of Total Revenue

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Product	49%	46%	58%
Services	26%	27%	20%
Maintenance	25%	27%	22%

Product revenue increased \$122 million in 2000, when compared to 1999, primarily due to an overall increase in price and volume of license renewals with major customers. The increases in sales volume of products was primarily attributable to increased sales of intellectual property creation products, which include mixed signal and simulation products, integrated circuit implementation products, which include place and route, physical design, and physical verification products, and printed circuit board related products.

Product revenue decreased \$255.1 million in 1999, when compared to 1998, primarily due to the implementation of Cadence's new software subscription licensing model during the third quarter of 1999 and

to a lesser extent a decrease in sales volume of Cadence's software products. These decreases were partially offset by an increase in emulation hardware product revenue in the same periods and the favorable impact of foreign currency exchange rate differences, primarily the Japanese yen. Revenue associated with software products under subscription licenses is recognized ratably over the license period because the agreements allow customers to exchange licensed products for unspecified future technology.

Services revenue increased \$41.1 million in 2000, when compared to 1999, primarily due to an increase in Tality revenue of \$69.5 million, partially offset by a decrease of \$28.4 million in methodology services revenue. Tality's revenue increase is primarily due to increases in the total size of active client engagements and total client service hours billed. The decrease in methodology services engagements is primarily due to lower staffing levels. Services revenue increased \$29.7 million in 1999, when compared to 1998, primarily due to an increase in Tality revenue of \$23.6 million. Tality's increase is primarily due to an increase in the total size of active client engagements and an increase in total client service hours billed.

Maintenance revenue increased \$23.2 million in 2000 when compared to 1999, primarily due to the growth of the installed customer base. Maintenance revenue was relatively flat in 1999 compared to 1998.

Revenue by Geography

	<u>2000</u>	<u>1999</u> (In millions)	<u>1998</u>	<u>% Change</u>	
				<u>00/99</u>	<u>99/98</u>
Domestic	\$ 720.8	\$ 526.8	\$ 676.6	37%	(22)%
International	558.8	566.5	643.6	(1)%	(12)%
Total revenue	<u>\$1,279.6</u>	<u>\$1,093.3</u>	<u>\$1,320.2</u>	17%	(17)%

Revenue by Geography as a Percent of Total Revenue

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Domestic	56%	48%	51%
International	44%	52%	49%

International revenue decreased \$7.7 million in 2000 when compared to 1999, primarily due to decreases in product revenue in Japan and services revenue in Europe and Japan, partially offset by an increase in product and maintenance revenue in Europe.

International revenue decreased \$77.1 million in 1999 when compared to 1998, primarily due to decreases in product revenue in all international regions resulting from the implementation of Cadence's new subscription licensing model during the third quarter of 1999. The decrease in international product revenue was partially offset by an increase in services revenue in all international regions except Asia.

Other differences in the rate of revenue growth over the years presented and as compared geographically are primarily due to fluctuations in sales volume of place and route and physical design products and for Cadence's design and methodology services offerings.

Foreign currency exchange rates negatively affected reported revenue by \$3.8 million in 2000, primarily due to the weakening of the British pound and German mark in relation to the U.S. dollar, partially offset by the strengthening of the Japanese yen in relation to the U.S. dollar. Foreign currency exchange rates positively affected reported revenue by \$16.2 million in 1999, primarily due to the strengthening of the Japanese yen in relation to the U.S. dollar. Additional information about revenue by geographic areas can be found under "Segment Reporting" in the Notes to Consolidated Financial Statements.

Cost of Revenue

	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>% Change</u>	
				<u>00/99</u>	<u>99/98</u>
	(In millions)				
Product	\$ 89.9	\$ 79.5	\$ 77.5	13%	3%
Services	\$215.6	\$191.8	\$188.8	12%	2%
Maintenance	\$ 63.3	\$ 53.6	\$ 52.4	18%	2%

Cost of Revenue as a Percent of Related Revenue

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Product	14%	16%	10%
Services	64%	65%	71%
Maintenance	20%	18%	18%

Cost of product revenue includes costs of production personnel, packaging and documentation, royalties, and amortization of capitalized software development costs for software products. Manufacturing costs associated with hardware emulation system products include materials, labor, and overhead.

Cost of product revenue increased \$10.4 million or 13% in 2000 when compared to 1999. The increase was primarily due to increases in manufacturing expenses associated with emulation system products and amortization of capitalized software development costs. Cost of product revenue increased \$2 million or 3% in 1999 when compared to 1998. The increase was primarily due to increases in manufacturing expenses associated with emulation system products, the acquisition of OrCAD in 1999, and amortization of capitalized software development costs. These costs were offset partially by inventory obsolescence charges of \$5.7 million associated with the introduction of the MERCURY Design Verification System recorded in 1998, reductions in purchased software amortization, and third-party royalty expenses.

Because the majority of Cadence's cost of software product revenue does not vary significantly with changes in revenue, product gross margin increased in 2000 when compared to 1999, due primarily to increased sales of software products and the introduction of the new subscription licensing model during the third quarter of 1999.

Cost of services revenue includes costs associated with providing services to customers, primarily salaries and benefits, costs to recruit, develop and retain personnel, cost of software, depreciation, facilities and project management, and costs to maintain the infrastructure necessary to manage a services organization. Cost of services revenue increased \$23.8 million or 12% in 2000, when compared to 1999, primarily due to an increase in the number of design engineers. Cost of services revenue increased \$3 million or 2% in 1999, when compared to 1998, primarily due to increases in amortization of purchased software and distributor commission costs for methodology services in Japan, offset partially by a decrease in employee related costs, including incentive pay, associated primarily with Cadence's 1998 restructuring and lower revenues.

Services gross margins remained relatively flat in 2000 as compared to 1999. The increase in services gross margins to 35% in 1999, as compared to 29% in 1998, was primarily due to increased utilization of services capacity and the management of expenses. Services gross margins have been and may continue to be adversely affected by the cost of integrating new services professionals as well as Cadence's inability to fully utilize these resources. In addition, services gross margins may continue to be adversely affected by Cadence's inability to achieve operating efficiencies with its resources when implementing a growing number of service offerings.

Cost of maintenance revenue includes the cost of customer services, such as hot-line and on-site support, production personnel, packaging, and documentation of maintenance updates. Cost of maintenance revenue increased \$9.7 million or 18% in 2000, when compared to 1999, primarily due to costs associated with the OrCAD acquisition which was completed in the third quarter of 1999, for which there were no similar costs in the first seven months of 1999, and increases in employee-related costs and costs to invest in customer service.

Cost of maintenance revenue in absolute dollars and as a percent of related revenue remained relatively flat in 1999 when compared to 1998.

Amortization of Acquired Intangibles

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Amortization of acquired intangibles	\$80.5	\$61.8	\$18.5

Amortization of Acquired Intangibles as a Percent of Total Revenue

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Amortization of acquired intangibles	6%	6%	1%

Amortization of acquired intangibles increased \$18.7 million in 2000, when compared to 1999, primarily due to a full year’s amortization related to Cadence’s 1999 acquisitions of OrCAD and Diablo, partially offset by the decrease in amortization related to the \$13.3 million asset impairment charge of EXD in the fourth quarter of 1999. Amortization of acquired intangibles increased \$43.3 million in 1999, when compared to 1998, primarily due to the 1999 acquisitions of OrCAD and DAI, and a full year’s amortization related to Cadence’s 1998 acquisitions of Ambit, BLDA, EXD, and Symbionics. For additional information regarding these acquisitions see below under “In-Process Technology.”

Operating Expenses

	<u>2000</u>	<u>1999</u>	<u>1998</u>	<u>% Change</u>	
		(In millions)		<u>00/99</u>	<u>99/98</u>
Marketing and sales	\$390.1	\$354.2	\$340.3	10%	4%
Research and development	\$263.9	\$219.2	\$202.8	20%	8%
General and administrative	\$ 94.5	\$ 86.7	\$ 86.8	9%	0%

Operating Expenses as a Percent of Total Revenue

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Marketing and sales	30%	32%	26%
Research and development	21%	20%	15%
General and administrative	7%	8%	7%

Marketing and Sales

The increase in marketing and sales expenses of \$35.9 million for 2000, when compared to 1999, was primarily due to an increase in employee-related costs, the acquisition of OrCAD, and marketing program costs, partially offset by lower consulting costs. Foreign currency exchange rates positively affected marketing and sales expenses by \$2.7 million in 2000, when compared to 1999, primarily due to the weakening of the German mark, the French franc, and the British pound in relation to the U.S. dollar, partially offset by the strengthening of the Japanese yen in relation to the U.S. dollar. The increase in marketing and sales expenses of \$13.9 million for 1999, when compared to 1998, was primarily due to an increase in sales support costs, the acquisition of OrCAD, and marketing program costs, partially offset by lower employee-related costs, resulting from Cadence’s 1998 restructuring, lower employee training and education costs, and travel costs. Foreign currency exchange rates negatively affected marketing and sales expenses by \$4.6 million in 1999, when compared to 1998, primarily due to the strengthening of the Japanese yen in relation to the U.S. dollar.

Research and Development

The increase in net research and development expenses of \$44.7 million for 2000, when compared to 1999, was primarily attributable to higher employee-related costs, the acquisition of OrCAD which was completed in the third quarter of 1999 and for which there were no similar costs in the first seven months of 1999, and consulting and other services. The increase in net research and development expenses of \$16.4 million for 1999, when compared to 1998, was primarily attributable to higher employee-related costs due to increases in headcount from Cadence's acquisition of OrCAD in 1999 and the acquisitions of Ambit and BLDA in the third quarter of 1998, partially offset by increased capitalization of software development expenses.

Cadence's expenses in research and development, prior to the reduction for capitalization of software development costs, was \$292.4 million for 2000, \$244.9 million for 1999, and \$224.5 million for 1998, representing 23% of total revenue for 2000, 22% for 1999, and 17% for 1998. Cadence capitalized software development costs of approximately \$28.4 million for 2000, \$25.7 million for 1999, and \$21.7 million for 1998, which represented approximately 10% of total research and development expenditures for 2000, 1999, and 1998. The increase in capitalized software development costs in each of these three years resulted primarily from general increases in new product development. The amount of capitalized software development costs in any given period may vary depending on the exact nature of the development performed.

General and Administrative

General and administrative expenses increased \$7.7 million in 2000, when compared to 1999, primarily due to employee-related costs, partially offset by decreases in bad debt expense and consulting and outside services costs. General and administrative expenses remained relatively flat in 1999 when compared to 1998.

Amortization of Deferred Stock Compensation

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Amortization of deferred stock compensation	\$11.4	\$—	\$—

Amortization of Deferred Stock Compensation as a Percent of Total Revenue

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Amortization of deferred stock compensation	1%	0%	0%

Deferred stock compensation represents the difference between the exercise price of stock option grants to Tality employees and directors, and restricted stock sales to certain Cadence executives and key employees, and the deemed fair market value of Tality's common stock at the time of those grants and sales. For the year ended December 30, 2000, Cadence recorded a total of \$72.4 million of deferred stock compensation, \$64.1 million related to the stock option grants, and \$8.3 million related to the restricted stock sales. Cadence is amortizing deferred stock compensation to expense over the period during which the stock options and restricted stock vest, four years and one year, respectively.

Unusual Items

Described below are unusual item charges in 2000, 1999, and 1998.

	<u>2000</u>	<u>1999</u>	<u>1998</u>
		(In millions)	
Separation costs	\$6.8	\$ —	\$ —
Write-off of acquired in-process technology	—	20.7	194.1
Asset impairment	—	19.9	—
Restructuring charges	—	13.3	69.5
Merger costs	—	8.4	—
Litigation settlement	—	(3.0)	—
Total unusual items	<u>\$6.8</u>	<u>\$59.3</u>	<u>\$263.6</u>

Separation Costs

In the year ended December 30, 2000, Cadence recorded \$6.8 million in separation costs related to the separation of its design services business, and the related planned IPO of Tality, Cadence's newly formed subsidiary. These costs primarily include legal and accounting services, strategic business planning, information systems separation, development of compensation and benefits strategies, and recruitment and formation of Tality's senior management team.

In-Process Technology

In August 1999, Cadence acquired OrCAD, Inc., a supplier of computer-aided engineering and computer-aided design software and services for the printed circuit board industry, for cash. Cadence acquired all of the outstanding stock of OrCAD and assumed all outstanding OrCAD stock options. The purchase price was \$131.4 million and the acquisition was accounted for as a purchase.

Upon consummation of the OrCAD acquisition, Cadence immediately charged to expense \$11.8 million representing acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. See "Notes to Consolidated Financial Statements." The value assigned to acquired in-process technology was determined by identifying research projects in areas for which technological feasibility has not been established. The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects, and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty surrounding the successful development of the acquired in-process technology. Certain acquired in-process technology was commercially viable in 1999 and other acquired in-process technology became commercially viable in 2000. Expenditures to complete this acquired in-process technology did not exceed \$2.3 million.

At the time of its acquisition by Cadence, OrCAD's in-process research and development projects in the schematic entry area were related to the development of an online component catalog and a new schematic design entry interface. In-process research and development projects in the simulation area were related to a rearchitecture of the simulation engine and replacement of the simulation engine. Additional features under development included randomized expressions and no selection limits. The nature of the efforts to complete these projects related, in varying degrees, to the completion of all planning, designing, prototyping, verification, and testing activities that were necessary to establish that the proposed technologies meet their design specifications including functional, technical, and economic performance requirements.

The net cash flows resulting from the projects underway at OrCAD used to value the purchased research and development were based on management's estimates of revenue, cost of revenue, research and development costs, selling, general and administrative costs, and income taxes from such projects. The revenue projections were based on the potential market size that the projects address, Cadence's ability to gain market acceptance in these segments, and the life cycle of this in-process technology.

Estimated total revenue from the acquired in-process technology is expected to peak in 2001 and decline rapidly thereafter as other new products are expected to enter the market. In addition, a portion of the anticipated revenue had been attributed to enhancements of the base technology under development, and had been excluded from net cash flow calculations. Existing technology was valued at \$10.8 million. The net cash flows generated from the acquired in-process technology were expected to reflect earnings before interest, taxes, and depreciation of approximately 32% of the sales generated from in-process technology. However, there can be no assurance that these assumptions will prove accurate, or that Cadence will realize the anticipated benefit of the acquisition.

The discount of the net cash flows to their present value was based on the weighted average cost of capital, or WACC. The WACC calculation produces the average required rate of return of an investment in an operating enterprise, based on the required rates of return from investments in various areas of the enterprise. The rate used to discount the net cash flows from purchased in-process technology was 22%. The discount rate is sometimes higher than the WACC due to the inherent uncertainties in the estimates, including the uncertainty surrounding the successful development of the acquired in-process technology, the useful life of such technology, the profitability levels of such technology, if any, and the uncertainty of technological advances, all of which were unknown at that time.

In January 1999, Cadence acquired DAI, a supplier of design verification technology used in SOC design. Cadence acquired all of the outstanding stock of DAI for approximately 0.6 million shares of Cadence common stock and \$2.9 million of cash. The total purchase price was \$25.7 million and the acquisition was accounted for as a purchase.

Upon consummation of the DAI acquisition, Cadence immediately charged to expense \$8.9 million representing acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. See "Notes to Consolidated Financial Statements." The value assigned to acquired in-process technology was determined by identifying research projects in areas for which technological feasibility has not been established. The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects, and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty surrounding the successful development of the acquired in-process technology. Certain acquired in-process technology under development at the time of acquisition was initially expected to become commercially viable in 1999, but instead became viable in 2000. Expenditures to complete this in-process technology did not exceed \$1.5 million.

At the time of its acquisition by Cadence, DAI had several significant research and development projects in process that were intended to provide a next generation environment for design verification and analysis. These efforts included the development of a highly automated approach for high-level test bench creation and analysis, a waveform viewer capable of supporting analog and mixed signal designs, and a tool designed to analyze verification code coverage at the transactional level. The nature of the efforts to complete these in-process research and development projects related, in varying degrees, to the completion of all planning, designing, prototyping, verification, and testing activities that were necessary to establish that the proposed in-process technologies meet their design specifications, which include functional, technical, and economic performance requirements.

The net cash flows generated by the projects underway at DAI used to value the acquired in-process technology were based on management's estimates of revenue, cost of revenue, research and development costs, selling, general and administrative costs, and income taxes from such projects. The revenue projections were based on the potential market size that these projects address, Cadence's ability to gain market acceptance for these projects, and the life cycle of this in-process technology.

Estimated total revenue from the acquired in-process technology is expected to peak in 2001 through 2002 and decline rapidly thereafter as other new products are expected to enter the market. In addition, a portion of the anticipated revenue has been attributed to enhancements of the base technology under development, and has been excluded from net cash flow calculations. Existing technology was valued at \$11.4 million. The net cash flows generated from the acquired in-process technology are expected to reflect

earnings before interest, taxes, and depreciation of approximately 60% of the sales generated from in-process technology. However, there can be no assurance that these assumptions will prove accurate, or that Cadence will realize the anticipated benefits of this acquisition.

The discount applied to the net cash flows to calculate the present value of such net cash flows was based on the WACC. The rate used to discount the net cash flows from purchased in-process technology was 22%.

In September 1998, Cadence acquired all of the outstanding stock of Ambit for cash. Ambit was a leading developer of design automation technology used in SOC design. The total purchase price was \$255 million and the acquisition was accounted for as a purchase.

Upon consummation of the Ambit acquisition, Cadence immediately charged to expense \$106.5 million representing acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. See "Notes to Consolidated Financial Statements." The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects, and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty surrounding the successful development of the acquired in-process technology. The acquired in-process technology was commercially viable in 1999, with the exception of one module, called Datapath Compiler, which became commercially viable in 2000. BUILDGATES 3.0 software and Physically Knowledgeable Synthesis were commercially viable in 1999. Expenditures to complete all in-process technology did not exceed \$15 million.

At the time of its acquisition by Cadence, Ambit was working on several significant research and development projects that were intended to provide the next generation version of its existing product, BUILDGATES 2.2. The nature of the efforts to complete the next generation version of BUILDGATES related to the completion of all planning, designing, prototyping, verification, and testing activities that were necessary to establish that the proposed technologies meet their design specifications, including functional, technical, and economic performance requirements.

Cadence expects Ambit's creation of a fundamentally new approach to synthesis in deep submicron and in SOC to create the opportunity for additional revenue through the creation of an integrated, next generation version of BUILDGATES software.

In September 1998, Cadence acquired BLDA for cash. BLDA was a design automation development organization that focused on the complex verification challenges companies face when designing integrated circuits and next-generation SOC. The total purchase price was \$58 million and the acquisition was accounted for as a purchase.

Upon consummation of the BLDA acquisition, Cadence immediately charged to expense \$30.3 million representing acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. See "Notes to Consolidated Financial Statements." The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects, and discounting the net cash flows back to their present value. The discount rate includes a factor that took into account the uncertainty surrounding the successful development of the acquired in-process technology. The acquired in-process technology became commercially viable in 2000. Expenditures to complete this in-process technology did not exceed \$5 million.

BLDA's in-process research and development projects were related to its FORMALCHECK® and CLOVER® technologies. BLDA had two major enhancements underway for FORMALCHECK. This effort resulted in a revenue-generating product in 2000. BLDA's research and development related to CLOVER technology involved the design and development of new parasitic extraction tools, which were expected to substantially improve the performance and functionality of the technology. The parasitic extraction tools began generating revenue in 2000.

The net cash flows resulting from the projects underway at Ambit and BLDA used to value the purchased research and development were based on management's estimates of revenue, cost of revenue, research and development costs, selling, general and administrative costs, and income taxes from such projects. The

revenue projections were based on the potential market size that the projects address, Cadence's ability to gain market acceptance for these projects, and the life cycle of this in-process technology.

Estimated total revenue from the acquired in-process technology is expected to peak in 2001 through 2002 and decline rapidly in 2003 and 2004 as other new products enter the market. In addition, a portion of the anticipated revenue has been attributed to enhancements of the base technology under development, and has been excluded from net cash flow calculations. Existing technology was valued at \$50.3 million in connection with the Ambit acquisition and \$23.2 million in connection with the BLDA acquisition. There can be no assurance that these assumptions will prove accurate, or that Cadence will realize the anticipated benefit of the acquisitions. The net cash flows generated from the acquired in-process technology are expected to reflect earnings before interest, taxes, and depreciation of approximately 38% to 49% of the sales generated from this in-process technology.

The discount of the net cash flows to their present value was based on the WACC. The discount rates used to discount the net cash flows from acquired in-process technology were 28% for Ambit and 25% for BLDA. These discount rates reflected the uncertainty surrounding the successful development of the acquired in-process technology, the useful life of such technology, the profitability levels of such technology, if any, and the uncertainty of technological advances, all of which were unknown at that time.

In March 1998, Cadence acquired all of the outstanding stock of EXD. EXD provided ASIC and SOC design and library development. The total purchase price was \$40.9 million in cash and the acquisition was accounted for as a purchase.

Upon consummation of the EXD acquisition, Cadence immediately charged to expense \$28.4 million representing acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. See "Notes to Consolidated Financial Statements." The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty surrounding the successful development of the acquired in-process technology. The in-process projects were expected to be commercially viable on dates ranging from the end of 1998 through 2000. However, the progression of these projects became impaired in the fourth quarter of 1999 as discussed further below.

At the time of its acquisition by Cadence, EXD had several significant research and development projects in process that, if successful, would have represented the introduction of new products and technologies to meet future market needs. These efforts included the development of new tools for library generation, delay calculation, memory compilation, and semiconductor intellectual property technology. These new technologies were intended to be fully supportive of deep submicron design functions, which are a critical market requirement. The nature of the efforts required to complete these research and development projects related, to varying degrees, to the completion of all planning, designing, prototyping, verification, and testing activities that were necessary to establish that the proposed technologies meet their design specifications, including functional, technical, and economic performance requirements.

The successful completion of the EXD acquired in-process projects has been impaired and as a result differed significantly from the forecasted assumptions. In the fourth quarter of 1999, Cadence recorded a \$13.3 million asset impairment charge. This asset impairment charge resulted from reduced Japanese market opportunities and the loss of key EXD employees resulting in diminished cash flow projections. Cadence entered into certain support agreements with external parties to provide support for EXD software tools previously sold to Cadence customers. The fair value of the EXD acquired intangibles was based on an evaluation of the present value of their estimated expected future cash flows, discounted at 16%.

In February 1998, Cadence acquired all of the outstanding stock of Symbionics for approximately 1 million shares of Cadence common stock and \$21.3 million of cash. Symbionics provided product development design services to leading electronics manufacturers. The total purchase price was \$56.1 million and the acquisition was accounted for as a purchase.

Upon consummation of the Symbionics acquisition, Cadence immediately charged to expense \$28.5 million representing acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. See “Notes to Consolidated Financial Statements.” The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty surrounding the successful development of the acquired in-process technology. The in-process projects were commercially viable by the end of 1999. Expenditures to complete these projects did not exceed \$6 million.

At the time of its acquisition by Cadence, Symbionics was working on several significant research and development projects that, if successful, would meet future market needs. These efforts involve digital television, wireless home networking, cellular roaming and digital voice technologies, which were intended to ensure the long-term success and survival of the organization. The nature of the efforts required to complete the research and development projects related, to varying degrees, to the completion of all planning, designing, prototyping, verification, and testing activities that were necessary to establish that the proposed technologies meet their design specifications, including functional, technical, and economic performance requirements.

The net cash flows resulting from the projects which were underway at Symbionics used to value the acquired in-process technology at the time of acquisition were based on management’s estimates of revenue, cost of revenue, research and development costs, selling, general and administrative costs, and income taxes from such projects. The revenue projections are based on the potential market size that the projects address, Cadence’s ability to gain market acceptance in these segments and the life cycle of this in-process technology.

Estimated total revenue from the acquired in-process technology is expected to peak in 2001 and 2002 and decline rapidly thereafter as other new products enter the market. In addition, a portion of the anticipated revenue has been attributed to enhancements of the base technology under development, and has been excluded from net cash flow calculations. Existing technology was valued at \$6 million. There can be no assurance that these assumptions will prove accurate, or that Cadence will realize the anticipated benefit of the acquisition. The net cash flows generated from the acquired in-process technology are expected to reflect earnings before interest and taxes of approximately 39% of the sales generated from Symbionics’ in-process technology.

The discount applied to the net cash flows to calculate their present value was based on the WACC at the time of acquisition. The discount rates used to discount the net cash flows from the acquired in-process technology range from 22.5% to 27.5%. The discount rates are sometimes higher than the WACC due to the inherent uncertainties in the estimates, including the uncertainty surrounding the successful development of the acquired in-process technology, the useful life of such technology, the profitability levels of such technology, if any, and the uncertainty of technological advances, all of which were unknown at that time.

Asset Impairment

In 1999, Cadence incurred charges totaling \$19.9 million in asset impairment charges. Of this amount, \$13.3 million represented asset impairment of acquired intangibles from the EXD acquisition. This asset impairment charge resulted from reduced Japanese market opportunities and the loss of key EXD employees resulting in diminished cash flow projections. Cadence entered into certain support agreements with external parties to provide support for EXD software tools previously sold to Cadence customers. The fair value of the EXD acquired intangibles was based on an evaluation of the present value of the estimated expected future cash flows, discounted at 16%. The remaining \$6.6 million in asset impairment charges were incurred in connection with the cancellation of an information technology services contract with a third-party, the abandonment of capitalized software development costs associated with certain Cadence products that will no longer be sold, and the abandonment of certain third-party software licenses that will no longer be used by Cadence’s design services business.

Restructuring

In 1999, Cadence recorded \$13.3 million of restructuring charges that consisted of \$11.3 million to terminate approximately 100 employees and \$2 million to downsize and close excess facilities. Cadence's restructuring plans were primarily aimed at reducing costs after Cadence merged with Quickturn, further restructuring of Cadence's services business in Japan, and severance resulting from the resignation of Cadence's former Chief Executive Officer. Severance costs include severance benefits, notice pay, and outplacement services. All terminations and termination benefits were communicated to the affected employees prior to year-end and substantially all remaining severance benefits were paid in 2000.

Facilities consolidation charges of \$2 million were incurred in connection with the closure of 15 Quickturn facilities, including \$1 million to close duplicate and excess facilities and \$1 million of abandonment costs for the related leasehold improvements. Closure and exit costs include payments required under lease contracts, less any applicable sublease income, after the properties were abandoned, lease buyout costs, restoration costs associated with certain lease arrangements, and costs to maintain facilities during the period after abandonment. Asset-related write-offs consist of leasehold improvements of facilities that were abandoned and whose estimated fair market value is zero. As of December 30, 2000, 13 of the 15 Quickturn sites had been vacated. Noncancelable lease payments on vacated facilities will be paid out through 2003.

In 1998, Cadence recorded \$69.5 million of restructuring charges primarily associated with Cadence's worldwide restructuring plan announced in the second half of 1998. Cadence's restructuring plans and associated costs consisted of \$36.9 million to terminate approximately 700 employees, \$29.9 million to downsize and close excess facilities, and \$2.7 million of other restructuring expenses. Cadence's restructuring plan was primarily aimed at reducing the cost of excess personnel and capacity in its services business. A discussion about Cadence's gross margin trends for its services business can be found under "Cost of Revenue" within this section. Severance costs included severance benefits, notice pay, and outplacement services. In 1998, approximately \$10.1 million of these costs resulted from the acceleration of stock options vesting under employment agreements. All terminations and termination benefits were communicated to the affected employees prior to year-end and all remaining severance benefits were substantially paid in 1999.

Facilities consolidation charges of \$29.9 million were incurred in connection with the closure of 58 sales and engineering facilities, including \$16.7 million to downsize and close facilities and \$13.2 million in abandonment costs for the related leasehold improvements. Closure and exit costs included payments required under lease contracts, less any applicable sublease income, after the properties were abandoned, lease buyout costs, restoration costs associated with certain lease arrangements, and costs to maintain facilities during the period after abandonment. Asset related costs written-off consist of leasehold improvements of facilities that were abandoned and whose estimated fair market value is zero. As of December 30, 2000, all but one of the 58 sites had been vacated. Noncancelable lease payments on vacated facilities will be paid out through 2008.

Cadence also recorded \$2.7 million of other restructuring charges consisting primarily of cancellation fees associated with certain vendor and conference arrangements and abandoned software.

Liabilities for excess facilities and other restructuring charges are included in accrued and other long-term liabilities while severance and benefits liabilities are included in payroll and payroll related accruals. Actual amounts of termination benefits, facilities and other restructuring related payments can be found in Notes to Consolidated Financial Statements under "Restructuring."

Merger Costs

In connection with the acquisition of Quickturn in 1999 Cadence charged to expense merger costs of \$8.4 million, representing professional fees for financial advisors, attorneys, and accountants.

Litigation Settlement

In 1999, Cadence and Mentor announced the settlement of a patent infringement action pending in the U.S. District Court for the District of Oregon. As a result, the Court entered a judgment declaring that certain Quickturn patents are valid, enforceable, and were infringed by Mentor's sale of SimExpress products in the

U.S. Mentor is permanently enjoined from producing, marketing, or selling SimExpress emulation systems in the U.S. In connection with the settlement, Mentor paid Cadence \$3 million.

Other Income, net

Other income, net for 2000, 1999, and 1998 is as follows:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(In millions)		
Gain (loss) on foreign exchange	\$ 5.1	\$(0.6)	\$ 2.8
Interest income	4.6	5.4	13.5
Equity income (loss) from investments	1.1	0.1	(0.9)
Minority interest income (expense)	0.6	0.1	(0.2)
Interest expense	(2.4)	(3.3)	(3.7)
Other expense, net	<u>(4.4)</u>	<u>(0.3)</u>	<u>(0.9)</u>
Total other income, net	<u>\$ 4.6</u>	<u>\$ 1.4</u>	<u>\$10.6</u>

Other income, net, increased \$3.2 million in 2000, when compared to 1999, primarily due to an increase in foreign exchange gains, partially offset by \$2.2 million of investment losses from a venture capital partnership shown in other expense, net. Other income, net, decreased \$9.2 million in 1999, when compared to 1998, primarily due to interest income reductions of \$8.1 million and loss on foreign exchange of \$3.4 million. The decrease in interest income was primarily due to lower average cash and investment balances due in part to the payments made for acquisitions. The loss on foreign exchange was due to the expense of option premiums in relation to Cadence's hedging program.

Income Taxes

The provision for income taxes and the effective tax rates for 2000, 1999, and 1998 are as follows:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(Dollars in millions)		
Provision for income taxes	\$18.0	\$ 2.7	\$74.9
Effective tax rate	26.5%	(23.7)%	74.9%

As of December 30, 2000, Cadence had total net deferred tax assets of approximately \$82.7 million. Realization of the deferred tax assets will be dependent on generating sufficient taxable income prior to the expiration of certain net operating loss and tax credit carryforwards. Although realization is not assured, management believes that it is more likely than not that the net deferred tax assets will be realized. The amount of the net deferred tax assets, however, could be reduced or increased in the near term if actual facts, including the estimate of future taxable income, differ from those estimated.

The effective tax rate includes the write-off of acquired in-process technology of approximately \$20.7 million for 1999 and \$194.1 million for 1998. The effective tax rates, excluding the write-off of acquired in-process technology, were 28.9% for 1999 and 28.4% for 1998.

Disclosures About Market Risk

Interest Rate Risk

Cadence's exposure to market risk for changes in interest rates relates primarily to its investment portfolio and long-term debt obligations. While Cadence is exposed with respect to interest rate fluctuations in many of the world's leading industrialized countries, Cadence's interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. In this regard, changes in U.S. interest rates affect the interest earned on Cadence's cash and cash equivalents, short-term and long-term investments, and interest paid on its long-term debt obligations as well as costs associated with foreign currency hedges.

Cadence invests in high quality credit issuers and, by policy, limits the amount of its credit exposure to any one issuer. As stated in its policy, Cadence's first priority is to reduce the risk of principal loss. Consequently, Cadence seeks to preserve its invested funds by limiting default risk, market risk, and reinvestment risk. Cadence mitigates default risk by investing in only high quality credit securities that it believes to be low risk and by positioning its portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity.

On September 29, 2000, Cadence entered into two syndicated senior unsecured credit facilities that allow Cadence to borrow up to \$350 million, referred to as the 2000 Facilities. The 2000 Facilities replace a prior \$355 million revolving credit facility consisting of a \$177.5 million two-year revolving credit facility, which was terminated on September 27, 2000, and a \$177.5 million 364-day revolving credit facility, which was terminated immediately prior to consummation of the 2000 Facilities. One of the new 2000 Facilities is a \$100 million three-year revolving credit facility, referred to as the Three-Year Facility. The other new facility is a \$250 million 364-day revolving credit facility convertible into a two-year term loan, referred to as the 364-Day Facility. The Three-Year Facility terminates on September 29, 2003. The 364-Day Facility will terminate on September 28, 2001, at which time the 364-Day Facility may be converted to a two-year term loan with a maturity date of September 29, 2003, or, at the request of Cadence and with the consent of members of the bank group that wish to do so, the termination date of the 364-Day Facility may be extended for one additional 364-day period with respect to the portion of the 364-Day Facility that a consenting bank holds. For both the 2000 Facilities, Cadence has the option to pay interest based on LIBOR plus a spread of between 1.25% and 1.50%, based on a pricing grid tied to a financial covenant, or the higher of the (i) Federal Funds Rate plus 0.50% and (ii) prime rate. As a result, Cadence's interest expenses associated with this borrowing will vary with market rates. In addition, commitment fees are payable on the unused portion of the Three-Year Facility at rates between 0.25% and 0.34% based on a pricing grid tied to a financial covenant and on the unused portion of the 364-Day Facility at a fixed rate of 0.20%. Cadence may not borrow under the 364-Day Facility at any time that any portion of the Three-Year Facility remains unused. The 2000 Facilities contain certain financial and other covenants. As of December 30, 2000, Cadence had no outstanding borrowings under these credit facilities.

The table below presents the carrying value and related weighted average interest rates for Cadence's interest bearing instruments. All highly liquid investments with an original maturity of three months or less at the date of purchase are considered to be cash equivalents; investments with original maturities between three and 12 months are considered to be short-term investments. Investments with original maturities greater than 12 months are considered long-term investments. As of December 30, 2000, all of Cadence's investments have maturities of less than 12 months. The carrying value approximated fair value at December 30, 2000.

	<u>Carrying Value</u>	<u>Average Interest Rate</u>
	(In millions)	
Interest Bearing Instruments:		
Short-term investments — fixed rate	\$51.7	5.20%
Cash — variable rate	21.3	3.57%
Cash equivalents — variable rate	7.0	6.45%
Cash — fixed rate	2.5	7.09%
Cash equivalents — fixed rate	<u>2.2</u>	6.75%
Total interest bearing instruments	<u>\$84.7</u>	4.99%

Interest Rate Swap Risk

Cadence entered into a 4.8% fixed interest rate-swap in connection with its accounts receivable financing program to modify the interest rate characteristics of the receivables sold to a financing institution on a non-recourse basis. As of December 30, 2000, the notional amount payable was \$8.7 million that will be amortized

in quarterly installments of approximately \$2.2 million through October 2001. The estimated fair value at December 30, 2000 was negligible.

Foreign Currency Risk

Cadence's operations include transactions in foreign currencies and, as such, Cadence benefits from a weaker dollar and is adversely affected by a stronger dollar relative to major currencies worldwide. Accordingly, the primary effect of foreign currency transactions on Cadence's results of operations is a reduction in revenue from a strengthening U.S. dollar, offset by a smaller reduction in expenses.

Cadence enters into foreign currency forward exchange contracts and purchases foreign currency put options with financial institutions primarily to protect against currency exchange risks associated with existing assets and liabilities and probable but not firmly committed transactions, respectively. Forward contracts are not accounted for as hedges and, therefore, the unrealized gains and losses are recognized in other income, net in advance of the actual foreign currency cash flows with the fair value of these forward contracts being recorded as accrued liabilities.

Cadence purchases put options to hedge the currency exchange risks associated with probable but not firmly committed transactions. Probable but not firmly committed transactions consist of revenue from Cadence's products and maintenance contracts in a currency other than the functional currency. These transactions are made through Cadence's subsidiaries in Ireland and Japan. The premium costs of the put options are recorded in other current assets while the gains and losses are deferred and recognized in income in the same period as the hedged transaction. Gains and losses on accounting hedges realized before the settlement date of the related hedged transaction are also generally deferred and recognized in income in the same period as the hedged transaction. Cadence does not use forward contracts and put options for trading purposes. Cadence's ultimate realized gain or loss with respect to currency fluctuations will depend on the currency exchange rates and other factors in effect as the forward contracts and put options mature.

The table below provides information as of December 30, 2000 about Cadence's forward contracts. As of December 30, 2000, there were no put options outstanding. The information is provided in U.S. dollar equivalent amounts. The table presents the notional amounts, at contract exchange rates, and the weighted average contractual foreign currency exchange rates. These forward contracts mature prior to May 17, 2001.

	<u>Notional Amount</u>	<u>Weighted Average Contract Rate</u>
	(In millions)	
Forward Contracts:		
British pound sterling	\$ 51.4	1.44
Japanese yen	36.2	107.86
Canadian dollars	21.6	1.53
Euro	19.0	0.88
Swedish krona	<u>2.3</u>	9.69
	<u>\$130.5</u>	
Estimated fair value	<u>\$ 2.7</u>	

While Cadence actively manages its foreign currency risks on an ongoing basis, there can be no assurance that Cadence's foreign currency hedging activities will substantially offset the impact of fluctuations in currency exchange rates on its results of operations, cash flows, and financial position. On a net basis, foreign currency fluctuations did not have a material impact on Cadence's results of operations and financial position during the year ended December 30, 2000. The realized gain (loss) on the forward contracts as they matured was not material to the consolidated operations of Cadence.

Equity Price Risk

As part of its authorized repurchase program, Cadence has sold put warrants and purchased call options through equity derivative transactions. The put warrants, if exercised and settled by physical delivery of shares,

would entitle the holder to sell shares of Cadence common stock to Cadence at a specified price. Similarly, the call options entitle Cadence to buy shares of Cadence common stock at a specified price. Cadence has the option to elect “net share settlement”, rather than physical settlement, of put warrants it issues that are exercised; that is, Cadence has the right to settle the exercised put warrants with shares of Cadence common stock valued at the difference between the exercise price and the fair value of the stock at the date of exercise.

Cadence repurchases shares of its common stock under stock repurchase programs for issuance under its Employee Stock Purchase Plan, or ESPP, its 1997 Stock Option Plan, referred to as the 1997 Plan, and its 2000 Stock Option Plan, referred to as the 2000 Plan, adopted in January 2000. As part of these repurchase programs, Cadence has purchased and will purchase call options or has sold and will sell put warrants. These transactions may result in sales of a large number of shares and consequent decline in the market price of Cadence common stock. Cadence’s stock repurchase program includes the following characteristics:

- Call options allow Cadence to buy shares of its common stock on a specified day at a specified price. If the market price of the stock is greater than the exercise price of a call option, Cadence will typically exercise the option and receive shares of its stock. If the market price of the common stock is less than the exercise price of a call option, Cadence typically will not exercise the option.
- Call option issuers may accumulate a substantial number of shares of Cadence common stock in anticipation of Cadence’s exercising its call option and may dispose of these shares if and when Cadence fails to exercise its call option. This could cause the market price of Cadence common stock to fall.
- Depending on the exercise price of the put warrants and the market price of Cadence common stock at the time of exercise, “net share settlement” of the put warrants with Cadence common stock could cause Cadence to issue a substantial number of shares to the holder of the put warrant. The holder may sell these shares in the open market, which could cause the price of Cadence common stock to fall.
- Put warrant holders may accumulate a substantial number of shares of Cadence common stock in anticipation of exercising their put warrants and may dispose of these shares if and when they exercise their put warrants and Cadence issues shares in settlement of their put warrants. This could also cause the market price of Cadence common stock to fall.

The table below provides information as of December 30, 2000 about Cadence’s outstanding put warrants and call options. The table presents the contract amounts and the weighted average strike prices. The put warrants and call options expire on various dates through November 2001 and Cadence has the contractual ability to settle the options prior to their maturity.

	<u>2001</u> <u>Maturity</u>	<u>Estimated</u> <u>Fair Value</u>
	(Shares and contract amounts in millions)	
Put Warrants:		
Shares	5.5	
Weighted average strike price	\$22.90	
Contract amount	\$125.9	\$ 8.3
Call Options:		
Shares	4.0	
Weighted average strike price	\$23.14	
Contract amount	\$ 93.7	\$26.2

Liquidity and Capital Resources

At December 30, 2000, Cadence’s principal sources of liquidity consisted of \$137 million of cash and cash equivalents and short-term investments, as compared with \$118.8 million at January 1, 2000, and \$249.5 million at January 2, 1999, and the 2000 Facilities. As of December 30, 2000, Cadence had no outstanding borrowings under these credit facilities.

Cash provided by operating activities increased \$14.9 million to \$142.1 million in the year ended December 30, 2000 as compared to the year ended January 1, 2000, primarily due to increases in collections on outstanding receivables and net income before unusual items. Cash provided by operating activities decreased \$99.9 million to \$127.2 million in the year ended January 1, 2000 as compared to the year ended January 2, 1999, primarily due to decreases in net income before unusual items, accounts payable and accrued liabilities, and receivables, partially offset by increases in installment contract receivables and deferred revenue.

At December 30, 2000, Cadence had net working capital of \$65.3 million, as compared with \$58.4 million at January 1, 2000. The primary reasons for the increase were increases in short-term investments of \$44.4 million and accounts receivable of \$41.4 million, partially offset by an increase in deferred revenue of \$63.7 million.

In addition to its short-term investments, Cadence's primary investing activities consisted of acquisitions and the related acquired intangibles, purchases of property, plant, and equipment, capitalization of software development costs, and venture capital partnership investments, which combined represented \$183.7 million at December 30, 2000, \$306.8 million at January 1, 2000, and \$591.3 million at January 2, 1999 of cash used for investing activities.

Cadence sells put warrants and purchases call options through private placements. See "Notes to Consolidated Financial Statements." At December 30, 2000, Cadence had a maximum potential obligation related to put warrants to buy back 5.5 million shares of its common stock at an aggregate price of approximately \$125.9 million. These put warrants expire at various dates through November 2001 and Cadence has the contractual ability to settle the put warrants and call options prior to their maturity. Cadence has the ability to settle these put warrants with its stock and, therefore, no amount was classified out of stockholders' equity in Cadence's consolidated balance sheets.

As part of its overall investment strategy, Cadence has become a limited partner in a venture capital fund and is committed to invest up to \$100 million. As of December 30, 2000, Cadence had contributed approximately \$49.8 million to this partnership for venture funding, which is reflected in other assets in the accompanying consolidated balance sheets, net of operating losses.

On September 29, 2000, Cadence entered into two syndicated senior unsecured credit facilities that allow Cadence to borrow up to \$350 million, referred to as the 2000 Facilities. The 2000 Facilities replace a prior \$355 million revolving credit facility consisting of a \$177.5 million two-year revolving credit facility, which was terminated on September 27, 2000, and a \$177.5 million 364-day revolving credit facility, which was terminated immediately prior to consummation of the 2000 Facilities. One of the new 2000 Facilities is a \$100 million three-year revolving credit facility, referred to as the Three-Year Facility. The other new facility is a \$250 million 364-day revolving credit facility convertible into a two-year term loan, referred to as the 364-Day Facility. The Three-Year Facility terminates on September 29, 2003. The 364-Day Facility will terminate on September 28, 2001, at which time the 364-Day Facility may be converted to a two-year term loan with a maturity date of September 29, 2003, or, at the request of Cadence and with the consent of members of the bank group that wish to do so, the termination date of the 364-Day Facility may be extended for one additional 364-day period with respect to the portion of the 364-Day Facility that a consenting bank holds. For both the 2000 Facilities, Cadence has the option to pay interest based on LIBOR plus a spread of between 1.25% and 1.50%, based on a pricing grid tied to a financial covenant, or the higher of the (i) Federal Funds Rate plus 0.50% and (ii) prime rate. As a result, Cadence's interest expenses associated with this borrowing will vary with market rates. In addition, commitment fees are payable on the unused portion of the Three-Year Facility at rates between 0.25% and 0.34% based on a pricing grid tied to a financial covenant and on the unused portion of the 364-Day Facility at a fixed rate of 0.20%. Cadence may not borrow under the 364-Day Facility at any time that any portion of the Three-Year Facility remains unused. The 2000 Facilities contain certain financial and other covenants. As of December 30, 2000 Cadence had no outstanding borrowings under these credit facilities.

Cadence anticipates that current cash and short-term investment balances, cash flow from operations, and the remaining amounts available under the 2000 Facilities will be sufficient to meet its working capital and capital requirements on a short-and long-term basis.

New Accounting Standards

In September 2000, the Emerging Issues Task Force, or EITF, published their consensus on EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," which was taken up to address implementation of the EITF's March 2000 final consensus of EITF Issue No. 00-7, "Application of EITF Issue No. 96-13 to Equity Derivative Instruments That Contain Certain Provisions That Require Net Cash Settlement If Certain Events Outside the Control of the Issuer Occur." The final consensus in Issue 00-7 generally stated that equity derivative contracts that contain provisions that implicitly or explicitly require net cash settlement outside of the control of the company must be treated as assets and liabilities and carried at fair value with changes in fair value recognized in earnings rather than equity instruments carried at original cost and reported as part of permanent equity. This interpretation becomes effective June 30, 2001 and is not expected to have a material effect on Cadence's consolidated financial position, results of operations, or cash flows.

In September 2000, the FASB issued Statement of Financial Accounting Standards, or SFAS, No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 140 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishment of liabilities. It requires a company, after a transfer of financial assets, to recognize the financial and servicing assets it controls and the liabilities it has incurred, derecognize financial assets when control has been surrendered, and derecognize liabilities when extinguished. This statement is effective for transfer and servicing of financial assets and extinguishments after March 31, 2001, as well as for disclosures relating to securitization transactions for fiscal years ending after December 15, 2000. The adoption of this statement is not expected to have a material effect on Cadence's consolidated financial position, results of operations, or cash flows.

In March 2000, the Financial Accounting Standards Board, or FASB, issued interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation", an interpretation of Accounting Principles Board, or APB, Opinion No. 25. This interpretation provides guidance regarding the application of APB Opinion No. 25 to stock compensation involving employees. This interpretation was effective July 1, 2000 and did not have a material effect on Cadence's consolidated financial position, results of operations, or cash flows.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin, No. 101, "Revenue Recognition in Financial Statements," or SAB 101, which provides guidance on the recognition, presentation, and disclosure of revenue in financial statements. Cadence adopted SAB 101 in the fourth quarter of its fiscal 2000. The adoption of this statement did not have a material effect on Cadence's consolidated financial position, results of operations, or cash flows.

In June 1998, the FASB issued Statement of Financial Accounting Standards, or SFAS, No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. It requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met and that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. In June 1999, SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities — Deferral of the Effective Date of FASB Statement No. 133," was issued. The statement defers the effective date of SFAS No. 133 until the first quarter of fiscal 2001. The adoption of this statement is not expected to have a material effect on Cadence's consolidated financial position, results of operations, or cash flows.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

The information required by Item 7A is incorporated by reference from the section entitled "Disclosures About Market Risk" found in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Item 8. Financial Statements and Supplementary Data

The financial statements required by Item 8 are submitted as a separate section of this Annual Report on Form 10-K. See Item 14.

Summary Quarterly Data — Unaudited

	2000				1999			
	4th	3rd	2nd	1st	4th	3rd	2nd	1st
	(In thousands, except per share amounts)							
Revenue	\$390,914	\$332,461	\$298,682	\$257,493	\$268,022	\$225,897	\$264,193	\$335,191
Cost of revenue	\$101,072	\$ 96,105	\$ 88,012	\$ 83,668	\$ 82,734	\$ 81,577	\$ 81,838	\$ 78,694
Amortization of acquired intangibles	\$ 20,321	\$ 20,648	\$ 19,868	\$ 19,666	\$ 19,385	\$ 16,833	\$ 12,856	\$ 12,714
Gross margin	\$269,521	\$215,708	\$190,802	\$154,159	\$165,903	\$127,487	\$169,499	\$243,783
Net income (loss)	\$ 42,489	\$ 13,671	\$ 5,626	\$(11,809)	\$(22,484)	\$(41,446)	\$ (3,007)	\$ 52,862
Net income (loss) per share — diluted	\$ 0.16	\$ 0.05	\$ 0.02	\$ (0.05)	\$ (0.09)	\$ (0.17)	\$ (0.01)	\$ 0.20

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

None.

PART III.

Item 10. Directors and Executive Officers of the Registrant

The information required by Item 10 as to directors is incorporated by reference from the sections entitled "Election of Directors" and "Compliance with the Reporting Requirements of Section 16(a)" in Cadence's definitive Proxy Statement for its 2001 annual stockholders' meeting to be held on May 16, 2001.

The executive officers of Cadence are listed at the end of Part I of this Annual Report on Form 10-K.

Item 11. Executive Compensation

The information required by Item 11 is incorporated by reference from the section entitled "Director and Executive Compensation" in Cadence's definitive Proxy Statement for its 2001 annual stockholders' meeting to be held on May 16, 2001.

Item 12. Security Ownership of Certain Beneficial Owners and Management

The information required by Item 12 is incorporated by reference from the section entitled "Security Ownership of Certain Beneficial Owners and Management" in Cadence's definitive Proxy Statement for its 2001 annual stockholders' meeting to be held on May 16, 2001.

Item 13. Certain Relationships and Related Transactions

The information required by Item 13 is incorporated by reference from the section entitled "Certain Transactions" in Cadence's definitive Proxy Statement for its 2001 annual stockholders' meeting to be held on May 16, 2001.

PART IV.

Item 14. Exhibits, Financial Statements, Schedules, and Reports on Form 8-K

(a) 1. *Financial Statements:*

	<u>Page</u>
• Report of Independent Public Accountants	54
• Report of Independent Accountants, related to Quickturn Design Systems, Inc., as of and for the fiscal year ended December 31, 1998	55
• Consolidated Balance Sheets at December 30, 2000 and January 1, 2000.....	56
• Consolidated Statements of Operations for the three fiscal years ended December 30, 2000	57
• Consolidated Statements of Stockholders' Equity for the three fiscal years ended December 30, 2000	58
• Consolidated Statements of Cash Flows for the three fiscal years ended December 30, 2000	59
• Notes to Consolidated Financial Statements	60

(a) 2. *Financial Statement Schedules:*

II. Valuation and Qualifying Accounts and Reserves	92
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All other schedules are omitted because they are not required or the required information is shown in the financial statements or notes thereto.

(a) 3. *Exhibits:*

The following exhibits are filed with this Annual Report on Form 10-K:

<u>Exhibit Number</u>	<u>Exhibit Title</u>
2.01	Agreement and Plan of Merger, dated as of December 8, 1998 among the Registrant, Quickturn Design Systems, Inc. and CDSI Acquisition, Inc. as amended on December 16, 1998 and January 4, 1999 (Incorporated by reference to Exhibit 2.01 to the Registrant's Form 8-K filed on 12/10/98, as amended by Forms 8-K/A filed on 12/22/98, 1/6/99, and 5/20/99. The Disclosure Schedules related to the Merger Agreement have been omitted but will be provided to the Commission upon its request pursuant to Item 601 (b) (2) of Regulation S-K.
2.02	Master Separation Agreement, dated as of July 14, 2000 by and among the registrant, Cadence Holdings, Inc. and Tality Corporation (Incorporated by reference to Exhibit 2.01 from the Registrant's Form 10-Q for the second quarter ended July 1, 2000 (the 2000 Second Quarter Form 10-Q)).
2.03	Amended and Restated Agreement of Limited Partnership of Tality, LP dated October 4, 2000, between Tality Corporation and Cadence Holdings, Inc (Incorporated by reference to Exhibit 2.01 from the Registrant's Form 10-Q for the third quarter ended September 30, 2000 (the 2000 Third Quarter Form 10-Q)).
2.04	Amended and Restated Master Separation Agreement dated as of October 4, 2000 by and among Tality Corporation, the Registrant, Cadence Holdings, Inc. and Tality LP (Incorporated by reference to Exhibit 2.02 from the 2000 Third Quarter Form 10-Q).
2.05	General Assignment and Assumption Agreement dated as of October 4, 2000 by and among Tality Corporation, the Registrant, Cadence Holdings, Inc. and Tality, LP (Incorporated by reference to Exhibit 2.03 from the 2000 Third Quarter Form 10-Q).

<u>Exhibit Number</u>	<u>Exhibit Title</u>
2.06	Master Intellectual Property Ownership and License Agreement dated as of October 4, 2000 by and among Tality Corporation, the Registrant, Cadence Holdings, Inc. and Tality, LP (Incorporated by reference to Exhibit 2.04 from the 2000 Third Quarter Form 10-Q).
2.07	Employee Matters Agreement dated as of October 4, 2000 by and among Tality Corporation, the Registrant, Cadence Holdings, Inc. and Tality, LP (Incorporated by reference to Exhibit 2.05 from the 2000 Third Quarter Form 10-Q).
2.08	Master Corporate Services Agreement dated as of October 4, 2000 by and among Tality Corporation, the Registrant, Cadence Holdings, Inc. and Tality, LP (Incorporated by reference to Exhibit 2.06 from the 2000 Third Quarter Form 10-Q).
2.09	Real Estate Matters Agreement dated as of October 4, 2000 by and among Tality Corporation, the Registrant, Cadence Holdings, Inc. and Tality, LP (Incorporated by reference to Exhibit 2.07 from the 2000 Third Quarter Form 10-Q).
2.10	Master Confidentiality Agreement dated as of October 4, 2000 by and among Tality Corporation, the Registrant, Cadence Holdings, Inc. and Tality, LP (Incorporated by reference to Exhibit 2.08 from the 2000 Third Quarter Form 10-Q).
2.11	Indemnification and Insurance Matters Agreement dated as of October 4, 2000 by and among Tality Corporation, the Registrant, Cadence Holdings, Inc. and Tality, LP (Incorporated by reference to Exhibit 2.09 from the 2000 Third Quarter Form 10-Q).
2.12	Asset Purchase Agreement dated as of October 4, 2000 by and among the Registrant, Cadence Design System (Canada) Limited and Tality Canada Corporation (Incorporated by reference to Exhibit 2.10 from the 2000 Third Quarter Form 10-Q).
2.13	Asset Purchase Agreement dated as of October 3, 2000 by and among Symbionics Limited, the Registrant and Cadence Design Systems Limited (Incorporated by reference to Exhibit 2.11 from the 2000 Third Quarter Form 10-Q).
2.14	Fixed Term License Agreement dated as of October 4, 2000 between the Registrant and Tality, LP (Incorporated by reference to Exhibit 2.12 from the 2000 Third Quarter Form 10-Q).
2.15	Joint Technology Development and Support Agreement dated as of October 4, 2000 by and among Tality Corporation, the Registrant, Cadence Holdings, Inc. and Tality, LP (Incorporated by reference to Exhibit 2.13 from the 2000 Third Quarter Form 10-Q).
2.16	Joint Sales Agreement dated as of October 4, 2000 by and among Tality Corporation, the Registrant, Cadence Holdings, Inc. and Tality, LP (Incorporated by reference to Exhibit 2.14 from the 2000 Third Quarter Form 10-Q).
3.01	(a) The Registrant's Certificate of Ownership and Merger as filed with the Secretary of State of the State of Delaware on June 1, 1988 (Incorporated by reference to Exhibit 3.02(c) to the Registrant's Form S-1 Registration Statement (No. 33-23107) filed on July 18, 1988 (the 1988 Form S-1)). (b) The Registrant's Certificate of Designation of Series A Junior Participating Preferred Stock, as amended on February 1, 2000, as filed with the Secretary of State of the State of Delaware on June 8, 1989 (Incorporated by reference to Exhibit 3A to the Registrant's Current Report on Form 8-K (No. 0-15867) filed on June 12, 1989 (the 1989 Form 8-K) and amended by Exhibit 4.01 to this Form 10-K). (c) The Registrant's Certificate of Designation of Series A Convertible Preferred Stock as filed with the Secretary of State of the State of Delaware on December 30, 1991 (Incorporated by reference to Exhibit 3.01(f) from the Registrant's Form 10-K for the year ended December 31, 1991). (d) The Registrant's Certificate of Amendment of Certificate of Incorporation as filed with the Secretary of State of the State of Delaware on May 13, 1998 (Incorporated by reference to Exhibit 3.01(i) to the Registrant's Form 10-Q for the quarter ended July 4, 1998 (the 1998 Second Quarter Form 10-Q)).

<u>Exhibit Number</u>	<u>Exhibit Title</u>
	(e) The Registrant's Restated Certificate of Incorporation as filed with the Secretary of State of the State of Delaware on May 13, 1998 (Incorporated by reference to Exhibit 3.01(j) to the 1998 Second Quarter Form 10-Q).
3.02	The Registrant's Bylaws, as currently in effect (Incorporated by reference to Exhibit 3.02 to the 1987 Form S-1 and as amended by Exhibit 3-b to the 1989 Form 8-K and Exhibit 3.01 to the Registrant's Form 10-Q for the quarter ended April 3, 1999).
4.01	Specimen Certificate of the Registrant's Common Stock (Incorporated by reference to Exhibit 4.01 to the Registrant's Form S-4 Registration Statement (No. 33-43400) filed October 17, 1991).
4.02	Amended and Restated Rights Agreement, dated as of February 1, 2000, between the Registrant and ChaseMellon Shareholder Services, L.L.C. which includes as exhibits thereto the Certificate of Designation for the Series A Junior Participating Preferred Stock, the form of Rights Certificate, and the Summary of Rights to Purchase Preferred Shares. (Incorporated by reference to Exhibit 4.02 to the Registrant's 2000 Annual Report on Form 10-K).
10.01	The Registrant's 1987 Stock Option Plan, as amended and restated on February 23, 1998 (Incorporated by reference to the Registrant's Preliminary Proxy Statement filed on March 16, 1998 (the 1998 Preliminary Proxy Statement)).
10.02	Form of Stock Option Agreement and Form of Stock Option Exercise Request, as currently in effect under the Registrant's 1987 Stock Option Plan (Incorporated by reference to Exhibit 4.01 to the Registrant's Form S-8 Registration Statement (No. 33-22652) filed on June 20, 1988).
10.03	The Registrant's 1988 Directors Stock Option Plan, as amended, including the Stock Option Grant and Form of Stock Option Exercise Notice and Agreement (the first document is Incorporated by reference to Exhibit 4.02 to the Registrant's Form S-8 Registration Statement (No. 33-53913) filed on May 31, 1994 (the 1994 Form S-8) and the latter two documents are Incorporated by reference to Exhibit 10.08-10.10 to the 1988 Form S-1).
10.04	The Registrant's 1993 Directors Stock Option Plan including the Form of Stock Option Grant (Incorporated by reference to Exhibit 10.04 of the 1994 Form S-8).
10.05	The Registrant's 1995 Directors Stock Option Plan including the Form of Stock Option Grant (Incorporated by reference to Exhibit 10.05 to the Registrant's Form 10-K for the fiscal year ended December 30, 1995 (the 1995 Form 10-K)).
10.06	The Registrant's 1990 Employee Stock Purchase Plan, as amended on March 4, 1997 (Incorporated by reference to Exhibit 10.07 to the Registrant's Form 10-K for the fiscal year ended December 28, 1996).
10.07	The Registrant's Senior Executive Bonus Plan (previously the Chief Executive Officer Bonus Plan for 1996), as amended January 1, 1998 (Incorporated by reference to the 1998 Preliminary Proxy Statement).
10.08	The Registrant's Deferred Compensation Plan for 1994 (Incorporated by reference to Exhibit 10.09 to the 1994 Form 10-K).
10.09	The Registrant's 1996 Deferred Compensation Venture Investment Plan (Incorporated by reference to Exhibit 10.11 to the 1995 Form 10-K).
10.10	The 1993 Non-Statutory Stock Option Plan (Incorporated by reference to Exhibit 4.05 to the 1994 Form S-8).
10.11	The Registrant's Amended and Restated 401(k) Plan (Incorporated by reference to Exhibit 10.29 of the Registrant's Form 10-Q for the first quarter ended March 30, 1996 (the 1996 First Quarter Form 10-Q)).
10.12	Amendment, dated May 3, 1996 to Registrant's 1993 Non-Statutory Stock Option Plan (Incorporated by reference to Exhibit 10.30 to the 1996 First Quarter Form 10-Q).

<u>Exhibit Number</u>	<u>Exhibit Title</u>
10.13	Amendment, dated August 2, 1996 to the Registrant's 1993 Non-Statutory Stock Option Plan, (Incorporated by reference to Exhibit 10.39 to the 1996 Second Quarter Form 10-Q).
10.14	Distribution Agreement, dated April 28, 1997, among Cadence Design Systems (Ireland) Ltd., Cadence Design Systems K.K., and Cadence Design Systems (Japan) B.V. (Incorporated by reference to Exhibit 10.48 to the Registrant's Form 10-Q for the second quarter ended June 28, 1997).
10.15	CCT 1993 Equity Incentive Plan, Form of Equity Incentive Plan Stock Option Agreement, Form of Exercise of Equity Incentive Plan Stock Option and Form of Equity Incentive Plan Stock Option Exercise Agreement (Incorporated by reference to Exhibit 10.49 to the Registrant's Form S-4 Registration Statement (No. 333-16779) filed on November 27, 1996).
10.16	Employment Agreement, dated October 19, 1997, between the Registrant and John R. Harding (Incorporated by reference to Exhibit 10.41 to the Registrant's Form 10-K for the fiscal year ended January 3, 1998 (the 1997 Form 10-K)).
10.17	Indemnity Agreement, dated October 19, 1997, by and between the Registrant and John R. Harding (Incorporated by reference to Exhibit 10.44 to the 1997 Form 10-K).
10.18	Form of Executive Severance Agreement (Incorporated by reference to Exhibit 10.43 to the 1997 Form 10-K).
10.19	Revolving Credit Agreement, dated September 30, 1998, by and between ABN-AMRO Bank and the Registrant (Incorporated by reference to Exhibit 10.45 from the Registrant's Form 10-Q for the third quarter ended October 3, 1998 (the 1998 Third Quarter Form 10-Q)).
10.20	Amendment, dated October 16, 1998, to the Revolving Credit Agreement, by and between ABN-AMRO Bank and the Registrant (Incorporated by reference to Exhibit 10.46 from the 1998 Third Quarter Form 10-Q).
10.21	Agreement and Plan of Reorganization, dated September 3, 1998, by and among the Registrant, Ambit Design Systems, Inc., and Adirondack Transaction Corp. (Incorporated by reference to Exhibit 2.01 to the Registrant's Current Report on Form 8-K originally filed on September 30, 1998).
10.22	Consulting Agreement, dated March 8, 1999, between the Registrant and George M. Scalise (Incorporated by reference to Exhibit 10.36 to the 1999 Form 10-K).
10.23	Executive Termination and Release Agreement, dated May 24, 1999, between Cadence and John R. Harding (Incorporated by reference to Exhibit 10.48 from the Registrant's Form 10-Q for the second quarter ended July 3, 1999 (the 1999 Second Quarter Form 10-Q)).
10.24	The Registrant's 1995 Directors Stock Option Plan, as amended May 5, 1999 (Incorporated by reference to Exhibit 10.49 from the 1999 Second Quarter Form 10-Q).
10.25	The Registrant's 1990 Employee Stock Purchase Plan, as amended May 5, 1999 (Incorporated by reference to Exhibit 10.50 from the 1999 Second Quarter Form 10-Q).
10.26	Employment Agreement, dated September 16, 1999, between the Registrant and H. Raymond Bingham (Incorporated by reference to Exhibit 10.51 from the Registrant's Form 10-Q for the third quarter ended October 2, 1999 (the 1999 Third Quarter Form 10-Q)).
10.27	Consulting Agreement, dated July 1999, between the Registrant and Alberto Sangiovanni-Vincentelli (Incorporated by reference to Exhibit 10.52 from the 1999 Third Quarter Form 10-Q).
10.28	Design Acceleration, Inc. 1994 Stock Option Plan (Incorporated by reference to Exhibit 99 to the Registrant's Form S-8 Registration Statement (No. 333-71717) originally filed on February 3, 1999).
10.29	Quickturn Design Systems, Inc. 1988 Stock Option Plan, as amended, (Incorporated by reference to Exhibit 99.1 to the Registrant's Form S-8 Registration Statement (No. 333-69589) filed on June 7, 1999).

<u>Exhibit Number</u>	<u>Exhibit Title</u>
10.30	Pi Design Systems, Inc. 1990 Stock Option Plan, as amended, (Incorporated by reference to Exhibit 99.2 to the Registrant's Form S-8 Registration Statement (No. 333-69589) filed on June 7, 1999).
10.31	Quickturn Design Systems, Inc. 1992 Key Executive Stock Option Plan, as amended, (Incorporated by reference to Exhibit 99.3 to the Registrant's Form S-8 Registration Statement (No. 333-69589) filed on June 7, 1999).
10.32	Quickturn Design Systems, Inc. 1993 Employee Qualified Stock Purchase Plan, as amended, (Incorporated by reference to Exhibit 99.4 to the Registrant's Form S-8 Registration Statement (No. 333-69589) filed on June 7, 1999).
10.33	Quickturn Design Systems, Inc. 1994 Outside Director Stock Option Plan (Incorporated by reference to Exhibit 99.7 to the Registrant's Form S-8 Registration Statement (No. 333-69589) filed on June 7, 1999).
10.34	Quickturn Design Systems, Inc. 1996 Supplemental Stock Plan, as amended, (Incorporated by reference to Exhibit 99.5 to the Registrant's Form S-8 Registration Statement (No. 333-69589) filed on June 7, 1999).
10.35	Quickturn Design Systems, Inc. 1997 Stock Option Plan, as amended, (Incorporated by reference to Exhibit 99.6 to the Registrant's Form S-8 Registration Statement (No. 333-69589) filed on June 7, 1999).
10.36	SpeedSim, Inc. 1995 Incentive and Nonqualified Stock Option Plan (Incorporated by reference to Exhibit 99.8 to the Registrant's Form S-8 Registration Statement (No. 333-69589) filed on June 7, 1999).
10.37	OrCAD, Inc. 1991 Non-Qualified Stock Option Plan (Incorporated by reference to Exhibit 99.1 to the Registrant's Form S-8 Registration Statement (No. 333-85591) filed on August 19, 1999).
10.38	OrCAD, Inc. 1995 Stock Option Plan (Incorporated by reference to Exhibit 99.2 to the Registrant's Form S-8 Registration Statement (No. 333-85591) filed on August 19, 1999).
10.39	OrCAD, Inc. Amended 1995 Stock Incentive Plan (Incorporated by reference to Exhibit 99.3 to the Registrant's Form S-8 Registration Statement (No. 333-85591) filed on August 19, 1999).
10.40	Form of Executive Retention Agreement between the Registrant and Key Executives of the Registrant (Incorporated by reference to Exhibit 10.57 to the 1999 Form 10-K).
10.41	Diablo Research Company LLC 1997 Stock Option Plan (Incorporated by reference to Exhibit 99.1 to the Registrant's Form S-8 Registration Statement (No. 333-93609) filed on December 24, 1999).
10.42	Diablo Research Company LLC 1999 Stock Option Plan (Incorporated by reference to Exhibit 99.2 to the Registrant's Form S-8 Registration Statement (No. 333-93609) filed on December 24, 1999).
10.43	The Registrant's 2000 Non-Statutory Equity Incentive Plan (Incorporated by reference to Exhibit 99.1 to the Registrant's Form S-8 Registration Statement filed on March 27, 2000).
10.44	Form of Indemnity Agreement between Cadence Design Systems, Inc. and its directors and executive officers (Incorporated by reference to Exhibit 10.01 from the 2000 Second Quarter Form 10-Q).
10.45	Credit Agreement, dated as of September 29, 2000, by and among the Registrant and ABN AMRO Bank N.V., Bank One, N.A., KeyBank National Association and UBS AG, Stamford Branch (Incorporated by reference to Exhibit 10.01 from the 2000 Third Quarter Form 10-Q).
10.46	364 Day Credit Agreement, dated as of September 29, 2000, by and among the Registrant and ABN AMRO Bank N.V., Bank One, N.A., KeyBank National Association and UBS AG, Stamford Branch (Incorporated by reference to Exhibit 10.02 from the 2000 Third Quarter Form 10-Q).
10.47	The Registrant's 1997 Stock Option Plan, as amended on November 1, 2000 (Incorporated by reference to Exhibit 10.03 from the 2000 Third Quarter Form 10-Q).

<u>Exhibit Number</u>	<u>Exhibit Title</u>
10.48	The Registrant's 2000 Non-Statutory Equity Incentive Plan, as amended (Incorporated by reference to the Registrant's Form S-8 Registration Statement filed on November 13, 2000).
10.49	Employment Agreement between Tality Corporation and Robert P. Wiederhold dated as of July 14, 2000 (Incorporated by reference to Exhibit 10.05 from the 2000 Third Quarter Form 10-Q).
10.50	Tality Corporation 2000 Equity Incentive Plan, as amended (Incorporated by reference to Exhibit 10.06 from the 2000 Third Quarter Form 10-Q).
10.51	Tality Corporation Directors Stock Option Plan (Incorporated by reference to Exhibit 10.07 from the 2000 Third Quarter Form 10-Q).
10.52	Employment Agreement between Ronald R. Barris and the Registrant, dated July 1, 2000.
10.53	Description of the Registrant's Stock Purchase Program.
10.54	Form of Promissory Note and Pledge Agreement for employees of the Registrant delivered in connection with purchases of shares of Tality Corporation restricted common stock.
10.55	Form of Promissory Note between Ronald R. Barris and the Registrant, dated September 18, 2000.
21.01	Subsidiaries of the Registrant.
23.01	Consent of Arthur Andersen LLP.
23.02	Consent of PricewaterhouseCoopers LLP.

(b) *Reports on Form 8-K:*

On March 15, 2000, the Registrant filed a Current Report on Form 8-K reporting the date of the Registrant's 2000 Annual Meeting of Stockholders and the record date for determining stockholders entitled to a vote at the annual meeting.

Cadence filed a Current Report on Form 8-K dated July 17, 2000 attaching Cadence's press release reporting the separation and initial public offering of Tality.

Cadence filed a Current Report on Form 8-K dated October 9, 2000 attaching Cadence's press release announcing the delay of the initial public offering of Tality.

(c) *Exhibits:*

Cadence hereby files as part of this Form 10-K the Exhibits listed in Item 14. (a) 3 above.

(d) *Financial Statement Schedule:*

See Item 14. (a) 2 of this Form 10-K.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Stockholders and Board of Directors of Cadence Design Systems, Inc.:

We have audited the accompanying consolidated balance sheets of Cadence Design Systems, Inc. (a Delaware corporation) and subsidiaries as of December 30, 2000 and January 1, 2000, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three fiscal years in the period ended December 30, 2000. These financial statements and the schedule referred to below are the responsibility of Cadence's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits. We did not audit the financial statements of Quickturn Design Systems, Inc., for the fiscal year ended December 31, 1998, a company acquired during 1999 in a transaction accounted for as a pooling of interests, as discussed in Acquisitions in the Notes to Consolidated Financial Statements. Such statements are included in the consolidated financial statements of Cadence Design Systems, Inc. and reflect total revenues of eight percent of the related consolidated total for the fiscal year ended January 2, 1999. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to amounts included for Quickturn Design Systems, Inc., is based solely on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Cadence Design Systems, Inc. and subsidiaries as of December 30, 2000 and January 1, 2000, and the results of their operations and their cash flows for each of the three fiscal years in the period ended December 30, 2000, in conformity with accounting principles generally accepted in the United States.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed in Item 14. (a) 2. is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic consolidated financial statements. This schedule has been subjected to the auditing procedures applied in the audit of the basic consolidated financial statements and, in our opinion, fairly states in all material respects the financial data required to be set forth therein in relation to the basic consolidated financial statements taken as a whole.

/s/ ARTHUR ANDERSEN LLP

ARTHUR ANDERSEN LLP

San Jose, California
January 19, 2001
(Except for the matter
discussed in Subsequent
Event, as to which the
date is February 28, 2001)

REPORT OF PRICEWATERHOUSECOOPERS LLP, INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders
of Quickturn Design Systems, Inc.:

In our opinion, the consolidated statements of operations, comprehensive loss, stockholders' equity and cash flows of Quickturn Design Systems, Inc. and its subsidiaries (not presented separately herein) present fairly, in all material respects, the results of their operations and their cash flows for the year ended December 31, 1998, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. We have not audited the consolidated financial statements of Quickturn Design Systems, Inc. for any period subsequent to December 31, 1998.

/s/ PricewaterhouseCoopers LLP

San Jose, California
January 15, 1999

CADENCE DESIGN SYSTEMS, INC.
CONSOLIDATED BALANCE SHEETS
December 30, 2000 and January 1, 2000
(In thousands, except per share amounts)

A S S E T S

	2000	1999
Current Assets:		
Cash and cash equivalents	\$ 85,220	\$ 111,401
Short-term investments	51,749	7,357
Receivables, net	289,468	248,034
Inventories, net	20,149	19,872
Prepaid expenses and other	110,262	93,248
Total current assets	556,848	479,912
Property, plant and equipment, net	368,879	330,409
Software development costs, net	10,738	10,692
Acquired intangibles, net	326,518	402,154
Installation contract receivables	38,420	84,160
Other assets	175,918	152,332
	<u>\$1,477,321</u>	<u>\$1,459,659</u>

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Notes payable and current portion of capital leases	\$ 2,212	\$ 3,924
Accounts payable and accrued liabilities	273,594	265,518
Deferred revenue	215,768	152,116
Total current liabilities	491,574	421,558
Long-Term Liabilities:		
Long-term debt and capital leases	3,298	25,024
Minority interest	11,612	41
Other long-term liabilities	61,372	26,887
Total long-term liabilities	76,282	51,952
Stockholders' Equity:		
Preferred stock — \$0.01 par value; authorized 400 shares in 2000 and 1999, none issued or outstanding	—	—
Common stock and capital in excess of \$0.01 par value		
Authorized: 600,000 shares		
Issued: 255,637 shares in 2000 and 253,768 shares in 1999		
Outstanding: 243,662 shares in 2000 and 243,328 shares in 1999	847,099	858,189
Treasury stock at cost: 11,975 shares in 2000 and 10,440 shares in 1999	(256,260)	(240,748)
Deferred compensation	(60,978)	(229)
Retained earnings	394,224	344,247
Accumulated other comprehensive income (loss)	(14,620)	24,690
Total stockholders' equity	909,465	986,149
	<u>\$1,477,321</u>	<u>\$1,459,659</u>

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

CADENCE DESIGN SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
For the three fiscal years ended December 30, 2000
(In thousands, except per share amounts)

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Revenue:			
Product	\$ 627,429	\$ 505,459	\$ 760,441
Services	335,967	294,916	265,211
Maintenance	<u>316,154</u>	<u>292,928</u>	<u>294,528</u>
Total revenue	<u>1,279,550</u>	<u>1,093,303</u>	<u>1,320,180</u>
Costs and Expenses:			
Cost of product	89,937	79,504	77,513
Cost of services	215,605	191,760	188,793
Cost of maintenance	63,315	53,579	52,386
Amortization of acquired intangibles	80,503	61,788	18,472
Marketing and sales	390,139	354,205	340,295
Research and development	263,947	219,181	202,810
General and administrative	94,478	86,735	86,828
Amortization of deferred stock compensation(1)	11,390	—	—
Unusual items	<u>6,821</u>	<u>59,301</u>	<u>263,595</u>
Total costs and expenses	<u>1,216,135</u>	<u>1,106,053</u>	<u>1,230,692</u>
Income (loss) from operations	63,415	(12,750)	89,488
Other income, net	4,581	1,370	10,558
Income (loss) before provision for income taxes	67,996	(11,380)	100,046
Provision for income taxes	18,019	2,695	74,922
Net income (loss)	<u>\$ 49,977</u>	<u>\$ (14,075)</u>	<u>\$ 25,124</u>
Basic Net Income (Loss) Per Share	<u>\$ 0.20</u>	<u>\$ (0.06)</u>	<u>\$ 0.11</u>
Diluted Net Income (Loss) Per Share	<u>\$ 0.19</u>	<u>\$ (0.06)</u>	<u>\$ 0.10</u>
Weighted average common shares outstanding	<u>244,565</u>	<u>242,037</u>	<u>234,605</u>
Weighted average common and potential common shares outstanding — assuming dilution	<u>262,696</u>	<u>242,037</u>	<u>257,862</u>

(1) Amortization of deferred stock compensation would be classified as follows:

Cost of services	\$ 3,445	\$ —	\$ —
Marketing and sales	2,131	—	—
Research and development	498	—	—
General and administrative	<u>5,316</u>	<u>—</u>	<u>—</u>
	<u>\$ 11,390</u>	<u>\$ —</u>	<u>\$ —</u>

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

CADENCE DESIGN SYSTEMS, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
For the three fiscal years ended December 30, 2000
(In thousands)

	Comprehensive Income	Common Stock		Treasury Stock		Deferred Stock Compensation	Retained Earnings	Accumulated Other Comprehensive Income
		Shares	Par Value and Capital in Excess of Par	Shares	Amount			
BALANCE, JANUARY 3, 1998		236,785	\$593,742	(6,739)	\$ (97,285)	\$ (573)	\$333,198	\$ (7,719)
Purchase of treasury stock		—	—	(6,479)	(172,171)	—	—	—
Issuance of common stock		10,586	85,096	1,804	30,400	—	—	—
Tax benefits from employee stock transactions		—	109,713	—	—	—	—	—
Treasury stock issued in connection with acquisitions		—	26,957	1,155	19,639	—	—	—
Treasury stock issued in connection with warrants exercised		—	322	100	—	—	—	—
Equity adjustments related to acquisitions		—	2,494	—	—	—	—	—
Amortization of deferred compensation ..		—	—	—	—	227	—	—
Net income	\$ 25,124	—	—	—	—	—	25,124	—
Unrealized holding gain on marketable securities	37	—	—	—	—	—	—	37
Translation loss	(1,371)	—	—	—	—	—	—	(1,371)
	<u>\$ 23,790</u>							
BALANCE, JANUARY 2, 1999		247,371	818,324	(10,159)	(219,417)	(346)	358,322	(9,053)
Purchase of treasury stock		—	(2)	(4,585)	(115,832)	—	—	—
Issuance of common stock		5,126	(2,549)	3,654	80,466	—	—	—
Issuance of common stock in connection with warrants exercised		1,271	13,340	—	—	—	—	—
Tax benefits from employee stock transactions		—	10,305	—	—	—	—	—
Treasury stock issued in connection with acquisitions		—	2,089	650	14,035	—	—	—
Equity adjustments related to acquisitions		—	16,682	—	—	—	—	—
Amortization of deferred compensation ..		—	—	—	—	117	—	—
Net loss	\$(14,075)	—	—	—	—	—	(14,075)	—
Unrealized holding gain on marketable securities	36,249	—	—	—	—	—	—	36,249
Translation loss	(2,506)	—	—	—	—	—	—	(2,506)
	<u>\$ 19,668</u>							
BALANCE, JANUARY 1, 2000		253,768	858,189	(10,440)	(240,748)	(229)	344,247	24,690
Purchase of treasury stock		—	—	(11,737)	(234,418)	—	—	—
Issuance of common stock		1,869	(27,893)	10,202	218,906	—	—	—
Tax benefits from employee stock transactions		—	11,470	—	—	—	—	—
Equity adjustments related to acquisitions		—	5,333	—	—	—	—	—
Deferred stock compensation		—	—	—	—	(72,369)	—	—
Amortization of deferred compensation — Tality		—	—	—	—	11,390	—	—
Amortization of deferred compensation — other		—	—	—	—	230	—	—
Net income	\$ 49,977	—	—	—	—	—	49,977	—
Unrealized holding loss on marketable securities	(34,567)	—	—	—	—	—	—	(34,567)
Translation loss	(4,743)	—	—	—	—	—	—	(4,743)
	<u>\$ 10,667</u>							
BALANCE, DECEMBER 30, 2000		<u>255,637</u>	<u>\$847,099</u>	<u>(11,975)</u>	<u>\$(256,260)</u>	<u>\$(60,978)</u>	<u>\$394,224</u>	<u>\$(14,620)</u>

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

CADENCE DESIGN SYSTEMS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the three fiscal years ended December 30, 2000
(In thousands)

	<u>2000</u>	<u>1999</u>	<u>1998</u>
Cash and Cash Equivalents at Beginning of Year.....	\$ 111,401	\$ 209,074	\$ 221,030
Cash Flows From Operating Activities:			
Net income (loss).....	49,977	(14,075)	25,124
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization.....	206,810	163,896	109,105
Asset impairment and write-off of equipment and non-current assets.....	—	20,973	357
Net investment gain on sale, equity loss, and write-downs.....	(12,404)	5,376	6,324
Write-off of acquired in-process technology.....	—	20,700	194,100
Minority interest expense (income).....	(638)	(125)	256
Provisions for losses on trade accounts receivable.....	2,306	9,070	7,687
Changes in current assets and liabilities, net of effect of acquired and disposed businesses:			
Receivables.....	(267,315)	(153,662)	(191,641)
Inventories.....	(5,739)	(9,969)	(2,439)
Prepaid expenses and other.....	(16,308)	12,462	21,410
Deferred income taxes.....	(29,039)	(1,431)	24,725
Installment contract receivables.....	89,263	57,008	(127,284)
Accounts payable and accrued liabilities.....	15,580	(22,021)	171,686
Tax benefit on stock option exercises.....	11,470	10,305	109,713
Deferred revenue.....	63,652	37,694	(10,925)
Other long-term liabilities.....	34,485	(8,979)	(111,045)
Net cash provided by operating activities.....	<u>142,100</u>	<u>127,222</u>	<u>227,153</u>
Cash Flows From Investing Activities:			
Maturities of short-term investments — held-to-maturity.....	998	25,990	60,367
Purchases of short-term investments — held-to-maturity.....	—	(43)	(35,872)
Maturities of short-term investments — available-for-sale.....	6,309	26,349	564,136
Purchases of short-term investments — available-for-sale.....	(49,636)	(15)	(513,241)
Purchases of property, plant, and equipment.....	(119,471)	(110,444)	(121,395)
Capitalization of software development costs.....	(28,435)	(25,684)	(21,695)
Increase in acquired intangibles and other assets.....	(37,578)	(28,490)	(82,856)
Investment in venture capital partnership and equity investment.....	6,321	(9,144)	(13,037)
Cash effect of business acquisitions and dispositions.....	(4,503)	(133,055)	(352,326)
Sale of put warrants.....	42,440	3,609	14,812
Purchase of call options.....	(42,440)	(3,609)	(14,812)
Net cash used for investing activities.....	<u>(225,995)</u>	<u>(254,536)</u>	<u>(515,919)</u>
Cash Flows From Financing Activities:			
Proceeds from long-term notes payable.....	60,000	267,069	150,000
Principal payments on long-term notes payable and capital leases.....	(83,704)	(378,320)	(17,757)
Proceeds from minority interest.....	1,375	—	—
Proceeds from issuance of common stock.....	117,329	91,244	104,763
Purchases of treasury stock.....	(232,958)	(115,832)	(170,830)
Proceeds from transfer of financial assets in exchange for cash.....	201,164	167,680	211,919
Net cash provided by financing activities.....	<u>63,206</u>	<u>31,841</u>	<u>278,095</u>
Effect of exchange rate changes on cash.....	(5,492)	(2,200)	(1,285)
Decrease in cash and cash equivalents.....	(26,181)	(97,673)	(11,956)
Cash and Cash Equivalents at End of Year.....	<u>\$ 85,220</u>	<u>\$ 111,401</u>	<u>\$ 209,074</u>

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

CADENCE DESIGN SYSTEMS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 30, 2000

CADENCE

Cadence provides comprehensive software and other technology and offers design and methodology services for the product development requirements of the world's leading electronics companies. Cadence licenses its leading-edge electronic design automation, or EDA, software and hardware technology and provides a range of services to companies throughout the world to help its customers optimize their product development processes. Cadence is a supplier of end-to-end products and services, which are used by companies to design and develop complex chips and electronic systems including semiconductors, computer systems and peripherals, telecommunications and networking equipment, mobile and wireless devices, automotive electronics, consumer products, and other advanced electronics.

On July 17, 2000, Cadence announced its plan to separate its electronics design services group into a new company named Tality Corporation, or Tality. Tality's separation from Cadence was substantially completed on October 4, 2000, and accordingly the electronic design services business now operates as a majority-owned subsidiary of Cadence. Tality filed a registration statement with the Securities and Exchange Commission for Tality's initial public offering, or IPO. On October 9, 2000, Cadence announced that the postponement of Tality's IPO due to unfavorable market conditions. Therefore, the financial statements and financial information in this Annual Report on Form 10-K do not give effect to the IPO.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of Cadence and its subsidiaries after elimination of intercompany accounts and transactions. Investments in companies in which ownership interests range from 20% to 50% are accounted for using the equity method of accounting. Cadence has one investment with ownership interest less than 20% which is accounted for using the equity method of accounting due to the fact Cadence has significant influence on this investment.

Cadence's fiscal year end is the Saturday closest to December 31. Certain prior year consolidated financial statement balances have been reclassified to conform to the 2000 presentation.

Use of Estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Foreign Currency Translation

Assets and liabilities of foreign subsidiaries, where the functional currency is the local currency, are translated using exchange rates in effect at the end of the period and revenue and costs are translated using average exchange rates for the period. Gains and losses on the translation into U.S. dollars of amounts denominated in foreign currencies are included in net income (loss) for those operations whose functional currency is the U.S. dollar, and as a separate component of stockholders' equity for those operations whose functional currency is the local currency.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Derivative Financial Instruments

Cadence enters into foreign currency forward exchange contracts and purchases foreign currency put options with financial institutions primarily to protect against currency exchange risks associated with existing assets and liabilities and probable but not firmly committed transactions, respectively. Forward contracts are not accounted for as hedges and, therefore, the unrealized gains and losses are recognized in other income, net, in the accompanying consolidated statements of operations, in advance of the actual foreign currency cash flows with the fair value of these forward contracts being recorded in accrued liabilities.

Cadence purchases put options to hedge the currency exchange risks associated with probable but not firmly committed transactions. Probable but not firmly committed transactions consist of revenue from Cadence's products and maintenance contracts in a currency other than the functional currency. These transactions are made through Cadence's subsidiaries in Ireland and Japan. The premium costs of the put options are recorded in prepaid expenses and other current assets while the gains and losses are deferred and recognized in income in the same period as the hedged transaction. Gains and losses on accounting hedges realized before the settlement date of the related hedged transaction are also generally deferred and recognized in income in the same period as the hedged transaction. Cadence does not use forward contracts and put options for trading purposes. Cadence's ultimate realized gain or loss with respect to currency fluctuations will depend on the currency exchange rates and other factors in effect as the forward contracts and put options mature.

Revenue Recognition

Product revenue consists principally of revenue earned under software license agreements and is generally recognized upon shipment of the software if collection of the resulting receivable is probable, the fee is fixed or determinable, and vendor-specific objective evidence exists to allocate the total fee to all delivered and undelivered elements of the arrangement. If vendor-specific objective evidence does not exist to allocate the total fee to all delivered and undelivered elements of the arrangement, revenue is deferred until such evidence does exist for the undelivered elements, or until all elements are delivered, whichever is earlier. Revenue associated with software products under subscription licenses is recognized ratably over the license period because the agreements allow customers to exchange licensed products for unspecified future technology. Installment contract receivables result from customer contracts with Cadence's top-rated credit customers. Cadence uses installment contracts as a standard business practice and has a history of successfully collecting under the original payment terms without making concessions on payments, products, or services. Emulation hardware product revenue is recognized upon installation.

Services revenue consists primarily of revenue received for performing methodology and design services. Fixed-price methodology and design service contracts are accounted for using contract accounting, which is generally the percentage-of-completion method versus the completed-contract method, and time and materials contracts are accounted for on a monthly basis as work is performed. In addition, for small fixed-price-projects, such as training classes and small, standard methodology service engagements of approximately \$10,000 in size, revenue is recognized when the work is completed.

Maintenance revenue consists of fees for providing technical support for software products and software product updates and is recognized ratably over the term of the support agreement.

Comprehensive Income (Loss)

Comprehensive income (loss) includes foreign currency translation gains and losses and other unrealized gains and losses that have been previously excluded from net income (loss) and reflected instead in equity. Cadence has reported the components of comprehensive income (loss) on its consolidated statements of stockholders' equity.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cash, Cash Equivalents and Short-Term Investments

Cadence considers all highly liquid debt instruments, including commercial paper, euro time deposits, repurchase agreements, and certificates of deposit with an original maturity of three months or less to be cash equivalents. Investments with original maturities greater than three months and less than one year are classified as short-term investments. Investments with original maturities greater than one year are classified as long-term investments.

Management determines the appropriate classification of its investments at the time of purchase. Securities classified as held-to-maturity are stated at amortized cost based on Cadence's positive intent to hold such securities until maturity. The cost of securities sold is determined using the specific identification method when computing realized gains and losses. Securities classified as available-for-sale are stated at fair value, with the unrealized gains and losses reported as a component of stockholders' equity until realized. The amortized cost of debt securities is adjusted for amortization of premiums and accretion of discounts to maturity. Such amortization and accretion is included in other income, net.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market. Cadence's inventories include high technology parts and components for complex computer systems that emulate the performance and operation of computer chips and electronic systems. These parts and components may be specialized in nature or subject to rapid technological obsolescence. While Cadence has programs to minimize the required inventories on hand and considers technological obsolescence when estimating required reserves to reduce recorded amounts to market values, it is reasonably possible that such estimates could change in the near term.

Property, Plant, and Equipment

Property, plant, and equipment is stated at cost. Depreciation and amortization are provided over the estimated useful lives, using the straight-line method, as follows:

Computer equipment and related software	3 – 8 years
Buildings	10 – 32 years
Leasehold and building improvements	Shorter of the lease term or the estimated useful life
Furniture and fixtures	3 – 5 years
Equipment	3 – 5 years

Cadence capitalizes the costs of software developed for internal use in compliance with Statement of Position 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" and with Emerging Issues Task Force Issue 00-2 "Accounting for Web Site Development Costs". Capitalization of software developed for internal use and web site development costs begins at the application development phase of the project. Amortization of software developed for internal use and web site development costs begins when the products are placed in productive use, and is computed on a straight-line basis over the estimated useful life of the product, generally three years.

Cadence recorded depreciation expense of property, plant, and equipment per ABP No. 12 for the fiscal years ended December 30, 2000, January 1, 2000, and January 2, 1999 in the amount of \$76.7 million, \$68.0 million, and \$60.8 million, respectively.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Software Development Costs and Acquired Intangibles

Cadence capitalizes software development costs in compliance with Statement of Financial Accounting Standards, or SFAS, No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." Capitalization of software development costs begins upon the establishment of technological feasibility of the product. Technological feasibility is established at the completion of detail program design and testing. The establishment of technological feasibility and the ongoing assessment of the recoverability of these costs requires considerable judgment by management with respect to certain external factors including, but not limited to, anticipated future gross product revenue, estimated economic life, and changes in software and hardware technology. Amortization of capitalized software development costs begins when the products are available for general release to customers and is computed on a straight-line basis over the remaining estimated economic life of the product, which is generally three years.

Cadence recorded amortization expense for software development costs per SFAS 86 for the fiscal years ended December 30, 2000, January 1, 2000, and January 2, 1999 in the amount of \$28.4 million, \$26.6 million, and \$23.7 million, respectively.

Acquired intangibles represent purchase price in excess of acquired tangible assets and in-process technology in connection with business combinations accounted for as purchases and are amortized on a straight-line basis over the remaining estimated economic life of the underlying products and technologies (original lives assigned are five to seven years).

It is reasonably possible that the estimates of anticipated future gross revenue, the remaining estimated economic life of the products and technologies, or both, could differ from those used to assess the recoverability of these costs and result in a write-down of the carrying amount or a shortened life of both the software development costs and acquired intangibles in the near term.

Long-lived Assets

Cadence periodically reviews long-lived assets, certain identifiable intangibles, and goodwill related to these assets for impairment in accordance with SFAS No. 121, "Accounting for the Impairment of Long-lived Assets and For Long-lived Assets to be Disposed Of."

For assets to be held and used, including acquired intangibles, Cadence initiates its review whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable. Recoverability of an asset is measured by comparison of its carrying amount to the expected future undiscounted cash flows (without interest charges) that the asset is expected to generate. Any impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair market value.

Assets to be disposed of and for which management has committed to a plan to dispose of the assets, whether through sale or abandonment, are reported at the lower of carrying amount or fair value less cost to sell.

Concentrations of Credit Risk

Financial instruments, including derivative financial instruments, that may potentially subject Cadence to concentrations of credit risk, consist principally of cash investments, short-term investments, long-term investments, accounts receivable, forward contracts and put options, and call options purchased in conjunction with Cadence's stock repurchase programs. Cadence's investment policy primarily limits investments to short-term, low-risk instruments. Concentration of credit risk related to accounts receivable is limited, due to the varied customers comprising Cadence's customer base and their dispersion across geographies. Credit exposure related to the forward contracts and the call options is limited to the realized and unrealized gains on

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

these contracts. All financial instruments are executed with financial institutions with strong credit ratings, which minimizes risk of loss due to nonpayment. Cadence has not experienced any losses due to credit impairment related to its financial instruments.

Accrued Warranty

Cadence provides an accrual for future warranty costs based on the historical relationship of revenue to warranty costs incurred.

New Accounting Standards

In September 2000, the Emerging Issues Task Force, or EITF, published their consensus on EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," which was taken up to address implementation of the EITF's March 2000 final consensus of EITF Issue No. 00-7, "Application of EITF Issue No. 96-13 to Equity Derivative Instruments That Contain Certain Provisions That Require Net Cash Settlement If Certain Events Outside the Control of the Issuer Occur." The final consensus in Issue 00-7 generally stated that equity derivative contracts that contain provisions that implicitly or explicitly require net cash settlement outside of the control of the company must be treated as assets and liabilities and carried at fair value with changes in fair value recognized in earnings rather than equity instruments carried at original cost and reported as part of permanent equity. This interpretation becomes effective June 30, 2001 and is not expected to have a material effect on Cadence's consolidated financial position, results of operations, or cash flows.

In September 2000, the FASB issued SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." SFAS No. 140 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishment of liabilities. It requires a company, after a transfer of financial assets, to recognize the financial and servicing assets it controls and the liabilities it has incurred, derecognize financial assets when control has been surrendered, and derecognize liabilities when extinguished. This statement is effective for transfer and servicing of financial assets and extinguishments after March 31, 2001, as well as for disclosures relating to securitization transactions for fiscal years ending after December 15, 2000. The adoption of this statement is not expected to have a material effect on Cadence's consolidated financial position, results of operations, or cash flows.

In March 2000, the Financial Accounting Standards Board, or FASB, issued interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation", an interpretation of Accounting Principles Board, or APB, Opinion No. 25. This interpretation provides guidance regarding the application of APB Opinion No. 25 to stock compensation involving employees. This interpretation was effective July 1, 2000 and did not have a material effect on Cadence's consolidated financial position, results of operations, or cash flows.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin, No. 101, "Revenue Recognition in Financial Statements," or SAB 101, which provides guidance on the recognition, presentation, and disclosure of revenue in financial statements. Cadence adopted SAB 101 in the fourth quarter of its fiscal 2000. The adoption of this statement did not have a material effect on Cadence's consolidated financial position, results of operations, or cash flows.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. It requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met and that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting. In June 1999, SFAS No. 137, "Accounting for Derivative

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Instruments and Hedging Activities — Deferral of the Effective Date of FASB Statement No. 133,” was issued. The statement defers the effective date of SFAS No. 133 until the first quarter of fiscal 2001. The adoption of this statement is not expected to have a material effect on Cadence’s consolidated financial position, results of operations, or cash flows.

BALANCE SHEET COMPONENTS

A summary of balance sheet components follows:

	<u>2000</u>	<u>1999</u>
	(In thousands)	
Receivables:		
Accounts receivable	\$ 284,322	\$ 201,951
Installment contract receivables—current	47,148	90,671
Total Receivables	<u>331,470</u>	<u>292,622</u>
Less: Allowances	<u>(42,002)</u>	<u>(44,588)</u>
Receivables, net	<u>\$ 289,468</u>	<u>\$ 248,034</u>
Inventories:		
Raw materials	\$ 17,897	\$ 19,033
Work in process	2,252	839
Inventories, net	<u>\$ 20,149</u>	<u>\$ 19,872</u>
Prepaid Expenses and Other:		
Prepaid expenses and other	\$ 57,286	\$ 61,779
Deferred income taxes	52,976	31,469
Prepaid expenses and other, net	<u>\$ 110,262</u>	<u>\$ 93,248</u>
Property, Plant, and Equipment:		
Computer equipment and related software	\$ 324,678	\$ 261,696
Buildings	97,169	96,735
Land	68,544	64,745
Leasehold and building improvements	65,014	61,552
Furniture and fixtures	53,572	57,488
Equipment	43,882	43,978
Construction in progress and internally developed software	36,760	16,761
Total cost	689,619	602,955
Less: Accumulated depreciation and amortization	<u>(320,740)</u>	<u>(272,546)</u>
Property, plant, and equipment, net	<u>\$ 368,879</u>	<u>\$ 330,409</u>
Software Development Costs:		
Cost	\$ 63,133	\$ 49,298
Less: Accumulated amortization	<u>(52,395)</u>	<u>(38,606)</u>
Software development costs, net	<u>\$ 10,738</u>	<u>\$ 10,692</u>
Acquired Intangibles:		
Goodwill and other intangibles	\$ 464,712	\$ 454,805
Purchased software	62,876	58,199
Less: Accumulated amortization	<u>(201,070)</u>	<u>(110,850)</u>
Acquired intangibles, net	<u>\$ 326,518</u>	<u>\$ 402,154</u>
Accounts Payable and Accrued Liabilities:		
Payroll and payroll related accruals	\$ 148,051	\$ 129,174
Other accrued liabilities	90,219	97,902
Accounts payable	35,324	38,442
Accounts payable and accrued liabilities	<u>\$ 273,594</u>	<u>\$ 265,518</u>

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

FINANCIAL INSTRUMENTS

Investments

A summary of Cadence's held-to-maturity and available-for-sale investment portfolios follows:

	2000	1999
	(In thousands)	
Held-to-maturity:		
Corporate debt securities	\$ —	\$ 998
Total held-to-maturity	—	998
Available-for-sale:		
Time Deposit	49,750	—
Money Market Funds	6,977	40,504
Commercial paper	2,151	—
Corporate debt securities	1,999	7,163
Auction rate securities	—	6,000
Repurchase agreements	—	5,000
U.S. Government notes	—	997
Foreign debt securities	—	194
Total available-for-sale	60,877	59,858
Total investment securities	60,877	60,856
Less: Cash equivalents	(9,128)	(51,504)
Total short-term and long-term investments	<u>\$51,749</u>	<u>\$ 9,352</u>

All investments outstanding as of December 30, 2000 will mature in fiscal 2001.

Excluding corporate debt securities, the carrying value of cash and cash equivalents, short-term investments, and long-term investments approximates fair value (based on quoted market prices) of such investments. Accordingly, the gross realized and unrealized gains and losses were immaterial for each of the two years presented. As of December 30, 2000 and January 1, 2000, the unrealized gain on the corporate debt securities was negligible.

Financing

Cadence has entered into agreements whereby it may transfer qualifying accounts receivables, for which Cadence has recognized the related revenue, to certain financing institutions on a non-recourse basis. These transfers are recorded as sales and accounted for in accordance with SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." During the fiscal years ended December 30, 2000 and January 1, 2000, Cadence transferred accounts receivable totaling \$201.2 million and \$167.7 million, respectively, which approximated fair value, to financing institutions on a non-recourse basis. Transfers of accounts receivable for cash are reported in Cadence's consolidated statements of cash flows as a financing activity.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Derivative Financial Instruments

The following table shows the notional principal and fair value of Cadence's derivative financial instruments as of December 30, 2000 and January 1, 2000:

	<u>2000</u>		<u>1999</u>	
	<u>Notional Principal</u>	<u>Fair Value</u>	<u>Notional Principal</u>	<u>Fair Value</u>
	(In thousands)			
Forward contracts	\$35,576	\$2,689	\$73,135	\$(2,530)
Put options	\$ —	\$ —	\$27,779	\$ 323

The estimates of fair value are based on applicable and commonly used pricing models using prevailing financial market information as of December 30, 2000, and January 1, 2000. As of December 30, 2000 and January 1, 2000, the credit risk associated with the forward contracts and put options was negligible. Although the table above reflects the notional principal and fair value amounts of Cadence's foreign exchange instruments, it does not reflect the gains or losses associated with the underlying exposures and underlying transactions. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

ACQUISITIONS

Diablo Research Company LLC

In December 1999, Cadence acquired all of the outstanding stock of Diablo Research Company LLC for \$39.9 million in cash in a transaction accounted for as a purchase. Diablo was a high-technology engineering services firm with expertise in wireless communication, global positioning satellite solutions, and data transfer and home automation markets. In connection with the acquisition, Cadence added approximately 100 qualified engineers with the requisite education and experience to service existing and potential clients, develop and introduce new technology and respond to changing design environments and standards. In connection with the acquisition, Cadence acquired goodwill of \$29.9 million which is being amortized over five years, and acquired workforce intangibles of \$11 million, which is being amortized over three years.

OrCAD, Inc.

In August 1999, Cadence acquired OrCAD, Inc., a supplier of computer-aided engineering and computer-aided design software and services for the printed circuit board industry, for cash. Cadence acquired all of the outstanding stock of OrCAD and assumed all outstanding stock options. The purchase price was \$131.4 million and the acquisition was accounted for as a purchase. In connection with the acquisition, Cadence acquired net intangibles of \$94 million. The results of operations of OrCAD and the estimated fair value of the assets acquired and liabilities assumed are included in Cadence's consolidated financial statements from the date of acquisition. Intangibles arising from the OrCAD acquisition are being amortized on a straight-line basis over five years.

Management estimated that \$11.8 million of the purchase price for OrCAD represented acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. Accordingly, this amount was immediately charged to expense in the consolidated statements of operations upon consummation of the acquisition. The value assigned to acquired in-process technology was determined by identifying research projects in areas for which technological feasibility had not been established. The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects, and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

surrounding the successful development of the acquired in-process technology. The acquired in-process technology became commercially viable in 1999 and 2000. The value of other intangible assets acquired may become impaired.

Comparative pro forma financial information has not been presented because the results of operations of Diablo and OrCAD were not material to Cadence's consolidated financial statements, either individually or in the aggregate.

Quickturn Design Systems, Inc.

In May 1999, Cadence completed its merger with Quickturn Design Systems, Inc. Quickturn designed, manufactured, sold, and supported hardware and software products that verified the design of computer chips and electronic systems. Cadence acquired all of the outstanding shares of Quickturn common stock in a tax-free, stock-for-stock transaction for approximately 24.6 million shares of Cadence common stock. The acquisition was accounted for as a pooling of interests. In addition, Cadence assumed all outstanding stock options and warrants of Quickturn. All prior period consolidated financial statements were restated as if the merger took place at the beginning of such periods, in accordance with required pooling of interests accounting and disclosures. Revenue and net income (loss) of the separate companies for the fiscal year preceding the acquisition is as follows:

	<u>Year Ended January 2, 1999</u> (In thousands)
Revenue:	
Cadence, as previously reported	\$1,216,070
Quickturn	<u>104,110</u>
Combined	<u>\$1,320,180</u>
Net Income (Loss):	
Cadence, as previously reported	\$ 31,982
Quickturn	<u>(6,858)</u>
Combined	<u>\$ 25,124</u>

Design Acceleration, Inc.

In January 1999, Cadence acquired Design Acceleration, Inc., or DAI, a supplier of design verification technology used in system-on-a-chip design. Cadence acquired all of the outstanding stock of DAI for approximately 0.6 million shares of Cadence common stock and \$2.9 million of cash. The total purchase price was \$25.7 million and the acquisition was accounted for as a purchase. In connection with the acquisition, Cadence acquired net intangibles of \$24.1 million. The results of operations of DAI and the estimated fair value of the assets acquired and liabilities assumed are included in Cadence's consolidated financial statements from the date of acquisition. Intangibles arising from the acquisition are being amortized on a straight-line basis over five years.

Management estimated that \$8.9 million of the purchase price for DAI represented acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. Accordingly, this amount was immediately charged to expense in the consolidated statements of operations upon consummation of the acquisition. The value assigned to acquired in-process technology was determined by identifying research projects in areas for which technological feasibility had not been established. The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects, and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

surrounding the successful development of the purchased in-process technology. The acquired in-process technology became commercially viable in 2000. The value of other intangible assets acquired may become impaired. Comparative pro forma financial information has not been presented because the results of operations of DAI were not material to Cadence's consolidated financial statements.

Ambit Design Systems, Inc.

In September 1998, Cadence acquired all of the outstanding stock of Ambit Design Systems, Inc. for cash. The total purchase price was \$255 million and the acquisition was accounted for as a purchase. The results of operations of Ambit and the estimated fair value of the assets acquired and liabilities assumed are included in the accompanying consolidated financial statements from the date of acquisition. Intangibles arising from the acquisition are being amortized on a straight-line basis over seven years.

Management estimated that \$106.5 million of the purchase price represented acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. Accordingly, this amount was immediately charged to expense in the consolidated statements of operations upon consummation of the acquisition. The value assigned to acquired in-process technology was determined by identifying research projects in areas for which technological feasibility had not been established. The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects, and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty surrounding the successful development of the acquired in-process technology. The acquired in-process technology became commercially viable in 1999 and 2000. The value of other intangible assets acquired may become impaired.

In connection with the acquisition, net assets acquired were as follows:

	(In thousands)
Acquired intangibles, including in-process technology	\$308,678
Property, plant, and equipment, net and other non-current assets	9,333
Cash, receivables, and other current assets	8,349
Current liabilities assumed	(13,605)
Deferred income taxes	<u>(57,765)</u>
Net assets acquired	<u>\$254,990</u>

The following table represents unaudited consolidated pro forma financial information as if Cadence and Ambit had been combined as of the beginning of the period presented. The pro forma data are presented for illustrative purposes only and are not necessarily indicative of the combined financial position or results of operations of future periods or the results that actually would have resulted had Cadence and Ambit been a combined company during the specified period. The pro forma results include the effects of the amortization

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of acquired intangible assets and adjustments to the income tax provision. The pro forma combined results exclude acquisition-related charges for acquired in-process technology related to Ambit.

	<u>Fiscal Year Ended January 2, 1999</u> (Unaudited)
(In thousands, except per share amounts)	
Revenue	\$1,330,996
Net income	<u>\$ 112,772</u>
Net income per common share:	
Basic	<u>\$ 0.48</u>
Diluted	<u>\$ 0.44</u>

Bell Labs' Integrated Circuit Design Automation Group

In September 1998, Cadence acquired Bell Labs' Integrated Circuit Design Automation Group of Lucent Technologies Inc., or BLDA, for cash. The total purchase price was \$58.0 million and the acquisition was accounted for as a purchase. The results of operations of BLDA and the estimated fair value of the assets acquired and liabilities assumed are included in Cadence's consolidated financial statements from the date of acquisition. Intangibles arising from the acquisition are being amortized on a straight-line basis over five years.

Management estimated that \$30.3 million of the purchase price represented acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. Accordingly, this amount was immediately charged to expense in the consolidated statements of operations upon consummation of the acquisition. The value assigned to acquired in-process technology was determined by identifying research projects in areas for which technological feasibility had not been established. The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty surrounding the successful development of the acquired in-process technology. The acquired in-process technology became commercially viable in 2000. The value of other intangible assets acquired may become impaired.

Excellent Design, Inc.

In March 1998, Cadence acquired all of the outstanding stock of Excellent Design, Inc., or EXD, for cash. The total purchase price was \$40.9 million and the acquisition was accounted for as a purchase. The results of operations of EXD and the estimated fair value of the assets acquired and liabilities assumed are included in Cadence's consolidated financial statements from the date of acquisition. Intangibles arising from the acquisition are being amortized on a straight-line basis over five years.

Management estimated that \$28.4 million of the purchase price represented acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. Accordingly, this amount was immediately charged to expense in the consolidated statements of operations upon consummation of the acquisition. The value assigned to acquired in-process technology was determined by identifying research projects in areas for which technological feasibility had not been established. The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty surrounding the successful development of the acquired in-process technology. In the fourth quarter of fiscal

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

1999, Cadence recorded asset impairment charges of \$13.3 million. See further discussion at “Asset Impairment.”

Symbionics Group Limited

In February 1998, Cadence acquired all of the outstanding stock of Symbionics Group Limited for approximately 1 million shares of Cadence common stock and \$21.3 million of cash. Symbionics provided product development design services and intellectual property to leading electronics manufacturers in the wireless communications market. The total purchase price was \$56.1 million and the acquisition was accounted for as a purchase. The results of operations of Symbionics and the estimated fair value of the assets acquired and liabilities assumed are included in Cadence’s consolidated financial statements from the date of acquisition. In connection with the acquisition, Cadence acquired goodwill of \$15.9 million and acquired intangibles of \$11.5 million, representing assembled workforce, which are being amortized over five years.

Management estimated that \$28.5 million of the purchase price represented acquired in-process technology that had not yet reached technological feasibility and had no alternative future use. Accordingly, this amount was immediately charged to expense in the consolidated statements of operations upon consummation of the acquisition. The value assigned to acquired in-process technology was determined by identifying research projects in areas for which technological feasibility had not been established. The value was determined by estimating the costs to develop the acquired in-process technology into commercially viable products, estimating the resulting net cash flows from such projects and discounting the net cash flows back to their present value. The discount rate included a factor that took into account the uncertainty surrounding the successful development of the acquired in-process technology. The acquired in-process technology became commercially viable in 1999. The value of other intangible assets acquired may become impaired.

Comparative pro forma financial information has not been presented as the results of operations of BLDA, EXD, and Symbionics were not material to Cadence’s consolidated financial statements, either individually or in the aggregate.

CREDIT FACILITY AND LONG-TERM DEBT

On September 29, 2000, Cadence entered into two syndicated senior unsecured credit facilities that allow Cadence to borrow up to \$350 million, referred to as the 2000 Facilities. The 2000 Facilities replace a prior \$355 million revolving credit facility, referred to below as the 1998 Facility, of which \$177.5 million terminated on September 27, 2000, and a \$177.5 million was terminated immediately prior to closing of the 2000 Facilities. One of the new 2000 Facilities is a \$100 million three-year revolving credit facility, referred to as the Three-Year Facility. The other new facility is a \$250 million 364-day revolving credit facility convertible into a two-year term loan, referred to as the 364-day Facility. The Three-Year Facility terminates on September 29, 2003. The 364-Day Facility will terminate on September 28, 2001, at which time the 364-Day Facility may be converted to a two-year term loan with a maturity date of September 29, 2003, or, at the request of Cadence and with the consent of members of the bank group that wish to do so, the termination date of the 364-Day Facility may be extended for one additional 364-day period with respect to the portion of the 364-Day Facility that a consenting bank holds. For both the 2000 Facilities, Cadence has the option to pay interest based on LIBOR plus a spread of between 1.25% and 1.50%, based on a pricing grid tied to a financial covenant, or the higher of the (i) Federal Funds Rate plus 0.50% and (ii) prime rate. As a result, Cadence’s interest expenses associated with this borrowing will vary with market rates. In addition, commitment fees are payable on the unused portion of the Three-Year Facility at rates between 0.25% and 0.34% based on a pricing grid tied to a financial covenant and on the unused portion of the 364-Day Facility at a fixed rate of 0.20%. Cadence may not borrow under the 364-Day Facility at any time that any portion of the Three-Year Facility

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

remains unused. The 2000 Facilities contain certain financial and other covenants. As of December 30, 2000, Cadence had no outstanding borrowing under these credit facilities.

In October 1998, Cadence entered into a senior unsecured credit facility, referred to as the 1998 Facility, with a syndicate of banks that allowed Cadence to borrow up to \$355 million. As amended in September and November of 1999, the 1998 Facility was divided between a \$177.5 million two year revolving credit facility, referred to as the Two Year Facility, and a \$177.5 million 364-day revolving credit facility convertible into a one year term loan, referred to as the 364-Day Facility. The Two Year and 364-Day Facilities were both terminated in September 2000 and were replaced by the new 2000 Facilities. As of January 1, 2000, Cadence had \$20 million outstanding under the Two Year Facility at a weighted average interest rate of 8.11%.

During the year ended December 30, 2000, Cadence repaid all of the \$20 million outstanding under the 1998 Facility at January 1, 2000. At December 30, 2000, there were no borrowings outstanding under the 2000 Facilities.

A summary of long-term debt and capital leases follows:

	2000	1999
	(In thousands)	
Capital lease obligations	\$5,510	\$ 8,948
Revolving credit facility	—	20,000
Total	5,510	28,948
Less: Current portion	2,212	3,924
Long-term debt and capital leases	\$3,298	\$25,024

COMMITMENTS

Equipment and facilities are leased under various capital and operating leases expiring at various dates through the year 2017. Certain of these leases contain renewal options. Rental expense was \$22.2 million, \$25 million, and \$25.1 million for 2000, 1999, and 1998, respectively.

At December 30, 2000, future minimum lease payments under capital and operating leases and the present value of the capital lease payments were as follows:

	Capital Leases	Operating Leases
	(In thousands)	
For the years:		
2001	\$2,458	\$ 36,185
2002	1,789	27,612
2003	1,035	22,673
2004	541	17,656
2005	76	12,214
Thereafter	—	68,117
Total lease payments	5,899	\$184,457
Less: Amount representing interest (Average interest rate of 9.43%)	389	
Present value of lease payments	5,510	
Less: Current portion	2,212	
Long-term portion	\$3,298	

The cost of equipment under capital leases included in the consolidated balance sheets as property, plant, and equipment at December 30, 2000 and January 1, 2000 was approximately \$11.6 million and \$14 million,

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

respectively. Accumulated amortization of the leased equipment at December 30, 2000 and January 1, 2000 was approximately \$6.2 million and \$5.5 million, respectively.

CONTINGENCIES

From time to time Cadence is involved in various disputes and litigation matters that arise in the ordinary course of business. These include disputes and lawsuits related to intellectual property, mergers and acquisitions, licensing, contract law, distribution arrangements, and employee relations matters.

Cadence filed a complaint in the U.S. District Court for the Northern District of California on December 6, 1995 against Avant! Corporation and certain of its employees for misappropriation of trade secrets, copyright infringement, conspiracy, and other illegal acts.

On January 16, 1996, Avant! filed various counterclaims against Cadence and Joseph B. Costello, Cadence's former President and Chief Executive Officer, and with leave of the court, on January 29, 1998, filed a second amended counterclaim. The second amended counterclaim alleges, *inter alia*, that Cadence and Mr. Costello had cooperated with the Santa Clara County, California, District Attorney and initiated and pursued its complaint against Avant! for anti-competitive reasons, engaged in wrongful activity in an attempt to manipulate Avant!'s stock price, and utilized certain pricing policies and other acts to unfairly compete against Avant! in the marketplace. The second amended counterclaim also alleges that certain Cadence insiders engaged in illegal insider trading with respect to Avant!'s stock. Cadence and Mr. Costello believe that they have meritorious defenses to Avant!'s claims, and each intends to defend such action vigorously. By an order dated July 13, 1996, the court bifurcated Avant!'s counterclaim from Cadence's complaint and stayed the counterclaim pending resolution of Cadence's complaint. The counterclaim remains stayed.

In an order issued on December 19, 1997, as modified on January 26, 1998, the District Court entered a preliminary injunction barring Avant! from any further infringement of Cadence's copyrights in DESIGN FRAMEWORKII® software, or selling, licensing or copying such product derived from DESIGN FRAMEWORK II, including, but not limited to, Avant!'s ArcCell products. On December 7, 1998, the District Court issued a further preliminary injunction, which enjoined Avant! from selling its Aquarius product line. Cadence posted a \$10 million bond in connection with the issuance of the preliminary injunction. On July 30, 1999, the U.S. Court of Appeals for the Ninth Circuit affirmed the preliminary injunction.

By an order dated July 22, 1997, the District Court stayed most activity in the case pending in that court and ordered Avant! to post a \$5 million bond in light of related criminal proceedings pending against Avant! and several of its executives.

On September 7, 1999, the District Court ruled on the parties' Motions for Summary Adjudication, and granted in part, and denied in part, each party's motion regarding the scope of a June 6, 1994 Release Agreement between the parties. The court held that Cadence's copyright infringement claim against Avant! is not barred by the release and that Cadence may proceed on that claim. The court also held that Cadence's trade secret claim based on Avant!'s use of Cadence's DESIGN FRAMEWORK II source code is barred by the release. The Ninth Circuit has agreed to hear both parties' appeal from the District Court's order. The trial date has been vacated pending a decision on the appeal and the outcome of the criminal case, for which the trial is scheduled to begin in April 2001.

In February 1998, Aptix Corporation and Meta Systems, Inc. filed a lawsuit against Quickturn Design Systems, Inc. in the U.S. District Court for the Northern District of California. In this lawsuit, entitled Aptix Corporation and Meta Systems, Inc. v. Quickturn Design Systems, Civil Action No. C 98-00762 WHA, Aptix and Meta Systems alleged that Quickturn infringed a U.S. patent owned by Aptix and licensed to Meta. Quickturn filed a counterclaim requesting the District Court to declare the Aptix patent invalid in view of the prior art and unenforceable based on inequitable conduct during the prosecution of the patent. In June 2000 the District Court entered judgment in favor of Quickturn, dismissing the complaint and declaring the patent

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

unenforceable. On September 8, 2000 the Court ordered Aptix to pay \$4.2 million to Quickturn as reimbursement to Quickturn of the attorneys' fees and costs it incurred in the litigation. Aptix has appealed the District's Court's judgment and, in the meantime, has agreed to post a \$2 million bond to secure the judgment.

On January 7, 1999, in the suit captioned Mentor Graphics Corporation, et. al. v. Lobo, et. al., Delaware Chancery Court, New Castle County, Civ. Action No. 16843-NC ("Mentor v. Lobo"), an amended complaint was filed and served by Mentor asserting claims against Cadence, Quickturn Design Systems, Inc. and its Board of Directors for declaratory and injunctive relief for various alleged breaches of fiduciary duty purportedly owned by Quickturn and its Board of Directors to Quickturn's shareholders in connection with the merger between Quickturn and Cadence. Mentor alleged that Cadence aided and abetted Quickturn and its Board of Directors in those purported breaches. Mentor has not prosecuted the matter since January 1999. In May 2000, Mentor advised the Delaware Chancery Court of its objection to the settlement of a companion action brought on behalf of certain Quickturn shareholders. Mentor further advised the court that it would seek an award of attorneys' fees related to its prosecution of the Mentor v. Lobo action. At the request of the court, on July 28, 2000, Mentor filed its brief in support of its standing to seek such an award. Cadence, Quickturn and the individual defendants have opposed Mentor's request. A hearing on the matter was held on February 1, 2001. The court has taken the matter under submission.

On April 30, 1999, Cadence and several of its officers and directors were named as defendants in a lawsuit filed in the U.S. District Court for the Northern District of California, entitled Spett v. Cadence Design Systems, et al., civil action no. C 99-2082. The action was brought on behalf of a class of stockholders who purchased Cadence common stock between November 4, 1998 and April 20, 1999, and alleges violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The lawsuit arises out of Cadence's announcement of its first quarter 1999 financial results. On September 18, 2000 the District Court granted Cadence's Motion to Dismiss Plaintiffs' Claims with leave to amend. To date, no amended complaint has been filed. Should an amended complaint be filed, Cadence and the individual defendants intend to continue their vigorous defense of the allegations.

In early 1999, Cadence entered into negotiations with Intellect Communications, Inc., and Intellect's wholly-owned subsidiary, DNA Enterprises, Inc., with respect to a potential purchase of substantially all the assets of DNA. The transaction was not consummated and, in July 1999, Intellect and DNA filed suit against Cadence in a Texas state court alleging breach of contract, fraud, negligent misrepresentation and breach of fiduciary duty, seeking unspecified compensatory and punitive damages. Cadence has answered, denying liability, and discovery has commenced. A trial date has been schedule for October 2001. Cadence believes that it has defenses to and disputes the allegations made by Intellect and DNA, including the allegation that a purchase contract was entered into, and intends to defend the action vigorously.

On July 21, 1999, Mentor filed suit against Quickturn in the U.S. District Court for the District of Delaware, alleging that Quickturn's MERCURYTM hardware emulation systems infringe U.S. Patent Nos. 5,777,489 and 5,790,832 allegedly assigned to Mentor. At Quickturn's request, Cadence was added as a party defendant. Mentor has since asserted that Quickturn's MERCURYPLUSTM emulation systems also infringe U.S. Patent Nos. 5,777,489 and 5,790,832. The complaint seeks a permanent injunction and unspecified damages. Cadence intends to vigorously defend itself against these claims. On December 14, 1999, this action was transferred to the U.S. District Court for the Northern District of California, and renumbered Civil Action No. C 99-5464 SI.

On February 25, 2000, Cadence and several of its officers were named as defendants in a lawsuit filed in the U.S. District Court for the Northern District of California, entitled Maxick v. Cadence Design Systems, Inc., File No. C 00 0658PJH. The action was brought on behalf of a class of shareholders of OrCAD, Inc., and alleges violations of Section 14(d) (7) of the Securities Exchange Act of 1934, as amended, and Rule 14d-10 thereunder. The lawsuit arises out of Cadence's acquisition of OrCAD, which was completed in August 1999.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cadence's Motion to Dismiss plaintiffs' claims was denied. Discovery is continuing. The defendants believe the complaint is without merit and intend to continue their vigorous defense of the allegations.

On March 24, 2000, Mentor and Meta and several founders of Meta filed suit against Quickturn and Cadence and a former Quickturn employee in the U.S. District Court for the Northern District of California, Civil Action No. C 00-01030 WHA. The suit alleges patent infringement of a U.S. Patent allegedly assigned to Mentor, misappropriation of trade secrets and breach of confidence, and seeks unspecified damages, injunctive relief and the assignment to Mentor of a patent previously issued to Quickturn. Cadence intends to vigorously defend itself against these claims, and has filed a counterclaim for declaratory judgment of invalidity of several patents allegedly assigned to Mentor. Following a motion by Cadence, the former Quickturn employee was dismissed as a party to the action. Discovery in the action has subsequently been consolidated with discovery in Civil Action No. C 99-5464, the Mentor v. Quickturn suit transferred from Delaware.

In April 2000, Cadence filed suit against a former design services customer, IMI Telecommunications, Inc., for breach of contract relating to IMI Telecommunications' failure to make payments due and fulfill its obligations under a services agreement. Damages claimed by Cadence are approximately \$1 million. The defendant countersued, alleging breach of oral contract, rescission, negligent misrepresentation and fraud by Cadence and claiming damages exceeding \$100 million and seeking punitive damages exceeding \$500 million. Cadence filed a motion to dismiss the defendant's counterclaims, and a hearing on this motion was held on October 2, 2000. A ruling has not yet been issued. Cadence believes that it has defenses to and disputes the allegations made by IMI Telecommunications and intends to defend the action vigorously.

On September 11, 2000, Mentor filed a complaint against Quickturn and Cadence in the U.S. District Court for the Northern District of California (Case No. C-00-03291) accusing Quickturn and Cadence of infringing U.S. Patent No. 5,574,388, purportedly owned by Mentor and seeking unspecified damages and injunctive relief. Quickturn and Cadence believe the complaint filed by Mentor is without substance and that the patent that is the subject of this suit is invalid and not infringed. Cadence and Quickturn are vigorously defending the claim. On November 3, 2000, Mentor filed a motion for preliminary injunction, asking the Court to prohibit the sale of Quickturn's MERCURYPLUS emulation systems prior to trial of this action. The hearing on that motion is scheduled for March 30, 2001. The parties have agreed to consolidate this action with Civil Action Nos. C99-5464 and C 00-01030 WHA, described above, for purposes of discovery and pre-trial motions. A trial date of October 7, 2002 has been set for all three actions.

On November 2, 2000, Mentor and Meta filed a complaint for declaratory judgment against Quickturn and Cadence in the U.S. District Court for the District of Oregon (Case No. C-00-1489) seeking a ruling that Mentor's proposed design verification approach (in which chip designers would use U.S.-based computer terminals to operate SimExpress emulation systems located overseas) will not infringe Quickturn's patents and will not violate the permanent injunction entered by the Oregon District Court on July 7, 1999 in Civil Action No. C-96-00342. On January 5, 2001, Quickturn and Cadence answered the complaint. In their answer, Quickturn and Cadence denied Mentor and Meta's contention, and asserted that Mentor and Meta's complaint lacks subject matter jurisdiction and is barred by res judicata and collateral estoppel. Quickturn and Cadence intend to vigorously contest this action.

On November 22, 2000, a former design services customer, Uniden Corporation, filed an action for fraud, negligent misrepresentation and breach of contract in the State Court of Texas against Cadence, and alleged those causes of action as well as others against Intel Corporation and entities related to Intel. Uniden seeks compensatory and punitive damages in an unspecified amount. The suit was filed after Cadence demanded payment of approximately \$1 million for design services rendered to Uniden. Cadence since has filed a counterclaim to recover the approximate \$1 million owed for services rendered. Intel has filed a motion for forum non conveniens requesting that the action to be moved to California. Cadence has joined in that motion. Cadence intends to vigorously defend the action brought by Uniden.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Management believes that the ultimate resolution of the disputes and litigation matters discussed above will not have a material adverse effect on Cadence's business, operating results or financial condition. However, were an unfavorable ruling to occur in any specific period, there exists the possibility of a material adverse impact on the result of operations.

STOCKHOLDERS' EQUITY

Net Income (Loss) per Share

The following is a reconciliation of the weighted average common shares used to calculate basic net income (loss) per share to the weighted average common and potential common shares used to calculate diluted net income (loss) per share for the years 2000, 1999, and 1998:

	2000	1999	1998
	(In thousands)		
Weighted average common shares used to calculate basic net income (loss) per share	244,565	242,037	234,605
Options	17,053	—	22,778
Puts	400	—	257
Warrants and other contingent common shares	678	—	222
Weighted average common and potential common shares used to calculate diluted net income (loss) per share	<u>262,696</u>	<u>242,037</u>	<u>257,862</u>

Options to purchase 2,660,253 shares of common stock were outstanding at December 30, 2000, but were not included in the computation of diluted net income per share because their effect would be antidilutive. These options expire at various dates through 2010. Warrants to purchase 140,000 shares of common stock were outstanding at December 30, 2000, but were not included in the computation of diluted net income per share because their effect would be antidilutive. The warrants outstanding expire in June 2003. Put warrants to purchase 5,496,807 shares of common stock were outstanding at December 30, 2000, but were not included in the computation of diluted net income per share because their effect would be antidilutive. The put warrants outstanding expire at various dated through November 2001.

Options to purchase 56,181,714 shares of common stock were outstanding at January 1, 2000, but were not included in the computation of diluted net loss per share because their effect would be antidilutive. These options expire at various dates through 2009. Warrants to purchase 394,237 shares of common stock were outstanding at January 1, 2000, but were not included in the computation of diluted loss per share because their effect would be antidilutive. The warrants outstanding expire in February 2000 and June 2003. Put warrants to purchase 1,615,175 shares of common stock were outstanding at January 1, 2000, but were not included in the computation of diluted loss per share because their effect would be antidilutive. The put warrants outstanding expired in February 2000.

Options to purchase 1,161,006 shares of common stock were outstanding at January 2, 1999, but were not included in the computation of diluted net income per share because their effect would be antidilutive. These options expire at various dates through 2008. Warrants to purchase 170,400 shares of common stock were outstanding at January 2, 1999, but were not included in the computation of diluted net income per share because their effect would be antidilutive. The warrants outstanding expired in August 1999. Put warrants to purchase 2,588,820 shares of common stock were outstanding at January 2, 1999, but were not included in the computation of diluted net income per share because their effect would be antidilutive. The put warrants outstanding expired at various dated through November 1999.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Compensation Plans

Stock Option Plans

Cadence's 2000 Non-Statutory Stock Option Plan, referred to as the 2000 Plan, provides for the issuance of non-qualified options to its employees to purchase up to 30,000,000 shares of common stock at an exercise price not less than the fair market value of the stock on the date of grant. Options granted under the 2000 Plan become exercisable over periods up to four years, generally with one-fourth of the shares vesting one year from the vesting commencement date with respect to initial grants, and the remaining shares vesting in 36 equal monthly installments. Options under the 2000 Plan generally expire ten years from the date of grant.

Cadence's 1997 Non-Statutory Stock Option Plan, referred to as the 1997 Plan, provides for the issuance of non-qualified options to its employees to purchase up to 30,000,000 shares of common stock at an exercise price not less than the fair market value of the stock on the date of grant. Options granted under the 1997 Plan become exercisable over periods up to five years, with, generally, one-fifth of the shares vesting one year from the vesting commencement date with respect to initial grants, and the remaining shares vesting in 48 equal monthly installments. Options under the 1997 Plan generally expire ten years from the date of grant.

Cadence's 1987 Employee Stock Option Plan, referred to as the 1987 Plan, provides for the issuance of either incentive or non-qualified options to its employees to purchase up to 71,370,100 shares of common stock at an exercise price not less than fair market value of the stock on the date of grant. Options granted under the 1987 Plan become exercisable over periods of up to five years and generally expire five to ten years from the date of grant.

Cadence's 1993 Non-Statutory Stock Option Plan, referred to as the 1993 Non-Statutory Plan, provides for the issuance of non-qualified options to its employees to purchase up to 24,750,000 shares of common stock at an exercise price not less than the fair market value of the stock on the date of grant. Options granted under the 1993 Non-Statutory Plan become exercisable over a four year period, with one-fourth of the shares vesting one year from the vesting commencement date, and the remaining shares vesting in 36 equal monthly installments. Options under the 1993 Non-Statutory Plan generally expire ten years from the date of grant.

Under the 1995 and 1993 Directors' Stock Option Plans, referred to as the Directors' Plans, Cadence may grant non-qualified options to its non-employee directors for up to 2,032,502 shares of common stock at an exercise price not less than the fair market value of the stock on the date of grant. Options granted under the Directors' Plans have terms of up to ten years. Certain of the option grants vest one year from the date of grant, and other option grants vest one-third on the date which is one year from the date of grant and two-thirds ratably over the subsequent two years.

Cadence has assumed certain options granted to former employees of acquired companies, referred to as Acquired Options. The Acquired Options were assumed by Cadence outside of its stock option plans, and all are administered as if issued under their original plans. All of the Acquired Options have been adjusted to effectuate the price conversion under the terms of the Agreements and Plans of Reorganization between Cadence and the companies acquired. The Acquired Options generally become exercisable over a four or five year period and generally expire either five or ten years from the date of grant. No additional options will be granted under any of the acquired companies' plans.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A summary of the status of all of Cadence's stock option plans as of and during the years ended December 30, 2000, January 1, 2000, and January 2, 1999 follows:

	2000		1999		1998	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	56,181,714	\$14.29	42,678,756	\$14.07	46,733,239	\$11.28
Assumption of acquired companies options	—	—	2,649,553	\$ 5.78	816,334	\$ 2.83
Granted	15,536,900	\$19.65	25,205,953	\$14.48	13,510,326	\$18.64
Exercised	(8,655,150)	\$ 9.87	(6,658,815)	\$ 7.64	(11,136,992)	\$ 7.11
Forfeited	(13,063,305)	\$18.26	(7,693,733)	\$16.50	(7,244,151)	\$14.04
Outstanding at end of year	50,000,159	\$15.53	56,181,714	\$14.29	42,678,756	\$14.07
Options exercisable at year end	19,881,259		21,226,714		17,493,945	
Options available for future grant	38,544,937		11,541,925		19,261,461	
Weighted average fair value of options granted during the year	\$ 10.84		\$ 9.19		\$ 13.52	

A summary of the status of all of Cadence's stock option plans at December 30, 2000 follows:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at December 30, 2000	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at December 30, 2000	Weighted Average Exercise Price
\$ 0.14 – \$ 5.00	2,179,525	2.9	\$ 2.28	2,157,352	\$ 2.27
\$ 5.01 – \$10.00	6,101,535	6.1	\$ 7.08	4,748,444	\$ 6.96
\$10.01 – \$15.00	19,286,899	7.9	\$13.36	6,714,945	\$13.53
\$15.01 – \$20.00	10,516,507	8.2	\$18.08	3,430,146	\$17.85
\$20.01 – \$25.00	9,888,640	8.7	\$22.74	2,126,782	\$22.67
\$25.01 – \$30.00	1,759,071	8.4	\$26.43	487,602	\$26.31
\$30.01 – \$35.00	237,982	7.4	\$33.39	199,988	\$33.80
\$35.01 – \$35.06	30,000	7.3	\$35.06	16,000	\$35.06
Total	50,000,159		\$15.53	19,881,259	\$13.00

Stock Repurchase Plan

Cadence has authorized three seasoned systematic stock repurchase programs under which it repurchases Cadence common stock to satisfy estimated requirements for shares to be issued under its Employee Stock Purchase Plan, or ESPP, and the 2000 and 1997 Plans. Such repurchases are intended to cover Cadence's expected reissuances under the ESPP and the 2000 and 1997 Plans for the next 12 months and 24 months, respectively.

As part of its authorized repurchase program, Cadence has sold put warrants through private placements. At December 30, 2000, there were 5.5 million put warrants outstanding that entitle the holder to sell one share of common stock to Cadence on a specified date and at specified prices ranging from \$19.77 to \$24.39 per

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

share. Additionally, during this same period, Cadence purchased call options that entitle Cadence to buy one share of common stock at a specified price to satisfy anticipated stock repurchase requirements under Cadence's systematic repurchase programs. At December 30, 2000, Cadence had 4 million call options outstanding at specified prices ranging from \$20.02 to \$24.64 per share. The put warrants and call options outstanding at December 30, 2000 expire on various dates through November 2001 and Cadence has the contractual ability to settle the options prior to their maturity. At December 30, 2000, the estimated fair value of the call options was approximately \$26.2 million and the fair value of the put warrants was approximately \$8.3 million.

If exercised, Cadence has the right to settle the put warrants with common stock equal to the difference between the exercise price and the fair value at the date of exercise. Settlement of the put warrants with common stock could cause Cadence to issue a substantial number of shares, depending on the exercise price of the put warrants and the per share fair value of Cadence common stock at the time of exercise. In addition, settlement of put warrants in common stock could lead to the disposition by put warrant holders of shares of Cadence common stock that such holders may have accumulated in anticipation of the exercise of the put warrants or call options, which may adversely affect the price of Cadence common stock. At December 30, 2000, Cadence had the ability to settle these put warrants with common stock and, therefore, no amount was classified out of stockholders' equity in the consolidated balance sheets. The effect of the exercise of these put warrants and call options is reported in the line titled "Purchase of treasury stock" within the consolidated statements of stockholders' equity.

Employee Stock Purchase Plan

Under the ESPP, Cadence is authorized to issue up to 23,500,000 shares of common stock to its employees. Under the terms of the ESPP, employees can choose to have up to 12% of their annual base earnings plus bonuses withheld to purchase Cadence common stock. The purchase price of the stock is 85% of the lesser of the fair market value as of the beginning or the end of the offering periods. The offering periods provide for concurrent 24 month offering periods with a new 24 month offering period starting every six months. Each offering period will be divided into four consecutive six month purchase periods. Under the ESPP, Cadence issued 3,168,839, 2,110,222, and 1,252,855 shares to employees in 2000, 1999, and 1998, respectively. The weighted average purchase price and the weighted average fair value of shares issued in 2000 was \$9.36 and \$20.75, respectively.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Pro Forma Information

This information is required to illustrate the financial results of operations as if Cadence had accounted for its grants of employee stock options under the fair value method of SFAS No. 123, "Accounting for Stock—Based Compensation." The fair value of Cadence's options granted and shares purchased under the ESPP program for years ended December 30, 2000, January 1, 2000, and January 2, 1999 reported below was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions assuming a dividend yield of zero for all periods:

	Stock Options		
	2000	1999	1998
Risk-free interest rate	5.07%	5.90%	5.22%
Volatility factors of the expected market price of Cadence's common stock	59%	62%	59%
Weighted average expected life of an option	5 Years	5 Years	4 Years
	Employee Stock Purchase Plan		
	2000	1999	1998
Risk-free interest rate, based on weighted average	6.03%	4.95%	5.21%
Volatility factors of the expected market price of Cadence's common stock	59%	62%	59%
Weighted average expected life of ESPP shares	0.5 Years	0.5 Years	0.5 Years

For purposes of pro forma disclosures, the estimated fair value of the options is amortized over the options' vesting period. Cadence applies Accounting Principles Board Opinion No. 25 and related Interpretations in accounting for its plans. Had Cadence's fixed stock option and employee stock purchase plans been accounted for under SFAS No. 123, net income (loss) and net income (loss) per share would have been adjusted to the following pro forma amounts:

	2000	1999	1998
	(In thousands, except per share amounts)		
Net income (loss):			
As reported	<u>\$ 49,977</u>	<u>\$ (14,075)</u>	<u>\$ 25,124</u>
Pro forma	<u>\$ (65,296)</u>	<u>\$ (127,954)</u>	<u>\$ (57,569)</u>
Basic net income (loss) per share:			
As reported	<u>\$ 0.20</u>	<u>\$ (0.06)</u>	<u>\$ 0.11</u>
Pro forma	<u>\$ (0.27)</u>	<u>\$ (0.53)</u>	<u>\$ (0.25)</u>
Diluted net income (loss) per share:			
As reported	<u>\$ 0.19</u>	<u>\$ (0.06)</u>	<u>\$ 0.10</u>
Pro forma	<u>\$ (0.27)</u>	<u>\$ (0.53)</u>	<u>\$ (0.25)</u>

The effects of applying SFAS No. 123 on pro forma disclosures of net income (loss) and net income (loss) per share for 2000, 1999, and 1998 are not likely to be representative of the pro forma effects on net income (loss) and net income (loss) per share in future years.

Warrants

At December 30, 2000, Cadence had warrants outstanding to purchase 140,000 shares of Cadence common stock at \$3.22 per share. The warrants expire in June 2003 and can be exercised at any time in increments of not less than 50,000 shares.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Reserved for Future Issuance

At December 30, 2000, Cadence had reserved the following shares of authorized but unissued common stock for future issuance:

	<u>Shares</u>
Employee stock option plans	82,647,805
ESPP	5,493,394
Put warrants	5,496,807
Directors stock option plans	1,602,170
Warrants	140,000
Other option agreements	<u>7,500</u>
Total	<u><u>95,387,676</u></u>

Stockholder Rights Plan

In February 1996, Cadence adopted a new stockholder rights plan to protect its stockholders' rights in the event of a proposed or actual acquisition of 15% or more of the outstanding shares of Cadence common stock. As amended in February 2000, each share of Cadence common stock carries a right to purchase one one-thousandth ($1/1000$) of a share of Series A Junior Participating Preferred Stock, referred to as a Right, par value \$0.01 per share, of Cadence at a price of \$240 per one one-thousandth of a share, subject to adjustment. The Rights are subject to redemption at the option of the Board of Directors at a price of \$0.01 per Right until the occurrence of certain events. The Rights expire on February 20, 2006.

Deferred Stock Compensation

Deferred stock compensation represents the difference between the exercise price of stock option grants to Tality employees and directors, and restricted stock sales to certain Cadence executives and key employees, and the deemed fair value of Tality's common stock at the time of those grants and sales. For the year ended December 30, 2000, Cadence recorded a total of \$72.4 million of deferred stock compensation, \$64.1 million related to the stock option grants, and \$8.3 million related to the restricted stock sales. Cadence is amortizing deferred stock compensation to expense over the period during which the stock options and restricted stock vest, four years and one year, respectively

Other Comprehensive Income

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

	2000			1999			1998		
	Pre-Tax Amount	Tax (Expense) On Benefit	Net-of-Tax Amount	Pre-Tax Amount	Tax (Expense) On Benefit	Net-of-Tax Amount	Pre-Tax Amount	Tax (Expense) On Benefit	Net-of-Tax Amount
	(In thousands)								
Other comprehensive income (loss):									
Unrealized holding gains (losses) on marketable securities	\$(47,030)	\$12,463	\$(34,567)	\$47,509	\$(11,260)	\$36,249	\$ 147	\$(110)	\$ 37
Foreign currency translation loss	<u>(6,453)</u>	<u>1,710</u>	<u>(4,743)</u>	<u>(3,284)</u>	<u>778</u>	<u>(2,506)</u>	<u>(5,462)</u>	<u>4,091</u>	<u>(1,371)</u>
	<u><u>\$(53,483)</u></u>	<u><u>\$14,173</u></u>	<u><u>\$(39,310)</u></u>	<u><u>\$44,225</u></u>	<u><u>\$(10,482)</u></u>	<u><u>\$33,743</u></u>	<u><u>\$(5,315)</u></u>	<u><u>\$3,981</u></u>	<u><u>\$(1,334)</u></u>

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

INCOME TAXES

The provision for income taxes consisted of the following components:

	2000	1999	1998
	(In thousands)		
Current:			
Federal	\$ 39,678	\$ 16,391	\$ 68,854
State	6,369	1,771	14,925
Foreign	716	10,376	27,979
Total current	46,763	28,538	111,758
Deferred (prepaid):			
Federal	(24,009)	(22,074)	(37,257)
State	(3,486)	(5,486)	(6,958)
Foreign	(1,249)	1,717	7,379
Total deferred (prepaid)	(28,744)	(25,843)	(36,836)
Total provision for income taxes	\$ 18,019	\$ 2,695	\$ 74,922

Income (loss) before income taxes included income of approximately \$43.2 million for 2000, \$11.5 million for 1999, and \$1.6 million for 1998, from Cadence's foreign subsidiaries. The provision for income taxes is net of the benefit of operating loss carryforwards totaling \$28.9 million for 2000, \$28.3 million for 1999, and \$3.9 million for 1998.

The provision for income taxes differs from the amount estimated by applying the statutory federal income tax rate to income (loss) before income taxes as follows:

	2000	1999	1998
	(In thousands)		
Provision (benefit) computed at federal statutory rate	\$ 23,799	\$ (3,983)	\$ 35,017
State income tax, net of federal tax effect	6,369	(539)	7,125
Separation costs	2,451	—	—
Amortization of acquired intangibles	1,489	(11,429)	1,020
Other	693	(775)	948
Acquisition costs	—	2,952	(2,679)
Foreign withholding taxes	—	—	1,110
Foreign tax credit	—	—	(1,110)
Write-off of in-process technology	—	7,245	46,615
Research and development tax credit	—	(5,219)	(6,891)
Foreign income tax at a higher (lower) rate	(1,609)	3,014	(21,604)
Change in valuation allowance	(15,173)	11,429	15,371
Provision for income taxes	\$ 18,019	\$ 2,695	\$ 74,922
Effective tax rate	26.5%	(23.7)%	74.9%

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The components of deferred tax assets and liabilities consisted of the following:

	2000	1999
	(In thousands)	
Deferred Tax Assets:		
Intangibles	\$ 71,726	\$ 53,625
Accruals and reserves	37,194	34,939
Sales returns and allowance	30,957	20,865
Tax credits	28,452	24,238
Accrued intercompany royalty	24,546	33,685
Net operating losses	10,617	12,241
Other	10,303	15,294
Restructure reserves	6,399	10,069
Depreciation and amortization	—	10,293
Total deferred tax assets	220,194	215,249
Valuation allowance — provision for income taxes	(5,932)	(21,105)
Valuation allowance — equity and intangibles	(16,949)	(19,853)
Net deferred tax assets	197,313	174,291
Deferred Tax Liabilities:		
Intangibles	(89,743)	(85,856)
Other	(9,380)	(17,577)
Depreciation and amortization	(8,927)	—
Capitalized software	(6,560)	(7,570)
Accrued intercompany royalty	—	(9,624)
Total deferred tax liabilities	(114,610)	(120,627)
Total net deferred tax assets	\$ 82,703	\$ 53,664

Cadence provides for U.S. income taxes on the earnings of foreign subsidiaries unless they are considered permanently invested outside of the U.S. At December 30, 2000, the cumulative amount of earnings upon which U.S. income taxes have not been provided are approximately \$228.7 million. At December 30, 2000, the unrecognized deferred tax liability for these earnings was approximately \$64.4 million.

The net valuation allowance for provision for income taxes decreased by \$15.2 million in 2000. The valuation allowance for provision for income taxes decreased by \$17.8 million due to tax planning which allowed Cadence to benefit from certain foreign deferred tax assets against domestic taxes. The valuation allowance for provision for income taxes also increased by \$2.6 million due to the benefit of the amortization of Tality deferred stock compensation which will only be realized if the fair market value of Tality common stock on the date of exercise is greater than the exercise price of the Tality stock option.

The net valuation allowance for equity and intangibles decreased by \$2.9 million in 2000. The valuation allowance earmarked for equity and intangibles is due to domestic entities generating sufficient taxable income, including the deduction of stock options to realize certain domestic deferred tax assets. The remaining valuation allowance—equity and intangibles of \$16.9 million is due to the uncertainty of domestic entities generating sufficient taxable income, including the deduction for stock options to realize certain domestic deferred tax assets. This portion of the valuation allowance, identified in the above table as “valuation allowance — equity and intangibles”, if realizable, may reduce other intangibles and may not be available to offset future provision for income taxes.

The remaining net operating loss carryforwards will expire at various dates from 2001 through 2020 and federal tax credit carryforwards will expire at various dates from 2001 through 2015.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A dispute between Cadence and the Internal Revenue Service regarding \$15.6 million in tax credits for the tax years 1989 through 1991 was settled during 1999 with no material adjustments to the returns as originally filed.

EMPLOYEE BENEFIT PLAN

Cadence maintains 401(k) savings plans to provide retirement benefits through tax deferred salary deductions for all its domestic employees. Cadence may make discretionary contributions, as determined by the Board of Directors, which cannot exceed a specified percentage of the annual aggregate salaries of those employees eligible to participate. Cadence made total contributions to the plans of \$9.3 million, \$3.9 million, and \$4.2 million for 2000, 1999, and 1998, respectively.

In January 2000, Cadence amended its 401(k) plan to provide that Cadence will match contributions with 50% of every dollar contributed, up to a contribution level of 6% of the salaries of those employees who participate in the 401(k) plan.

STATEMENT OF CASH FLOWS

The supplemental cash-flow information for 2000, 1999, and 1998 follows:

	2000	1999	1998
	(In thousands)		
Cash Paid During the Year for:			
Interest	\$ 1,905	\$ 2,975	\$ 3,181
Income taxes (including foreign withholding tax)	<u>\$14,825</u>	<u>\$25,330</u>	<u>\$12,091</u>
Non-Cash Investing and Financing Activities:			
Capital lease obligations incurred for equipment	\$ 1,015	\$ 7,727	\$ 1,505
Common and treasury stock issued for acquisitions	<u>\$ 5,333</u>	<u>\$21,201</u>	<u>\$28,971</u>
Write-off of unearned deferred compensation	\$ —	\$ —	\$ 83
Notes receivables on employee investments in subsidiary	<u>\$10,759</u>	<u>\$ —</u>	<u>\$ —</u>
Transfer of inventory to fixed assets	<u>\$ 5,462</u>	<u>\$ —</u>	<u>\$ —</u>
Equity investment by transfer of equipment or software	<u>\$ 8,140</u>	<u>\$ —</u>	<u>\$ —</u>
Deferred stock compensation of stock options and restricted stock	<u>\$72,369</u>	<u>\$ —</u>	<u>\$ —</u>

UNUSUAL ITEMS AND RESTRUCTURING

Described below are unusual items and restructuring charges in 2000, 1999, and 1998:

	2000	1999	1998
	(In thousands)		
Separation costs	\$6,820	\$ —	\$ —
Write-off of acquired in-process technology	—	20,700	194,100
Asset impairment	—	19,891	—
Restructuring charges	—	13,274	69,495
Litigation settlement	—	(3,000)	—
Merger costs	—	8,436	—
Total unusual items	<u>\$6,820</u>	<u>\$59,301</u>	<u>\$263,595</u>

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Separation Costs

In the year ended December 30, 2000, Cadence recorded \$6.8 million in separation costs related to the separation of its design services business, and the related planned IPO of Tality, Cadence's newly-formed subsidiary. These costs primarily include legal and accounting services, strategic business planning, information systems separation, development of compensation and benefits strategies, and recruitment and formation of Tality's senior management team.

In-Process Technology

Described below are the write-offs of acquired in-process technology charges in 1999 and 1998:

	1999	1998
	(In thousands)	
OrCAD	\$11,800	\$ —
DAI	8,900	—
Ambit	—	106,500
BLDA	—	30,300
Symbionics	—	28,500
EXD	—	28,400
Other	—	400
Total unusual items	<u>\$20,700</u>	<u>\$194,100</u>

These acquired in-process technology charges represent in-process technology that had not reached technological feasibility and had no probable alternative future use. See "Acquisitions."

Asset Impairment

In 1999, Cadence incurred charges totaling \$19.9 million in asset impairment charges. Of this amount, \$13.3 million represented asset impairment of acquired intangibles from the EXD acquisition. This asset impairment charge resulted from reduced Japanese market opportunities and the loss of key EXD employees resulting in diminished cash flow projections. Cadence entered into certain support agreements with external parties to provide support for EXD software tools previously sold to Cadence customers. The fair value of the EXD acquired intangibles was based on an evaluation of the present value of the estimated expected future cash flows, discounted at 16%. The remaining \$6.6 million in asset impairment charges were incurred in connection with the cancellation of an information technology services contract with a third-party, the abandonment of capitalized software development costs associated with certain Cadence products that will no longer be sold, and the abandonment of certain third-party software licenses that will no longer be used by Cadence's design services business.

The impairment losses recorded were the amounts by which the carrying amounts of the intangible assets exceeded their fair market values.

Restructuring

In 1999, Cadence recorded \$13.3 million of restructuring charges that consisted of \$11.3 million to terminate approximately 100 employees and \$2 million to downsize and close excess facilities. Cadence's restructuring plans were primarily aimed at reducing costs after Cadence merged with Quickturn, further restructuring of Cadence's services business in Japan, and severance resulting from the resignation of Cadence's former Chief Executive Officer. Severance costs include severance benefits, notice pay, and

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

outplacement services. All terminations and termination benefits were communicated to the affected employees prior to year-end and substantially all remaining severance benefits were paid in 2000.

Facilities consolidation charges of \$2 million were incurred in connection with the closure of 15 Quickturn facilities, including \$1 million to close duplicate and excess facilities and \$1 million of abandonment costs for the related leasehold improvements. Closure and exit costs include payments required under lease contracts, less any applicable sublease income after the properties were abandoned, lease buyout costs, restoration costs associated with certain lease arrangements, and costs to maintain facilities during the period after abandonment. Asset related write-offs consist of leasehold improvements of facilities that were abandoned and whose estimated fair market value is zero. As of December 30, 2000, 13 of the 15 Quickturn sites had been vacated. Noncancelable lease payments on vacated facilities will be paid out through 2003.

In 1998, Cadence recorded \$69.5 million of restructuring charges primarily associated with Cadence's worldwide restructuring plan in the second half of 1998. Cadence's restructuring plans and associated costs consisted of \$36.9 million to terminate approximately 700 employees, \$29.9 million to downsize and close excess facilities, and \$2.7 million of other restructuring expenses. Cadence's restructuring plan was primarily aimed at reducing the cost of excess personnel and capacity in its services business. Severance costs included severance benefits, notice pay, and outplacement services. In 1998, approximately \$10.1 million of these costs resulted from the acceleration of stock options vesting under employment agreements. All terminations and termination benefits were communicated to the affected employees prior to year-end and all remaining severance benefits were substantially paid in 1999.

Facilities consolidation charges of \$29.9 million were incurred in connection with the closure of 58 sales and engineering facilities, including \$16.7 million to downsize and close facilities and \$13.2 million in abandonment costs for the related leasehold improvements. Closure and exit costs included payments required under lease contracts, less any applicable sublease income after the properties were abandoned, lease buyout costs, restoration costs associated with certain lease arrangements, and costs to maintain facilities during the period after abandonment. Asset related costs written-off consist of leasehold improvements of facilities that were abandoned and whose estimated fair market value is zero. As of December 30, 2000, all but one of the 58 sites had been vacated. Noncancelable lease payments on vacated facilities will be paid out through 2008.

Cadence also recorded \$2.7 million of other restructuring charges consisting primarily of cancellation fees associated with certain vendor and conference arrangements and abandoned software.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Liabilities for excess facilities and other restructuring charges are included in accrued and other long-term liabilities, while severance and benefits liabilities are included in payroll and payroll related accruals. The following table summarizes Cadence's restructuring activity during fiscal years 2000, 1999, and 1998:

	<u>Severance And Benefits</u>	<u>Excess Facilities</u>	<u>Other Restructuring</u>	<u>Assets</u>	<u>Total</u>
	(In thousands)				
Balance, January 3, 1998.....	\$ 2,287	\$ 2,638	\$ 2,511	\$ —	\$ 7,436
1998 restructuring charges	36,860	16,749	2,718	13,168	69,495
Non-cash charges	(10,095)	(1,364)	—	(1,862)	(13,321)
Cash charges	<u>(15,937)</u>	<u>(3,527)</u>	<u>(3,016)</u>	<u>(2)</u>	<u>(22,482)</u>
Balance, January 2, 1999	13,115	14,496	2,213	11,304	41,128
1999 restructuring charges	11,271	978	—	1,025	13,274
Reclassifications.....	(515)	179	501	(165)	—
Non-cash charges	(356)	(813)	(241)	(4,543)	(5,953)
Cash charges	<u>(15,502)</u>	<u>(8,376)</u>	<u>(2,047)</u>	<u>(1,760)</u>	<u>(27,685)</u>
Balance, January 1, 2000.....	8,013	6,464	426	5,861	20,764
Reclassifications.....	—	(1,061)	1,822	(761)	—
Non-cash charges	(242)	(73)	(744)	(4,716)	(5,775)
Cash charges	<u>(5,452)</u>	<u>(392)</u>	<u>(1,504)</u>	<u>(104)</u>	<u>(7,452)</u>
Balance, December 30, 2000	<u>\$ 2,319</u>	<u>\$ 4,938</u>	<u>\$ —</u>	<u>\$ 280</u>	<u>\$ 7,537</u>

Merger Costs

In connection with the Quickturn acquisition in 1999, Cadence charged to expense merger costs of \$8.4 million representing professional fees for financial advisors, attorneys, and accountants.

Litigation Settlement

In 1999, Cadence and Mentor announced the settlement of a patent infringement action pending in the U.S. District Court for the District of Oregon. As a result, the Court entered a judgment declaring that certain Quickturn patents are valid, enforceable, and were infringed by Mentor's sale of SimExpress products in the U.S. Mentor is permanently enjoined from producing, marketing or selling SimExpress emulation systems in the U.S. In connection with the settlement, Mentor paid Cadence \$3 million.

OTHER INCOME, NET

Other income, net components for 2000, 1999, and 1998 follows:

	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(In thousands)		
Gain (loss) on foreign exchange	\$ 5,069	\$ (600)	\$ 2,809
Interest income	4,558	5,406	13,501
Equity income (loss) from investments	1,128	124	(889)
Minority interest income (expense)	638	125	(256)
Interest expense.....	(2,398)	(3,296)	(3,735)
Other expense, net	<u>(4,415)</u>	<u>(389)</u>	<u>(872)</u>
Total other income, net	<u>\$ 4,580</u>	<u>\$ 1,370</u>	<u>\$10,558</u>

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SEGMENT REPORTING

In 1998, Cadence adopted Statement of Financial Accounting Standards, or SFAS, No. 131, "Disclosures about Segments of an Enterprise and Related Information." Under SFAS No. 131, operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker when deciding how to allocate resources and when assessing performance. Cadence's chief operating decision making group is the Executive Staff, which includes Cadence's President and Chief Executive Officer and his senior staff. Cadence's Executive Staff reviews the Cadence consolidated results within three segments: Product, Services, and Maintenance, and also reviews Tality's results separately as a stand-alone entity.

The Product segment includes revenue and associated costs to design and license to customers a variety of electronic design automation products. The Services segment includes revenue and associated costs to offer methodology and design services either to assist companies in developing electronic designs or to assume responsibility for the design effort when customers wish to outsource this work. The Maintenance segment includes revenue and associated costs primarily for a technical support organization, and maintenance agreements are offered to customers either as part of our product license agreements or separately. Within the Cadence consolidated results, Tality revenue is included in the Services segment, and associated Tality costs are reflected in each of the three segments, consistent with the benefit derived by the respective segments from those services.

Segment income from operations is defined as gross margin under generally accepted accounting principles and excludes operating expenses (marketing and sales, research and development, and general and administrative), unusual items, other income, net, and income taxes. Profitability information about Cadence's segments is available only to the extent of gross margin by segment, and operating expenses and other income and expense items are managed on a functional basis. There are no differences between the accounting policies used to measure profit and loss for segments and those used on a consolidated basis. Revenue is defined as revenue from external customers with no intersegment revenue.

Cadence's management does not identify or allocate its assets, including capital expenditures, by operating segment. Accordingly, assets are not being reported by segment because the information is not available by segment and is not reviewed by Cadence's Executive Staff to make decisions about resources to be allocated among the segments or to assess their performance. Depreciation and amortization is allocated among the segments in order to determine each segments' gross margin.

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables present information about reported segments for the years ended December 30, 2000, January 1, 2000, and January 2, 1999:

	<u>Product</u>	<u>Services</u>	<u>Maintenance</u>	<u>Other</u>	<u>Consolidated Total</u>	<u>Tality</u>
	(In thousands)					
2000:						
Revenue	\$627,429	\$335,967	\$316,154	\$ —	\$1,279,550	\$ 198,423
Cost of revenue	89,937	215,605	63,315	—	368,857	152,369
Amortization of acquired intangibles	<u>65,352</u>	<u>15,151</u>	<u>—</u>	<u>—</u>	<u>80,503</u>	<u>16,257</u>
Gross margin	472,140	105,211	252,839	—	830,190	29,797
Marketing and sales	—	—	—	(390,139)	(390,139)	(35,661)
Research and development . .	—	—	—	(263,947)	(263,947)	(11,895)
General and administrative . .	—	—	—	(94,478)	(94,478)	(38,171)
Amortization of deferred stock compensation	—	—	—	(11,390)	(11,390)	(7,258)
Unusual items	—	—	—	(6,821)	(6,821)	(4,877)
Other income, net	<u>—</u>	<u>—</u>	<u>—</u>	<u>4,581</u>	<u>4,581</u>	<u>802</u>
Income (loss) before provision (benefit) for income taxes	<u>\$472,140</u>	<u>\$105,211</u>	<u>\$252,839</u>	<u>\$(762,194)</u>	<u>\$ 67,996</u>	<u>\$ (67,263)</u>
Depreciation and Amortization	<u>\$ 99,203</u>	<u>\$ 30,062</u>	<u>\$ 2,463</u>	<u>\$ 76,752</u>	<u>\$ 208,480</u>	<u>\$ 30,063</u>
	<u>Product</u>	<u>Services</u>	<u>Maintenance</u>	<u>Other</u>	<u>Consolidated Total</u>	<u>Tality</u>
	(In thousands)					
1999:						
Revenue	\$505,459	\$294,916	\$292,928	\$ —	\$1,093,303	\$ 128,873
Cost of revenue	79,504	191,760	53,579	—	324,843	113,141
Amortization of acquired intangibles	<u>55,962</u>	<u>5,826</u>	<u>—</u>	<u>—</u>	<u>61,788</u>	<u>7,114</u>
Gross margin	369,993	97,330	239,349	—	706,672	8,618
Marketing and sales	—	—	—	(354,205)	(354,205)	(32,799)
Research and development . .	—	—	—	(219,181)	(219,181)	(9,588)
General and administrative . .	—	—	—	(86,735)	(86,735)	(28,546)
Unusual items	—	—	—	(59,301)	(59,301)	—
Other income, net	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,370</u>	<u>1,370</u>	<u>33</u>
Income (loss) before provision (benefit) for income taxes	<u>\$369,993</u>	<u>\$ 97,330</u>	<u>\$239,349</u>	<u>\$(718,052)</u>	<u>\$ (11,380)</u>	<u>\$ (62,282)</u>
Depreciation and Amortization	<u>\$ 85,843</u>	<u>\$ 20,289</u>	<u>\$ 2,192</u>	<u>\$ 55,572</u>	<u>\$ 163,896</u>	<u>\$ 21,866</u>

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Product	Services	Maintenance	Other	Consolidated Total	Totality
	(In thousands)					
1998:						
Revenue	\$760,441	\$265,211	\$294,528	\$ —	\$1,320,180	\$ 105,262
Cost of revenue	77,513	188,793	52,386	—	318,692	129,257
Amortization of acquired intangibles	14,800	3,672	—	—	18,472	4,942
Gross margin	668,128	72,746	242,142	—	983,016	(28,937)
Marketing and sales	—	—	—	(340,295)	(340,295)	(35,862)
Research and development . .	—	—	—	(202,810)	(202,810)	(7,176)
General and administrative . .	—	—	—	(86,828)	(86,828)	(33,208)
Unusual items	—	—	—	(263,595)	(263,595)	(46,317)
Other income, net	—	—	—	10,558	10,558	215
Income (loss) before provision (benefit) for income taxes	<u>\$668,128</u>	<u>\$ 72,746</u>	<u>\$242,142</u>	<u>\$(882,970)</u>	<u>\$ 100,046</u>	<u>\$(151,285)</u>
Depreciation and Amortization	<u>\$ 40,537</u>	<u>\$ 16,297</u>	<u>\$ 2,307</u>	<u>\$ 49,964</u>	<u>\$ 109,105</u>	<u>\$ 16,961</u>

Internationally, excluding Japan, Cadence markets and supports its products and services primarily through its subsidiaries and various distributors. Cadence licenses its products in Japan through Innotech Corporation, in which Cadence is an approximately 15% stockholder. Cadence markets its methodology and design services in Japan through a wholly-owned subsidiary.

Revenues are attributed to geographic areas based on the country in which the customer is domiciled. In 2000, 1999, and 1998, no one customer accounted for more than 10% of total revenues. Long-lived assets are attributed to geographic areas based on the country where the assets are located.

The following table presents a summary of revenues and long-lived assets by geographic region for years ended December 30, 2000, January 1, 2000, and January 2, 1999:

	2000		1999		1998	
	Revenues	Long-Lived Assets	Revenues	Long-Lived Assets	Revenues	Long-Lived Assets
	(In thousands)					
North America:						
United States	\$ 720,789	\$316,091	\$ 526,824	\$273,542	\$ 676,567	\$233,050
Other	33,891	3,344	25,853	3,843	36,710	3,995
Total North America	<u>\$ 754,680</u>	<u>\$319,435</u>	<u>\$ 552,677</u>	<u>\$277,385</u>	<u>\$ 713,277</u>	<u>\$237,045</u>
Europe:						
United Kingdom	\$ 99,055	\$ 35,729	\$ 94,037	\$ 37,250	\$ 85,010	\$ 21,349
Germany	55,092	925	38,839	860	54,953	1,328
Other	112,520	2,847	122,736	3,231	130,630	4,180
Total Europe	<u>\$ 266,667</u>	<u>\$ 39,501</u>	<u>\$ 255,612</u>	<u>\$ 41,341</u>	<u>\$ 270,593</u>	<u>\$ 26,857</u>
Japan and Asia:						
Japan	\$ 195,793	\$ 4,702	\$ 223,425	\$ 5,079	\$ 261,239	\$ 2,381
Asia	62,410	5,241	61,589	6,604	75,071	7,925
Total Japan and Asia	<u>258,203</u>	<u>9,943</u>	<u>285,014</u>	<u>11,683</u>	<u>336,310</u>	<u>10,306</u>
Total	<u>\$1,279,550</u>	<u>\$368,879</u>	<u>\$1,093,303</u>	<u>\$330,409</u>	<u>\$1,320,180</u>	<u>\$274,208</u>

CADENCE DESIGN SYSTEMS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

SUBSEQUENT EVENT

On December 29, 2000, Cadence entered into a definitive agreement to acquire CadMOS Design Technology, Inc., a privately held design tools firm headquartered in San Jose. CadMOS provides solutions to the noise problems experienced in ultra-deep submicron, or UDSM, processes. Its noise-analysis solutions are targeted at both digital and mixed signal designers working in microprocessors, DRAMs, mixed-signal system-on-chip, and application-specific integrated circuits. The acquisition was completed on February 28, 2001, in which Cadence acquired all of the outstanding stock of CadMOS and assumed all outstanding stock options and warrants. The acquisition will be accounted for as a purchase.

CADENCE DESIGN SYSTEMS, INC.
VALUATION AND QUALIFYING ACCOUNTS AND RESERVES
(In thousands)

Schedule II

<u>Description</u>	<u>Balance at Beginning of Period</u>	<u>Additions</u>		<u>Deductions(1)</u>	<u>Balance at End of Period</u>
		<u>Charged to Costs and Expenses</u>	<u>Charged to Other Accounts(2)</u>		
Deducted from asset accounts:					
Provisions for losses on trade accounts receivable and sales returns:					
Year Ended December 30, 2000	\$44,588	\$2,306	\$15,692	\$(20,584)	\$42,002
Year Ended January 1, 2000	\$22,989	\$9,070	\$33,963	\$(21,434)	\$44,588
Year Ended January 2, 1999	\$26,080	\$7,687	\$ 3,314	\$(14,092)	\$22,989

(1) Uncollectible accounts written-off, net of recoveries, and sales returns.

(2) Sales returns allowance, offset against revenue.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Cadence Design Systems, Inc. has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CADENCE DESIGN SYSTEMS, INC.

/s/ H. RAYMOND BINGHAM

H. Raymond Bingham
President and Chief Executive Officer
Dated: March 28, 2001

Pursuant to the requirement of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the date indicated.

<u>NAME/TITLE</u>	<u>DATE</u>
<u>/s/ H. RAYMOND BINGHAM</u> H. Raymond Bingham <i>President, Chief Executive Officer, and Director</i> <i>(Principal Executive Officer)</i>	March 28, 2001
<u>/s/ WILLIAM PORTER</u> William Porter <i>Senior Vice President and Chief Financial Officer</i> <i>(Principal Financial Officer and</i> <i>Principal Accounting Officer)</i>	March 28, 2001

ADDITIONAL DIRECTORS

<u>/s/ DONALD L. LUCAS</u> Donald L. Lucas	March 28, 2001
<u>/s/ CAROL BARTZ</u> Carol Bartz	March 28, 2001
<u>/s/ SUSAN L. BOSTROM</u> Susan L. Bostrom	March 28, 2001
<u>/s/ DR. LEONARD Y. W. LIU</u> Dr. Leonard Y. W. Liu	March 28, 2001
<u>/s/ DR. ALBERTO SANGIOVANNI-VINCENTELLI</u> Dr. Alberto Sangiovanni-Vincentelli	March 28, 2001
<u>/s/ GEORGE M. SCALISE</u> George M. Scalise	March 28, 2001
<u>/s/ DR. JOHN B. SHOVEN</u> Dr. John B. Shoven	March 28, 2001
<u>/s/ ROGER SIBONI</u> Roger Siboni	March 28, 2001

STOCKHOLDER INFORMATION

INDEPENDENT PUBLIC ACCOUNTANTS

Arthur Andersen LLP
333 West San Carlos Street
San Jose, California 95110

TRANSFER AGENT

For information regarding stock ownership, stock certificates, share transfers, change of address, stock splits, and tax basis questions, please contact our transfer agent in writing at:

Mellon Investor Services
P.O. Box 3315
South Hackensack, New Jersey 07606
phone 800.356.2017
email shrrelations@chasemellon.com

FORM 10-K

A copy of the Company's Form 10-K, as filed with the Securities and Exchange Commission for the year ended December 30, 2000, is available without charge either by written request from:

Cadence Design Systems, Inc.
Investor Relations
2655 Seely Avenue
San Jose, California 95134

or electronic request through the investor relations area of the Company's website at www.cadence.com

ANNUAL MEETING

The Cadence Design Systems, Inc. Annual Meeting of Stockholders will be held May 16, 2001 at 1:00pm at the Company's executive offices located at:

2655 Seely Avenue
San Jose, California

QUARTERLY EARNINGS ANNOUNCEMENTS

You will easily find our quarterly earnings announcements, along with other financial reports and information, on the Internet in the investor relations area of our website at www.cadence.com. Copies of these reports can also be requested electronically from the website.

INVESTOR RELATIONS

For further information on our Company, please contact Cadence Investor Relations in writing at:

Cadence Design Systems, Inc.
Investor Relations
2655 Seely Avenue
San Jose, California 95134
phone 877.236.5972
email investor_relations@cadence.com

BOARD OF DIRECTORS

DONALD L. LUCAS

Chairman
Cadence Design Systems, Inc.
Private Venture Capital Investor

H. RAYMOND BINGHAM

President and Chief Executive Officer
Cadence Design Systems, Inc.

CAROL BARTZ

Chief Executive Officer and Chairman
Autodesk, Inc.

SUSAN L. BOSTROM

Senior Vice President
Internet Business Solutions Group
Cisco Systems, Inc.

DR. LEONARD Y. W. LIU

President and
Chief Executive Officer
ASE Group

DR. ALBERTO SANGIOVANNI-VINCENTELLI

Professor of Electrical Engineering
and Computer Sciences
University of California, Berkeley

GEORGE M. SCALISE

President
Semiconductor Industry Association

DR. JOHN B. SHOVEN

Charles R. Schwab
Professor of Economics
Stanford University

ROGER S. SIBONI

President and
Chief Executive Officer
E.Piphany, Inc.

EXECUTIVE OFFICERS

H. RAYMOND BINGHAM

President, Chief Executive Officer,
and Director

RONALD R. BARRIS

Senior Vice President, Services

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