MENTOR GRAPHICS CORPORATION
(Exact name of registrant as specified in its charter)

Oregon
(State or other jurisdiction of incorporation or organization) 93-0786033
(IRS Employer Identification No.)

8005 SW Boeckman Road, Wilsonville, Oregon 97070-7777
(Address of principal executive offices) 97070-7777
(Zip Code)

Registrant’s telephone number, including area code: (503) 685-7000

None
(Former name, former address and former fiscal year, if changed since last report)

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 whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer ☒ Accelerated Filer ☐ Non-accelerated filer ☐ Smaller reporting Company ☐
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Number of shares of common stock, no par value, outstanding as of September 2, 2008: 92,357,794
## MENTOR GRAPHICS CORPORATION

### Index to Form 10-Q

**PART I. FINANCIAL INFORMATION**

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
<th>Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Financial Statements (unaudited)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Condensed Consolidated Statements of Operations for the three months ended July 31, 2008 and 2007</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>Condensed Consolidated Statements of Operations for the six months ended July 31, 2008 and 2007</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Condensed Consolidated Balance Sheets as of July 31, 2008 and January 31, 2008</td>
<td>5</td>
</tr>
<tr>
<td></td>
<td>Condensed Consolidated Statements of Cash Flows for the six months ended July 31, 2008 and 2007</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>Notes to Unaudited Condensed Consolidated Financial Statements</td>
<td>7</td>
</tr>
<tr>
<td>2.</td>
<td>Management’s Discussion and Analysis of Financial Condition and Results of Operations</td>
<td>24</td>
</tr>
<tr>
<td>3.</td>
<td>Quantitative and Qualitative Disclosures about Market Risk</td>
<td>39</td>
</tr>
<tr>
<td>4.</td>
<td>Controls and Procedures</td>
<td>41</td>
</tr>
</tbody>
</table>

**PART II. OTHER INFORMATION**

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
<th>Page Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>1A.</td>
<td>Risk Factors</td>
<td>42</td>
</tr>
<tr>
<td>4.</td>
<td>Submission of Matters to a Vote of Security Holders</td>
<td>49</td>
</tr>
<tr>
<td>6.</td>
<td>Exhibits</td>
<td>50</td>
</tr>
</tbody>
</table>

**SIGNATURES**

2
Mentor Graphics Corporation
Condensed Consolidated Statements of Operations
(Unaudited)

See accompanying notes to unaudited condensed consolidated financial statements.
**Mentor Graphics Corporation**

**Condensed Consolidated Statements of Operations**

(Unaudited)

**See accompanying notes to unaudited condensed consolidated financial statements.**

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System and software</td>
<td>$192,673</td>
<td>$245,769</td>
</tr>
<tr>
<td>Service and support</td>
<td>168,938</td>
<td>158,654</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td>361,611</td>
<td>404,423</td>
</tr>
<tr>
<td><strong>Cost of revenues:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System and software</td>
<td>9,638</td>
<td>11,842</td>
</tr>
<tr>
<td>Service and support</td>
<td>49,372</td>
<td>45,250</td>
</tr>
<tr>
<td>Amortization of purchased technology</td>
<td>5,230</td>
<td>5,374</td>
</tr>
<tr>
<td><strong>Total cost of revenues</strong></td>
<td>64,240</td>
<td>62,466</td>
</tr>
<tr>
<td><strong>Gross margin</strong></td>
<td>297,371</td>
<td>341,957</td>
</tr>
<tr>
<td><strong>Operating expenses:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research and development</td>
<td>128,633</td>
<td>123,922</td>
</tr>
<tr>
<td>Marketing and selling</td>
<td>149,447</td>
<td>147,699</td>
</tr>
<tr>
<td>General and administration</td>
<td>47,160</td>
<td>46,897</td>
</tr>
<tr>
<td>Other general income, net</td>
<td>(437)</td>
<td>(216)</td>
</tr>
<tr>
<td>Amortization of intangible assets</td>
<td>4,970</td>
<td>3,657</td>
</tr>
<tr>
<td>Special charges</td>
<td>12,885</td>
<td>4,045</td>
</tr>
<tr>
<td>In-process research and development</td>
<td>15,285</td>
<td>4,100</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td>357,943</td>
<td>330,104</td>
</tr>
<tr>
<td><strong>Operating income (loss)</strong></td>
<td>(60,572)</td>
<td>11,853</td>
</tr>
<tr>
<td>Other income, net</td>
<td>3,003</td>
<td>2,935</td>
</tr>
<tr>
<td>Interest expense</td>
<td>(7,960)</td>
<td>(10,059)</td>
</tr>
<tr>
<td><strong>Income (loss) before income tax and minority interest</strong></td>
<td>(65,529)</td>
<td>4,729</td>
</tr>
<tr>
<td>Income tax expense (benefit)</td>
<td>(23,345)</td>
<td>2,056</td>
</tr>
<tr>
<td>Minority interest in net loss of subsidiary</td>
<td>(89)</td>
<td>—</td>
</tr>
<tr>
<td><strong>Net income (loss)</strong></td>
<td>$ (42,095)</td>
<td>$ 2,673</td>
</tr>
<tr>
<td><strong>Net income (loss) per share:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>$ (0.46)</td>
<td>$ 0.03</td>
</tr>
<tr>
<td>Diluted</td>
<td>$ (0.46)</td>
<td>$ 0.03</td>
</tr>
<tr>
<td><strong>Weighted average number of shares outstanding:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>91,054</td>
<td>86,361</td>
</tr>
<tr>
<td>Diluted</td>
<td>91,054</td>
<td>88,704</td>
</tr>
</tbody>
</table>
Mentor Graphics Corporation
Condensed Consolidated Balance Sheets
(Unaudited)

See accompanying notes to unaudited condensed consolidated financial statements.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$90,673</td>
<td>$117,926</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>11,363</td>
<td>8,289</td>
</tr>
<tr>
<td>Restricted cash</td>
<td>5,910</td>
<td>—</td>
</tr>
<tr>
<td>Trade accounts receivable, net of allowance for doubtful accounts of $3,283 as of July 31, 2008 and $4,577 as of January 31, 2008</td>
<td>239,339</td>
<td>332,641</td>
</tr>
<tr>
<td>Income taxes receivable</td>
<td>27,614</td>
<td>—</td>
</tr>
<tr>
<td>Other receivables</td>
<td>9,231</td>
<td>7,936</td>
</tr>
<tr>
<td>Inventory</td>
<td>11,787</td>
<td>8,682</td>
</tr>
<tr>
<td>Prepaid expenses and other</td>
<td>24,174</td>
<td>21,433</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>12,622</td>
<td>9,574</td>
</tr>
<tr>
<td>Total current assets</td>
<td>432,713</td>
<td>506,481</td>
</tr>
<tr>
<td>Property, plant, and equipment, net of accumulated depreciation of $222,344 as of July 31, 2008 and $210,743 as of January 31, 2008</td>
<td>107,718</td>
<td>100,421</td>
</tr>
<tr>
<td>Term receivables, long-term</td>
<td>119,092</td>
<td>134,059</td>
</tr>
<tr>
<td>Goodwill</td>
<td>421,441</td>
<td>417,485</td>
</tr>
<tr>
<td>Intangible assets, net of accumulated amortization of $101,803 as of July 31, 2008 and $93,103 as of January 31, 2008</td>
<td>27,000</td>
<td>34,396</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>18,066</td>
<td>18,729</td>
</tr>
<tr>
<td>Unallocated purchase price (Note 7)</td>
<td>40,816</td>
<td>—</td>
</tr>
<tr>
<td>Other assets</td>
<td>27,209</td>
<td>26,542</td>
</tr>
<tr>
<td>Total assets</td>
<td>$1,194,055</td>
<td>$1,238,113</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities and Stockholders’ Equity</th>
<th>July 31, 2008</th>
<th>January 31, 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term borrowings</td>
<td>$6,169</td>
<td>$14,178</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>17,421</td>
<td>23,634</td>
</tr>
<tr>
<td>Income taxes payable</td>
<td>—</td>
<td>6,675</td>
</tr>
<tr>
<td>Accrued payroll and related liabilities</td>
<td>50,984</td>
<td>78,948</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>54,908</td>
<td>40,697</td>
</tr>
<tr>
<td>Deferred revenue</td>
<td>141,442</td>
<td>154,821</td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>270,924</td>
<td>318,953</td>
</tr>
<tr>
<td>Notes payable</td>
<td>201,102</td>
<td>201,102</td>
</tr>
<tr>
<td>Deferred revenue, long-term</td>
<td>20,011</td>
<td>18,977</td>
</tr>
<tr>
<td>Income tax liability</td>
<td>53,130</td>
<td>48,340</td>
</tr>
<tr>
<td>Other long-term liabilities</td>
<td>19,068</td>
<td>11,574</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>564,235</td>
<td>598,946</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Commitments and contingencies (Note 12)</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Minority interest</td>
<td>691</td>
<td>—</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Stockholders’ equity:</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock, no par value, 200,000 shares authorized; 92,338 shares issued and outstanding as of July 31, 2008 and 90,742 shares issued and outstanding as of January 31, 2008</td>
<td>558,922</td>
<td>531,153</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>29,055</td>
<td>71,150</td>
</tr>
<tr>
<td>Accumulated other comprehensive income</td>
<td>41,152</td>
<td>36,864</td>
</tr>
<tr>
<td>Total stockholders’ equity</td>
<td>629,129</td>
<td>639,167</td>
</tr>
<tr>
<td>Total liabilities and stockholders’ equity</td>
<td>$1,194,055</td>
<td>$1,238,113</td>
</tr>
</tbody>
</table>
## Mentor Graphics Corporation
### Condensed Consolidated Statements of Cash Flows
(UNAUDITED)

#### See accompanying notes to unaudited condensed consolidated financial statements.

<table>
<thead>
<tr>
<th>Six Months Ended July 31,</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>In thousands</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Operating Cash Flows:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>$(42,095)</td>
<td>$2,673</td>
</tr>
<tr>
<td>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation and amortization of property, plant, and equipment</td>
<td>15,447</td>
<td>13,225</td>
</tr>
<tr>
<td>Amortization</td>
<td>11,530</td>
<td>10,164</td>
</tr>
<tr>
<td>Write-off of debt issuance costs</td>
<td>—</td>
<td>62</td>
</tr>
<tr>
<td>Equity in losses of unconsolidated entities</td>
<td>643</td>
<td>—</td>
</tr>
<tr>
<td>Stock-based compensation</td>
<td>14,135</td>
<td>7,516</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>(2,229)</td>
<td>1,114</td>
</tr>
<tr>
<td>Changes in other long-term liabilities</td>
<td>374</td>
<td>(2,373)</td>
</tr>
<tr>
<td>In-process research and development</td>
<td>15,285</td>
<td>4,100</td>
</tr>
<tr>
<td>Minority interest in net loss of subsidiary</td>
<td>(89)</td>
<td>—</td>
</tr>
<tr>
<td>Stock-based compensation</td>
<td>14,135</td>
<td>7,516</td>
</tr>
<tr>
<td>Deferred revenue</td>
<td>(19,412)</td>
<td>(4,270)</td>
</tr>
<tr>
<td><strong>Net cash provided by operating activities</strong></td>
<td>43,137</td>
<td>5,483</td>
</tr>
<tr>
<td><strong>Investing Cash Flows:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds from sales and maturities of short-term investments</td>
<td>16,236</td>
<td>35,947</td>
</tr>
<tr>
<td>Purchases of short-term investments</td>
<td>(19,310)</td>
<td>(26,913)</td>
</tr>
<tr>
<td>Increase in restricted cash</td>
<td>(5,910)</td>
<td>—</td>
</tr>
<tr>
<td>Purchases of property, plant, and equipment, net</td>
<td>(19,773)</td>
<td>(20,154)</td>
</tr>
<tr>
<td>Acquisitions of businesses and equity interests, net of cash acquired</td>
<td>(48,786)</td>
<td>(37,283)</td>
</tr>
<tr>
<td><strong>Net cash used in investing activities</strong></td>
<td>(77,543)</td>
<td>(48,403)</td>
</tr>
<tr>
<td><strong>Financing Cash Flows:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds from issuance of common stock</td>
<td>14,362</td>
<td>15,967</td>
</tr>
<tr>
<td>Tax benefit from share options exercised</td>
<td>25</td>
<td>—</td>
</tr>
<tr>
<td>Net increase (decrease) in short-term borrowings</td>
<td>(7,472)</td>
<td>483</td>
</tr>
<tr>
<td>Repayments of notes payable and revolving credit facility</td>
<td>—</td>
<td>(3,401)</td>
</tr>
<tr>
<td><strong>Net cash provided by financing activities</strong></td>
<td>6,915</td>
<td>13,049</td>
</tr>
<tr>
<td><strong>Effect of exchange rate changes on cash and cash equivalents</strong></td>
<td>238</td>
<td>803</td>
</tr>
<tr>
<td><strong>Net change in cash and cash equivalents</strong></td>
<td>(27,253)</td>
<td>(29,068)</td>
</tr>
<tr>
<td>Cash and cash equivalents at the beginning of the period</td>
<td>117,926</td>
<td>95,232</td>
</tr>
<tr>
<td><strong>Cash and cash equivalents at the end of the period</strong></td>
<td>$90,673</td>
<td>$66,164</td>
</tr>
</tbody>
</table>
MENTOR GRAPHICS CORPORATION
Notes to Unaudited Condensed Consolidated Financial Statements
(In thousands, except for percentages, per share data, and number of employees)

(1) **General**—The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with United States (U.S.) generally accepted accounting principles and reflect all material normal recurring adjustments. However, certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In the opinion of management, the condensed consolidated financial statements include adjustments necessary for a fair presentation of the results of the interim periods presented. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2008.

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

(2) **Summary of Significant Accounting Policies**

**Principles of Consolidation**

The condensed consolidated financial statements include the financial statements of us and our wholly owned and majority-owned subsidiaries. All intercompany accounts and transactions were eliminated in consolidation.

We do not have off-balance sheet arrangements, financings, or other similar relationships with unconsolidated entities or other persons, also known as special purpose entities. In the ordinary course of business, we lease certain real properties, primarily field sales offices, research and development facilities, and equipment, as described in Note 12, “Commitments and Contingencies.”

**Revenue Recognition**

We report revenue in two categories based upon how the revenue is generated: (i) system and software and (ii) service and support.

**System and software revenues** – We derive system and software revenues from the sale of licenses of software products, emulation hardware systems, and finance fee revenues from our long-term installment receivables resulting from product sales. We primarily license our products using two different license types:

1. Term licenses – We use this license type primarily for software sales. This license type provides the customer with the right to use a fixed list of software products for a specified time period, typically three years, with payments spread over the license term, and does not provide the customer with the right to use the products after the end of the term. Term license arrangements may allow the customer to share products between multiple locations and remix product usage from the fixed list of products at regular intervals during the license term. We generally recognize product revenue from term license arrangements upon product delivery and start of the license term. In a term license agreement where we provide the customer with rights to unspecified or unreleased future products, we recognize revenue ratably over the license term. Revenue from emulation product sales where the software is incidental to the hardware is generally recognized upon delivery.

2. Perpetual licenses – We use this license type for software and emulation hardware system sales. This license type provides the customer with the right to use the product in perpetuity and typically does not provide for extended payment terms. We generally recognize product revenue from perpetual license arrangements upon product delivery assuming all other criteria for revenue recognition have been met.

We include finance fee revenues from the accretion on the discount of long-term installment receivables in System and software revenues. Finance fee revenues were $4,257 for the three months ended July 31, 2008 and $8,928 for the six months ended July 31, 2008 compared to $4,193 for the three months ended July 31, 2007 and $8,220 for the six months ended July 31, 2007.

**Service and support revenues** – We derive service and support revenues from software and hardware post-contract maintenance or support services and professional services, which include consulting, training, and other services. We recognize revenue ratably over the support services term. We record professional service revenue as the services are provided to the customer.
We apply the provisions of Statement of Position (SOP) 97-2, “Software Revenue Recognition,” as amended by SOP 98-9, “Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions,” to all software and hardware product revenue transactions where the software is not incidental. We determine whether product revenue recognition is appropriate based upon the evaluation of whether the following four criteria have been met:

1. Persuasive evidence of an arrangement exists – Generally, we use either a customer signed contract or qualified customer purchase order as evidence of an arrangement for both term and perpetual licenses. For professional service engagements, we generally use a signed professional services agreement and a statement of work to evidence an arrangement. Sales through our distributors are evidenced by an agreement governing the relationship, together with binding purchase orders from the distributor on a transaction-by-transaction basis.

2. Delivery has occurred – We generally deliver software and the corresponding access keys to customers electronically. Electronic delivery occurs when we provide the customer access to the software. We may also deliver the software on a compact disc. Our software license agreements generally do not contain conditions for acceptance. With respect to emulation hardware, we transfer title to the customer upon shipment. We offer non-essential installation services for emulation hardware sales or the customer may elect to perform the installation without assistance from us. Our emulation hardware system agreements generally do not contain conditions for acceptance.

3. Fee is fixed or determinable – We assess whether a fee is fixed or determinable at the outset of the arrangement, primarily based on the payment terms associated with the transaction. We have established a history of collecting under the original contract with installment terms without providing concessions on payments, products, or services. Additionally, for installment contracts, we determine that the fee is fixed or determinable if the arrangement has a payment schedule that is within the term of the licenses and the payments are collected in equal or nearly equal installments, when evaluated on a cumulative basis. If the fee is not deemed to be fixed or determinable, we recognize revenue as payments become due and payable.

4. Collectibility is probable – To recognize revenue, we must judge collectibility of the arrangement fees on a customer-by-customer basis pursuant to our credit review process. We typically sell to customers with whom there is a history of successful collection. We evaluate the financial position and a customer’s ability to pay whenever an existing customer purchases new products, renews an existing arrangement, or requests an increase in credit terms. For certain industries for which our products are not considered core to the industry or the industry is generally considered troubled, we impose higher credit standards. If we determine that collectibility is not probable based upon our credit review process or the customer’s payment history, we recognize revenue as payments are received.

Multiple element arrangements – For multiple element arrangements, vendor-specific objective evidence of fair value (VSOE) must exist to allocate the total fee among all delivered and non-essential undelivered elements of the arrangement. If undelivered elements of the arrangement are essential to the functionality of the product, we defer revenue until the essential elements are delivered. If VSOE does not exist for one or more non-essential undelivered elements, we defer revenue until such evidence does exist for the undelivered elements, or until all elements are delivered, whichever is earlier. If VSOE of all non-essential undelivered elements exists but VSOE does not exist for one or more delivered elements, we recognize revenue using the residual method. Under the residual method, we defer revenue related to the undelivered elements based upon VSOE and we recognize the remaining portion of the arrangement fee as revenue for the delivered elements, assuming all other criteria for revenue recognition have been met. If we could no longer establish VSOE for non-essential undelivered elements of multiple element arrangements, we would defer revenue until all elements are delivered or VSOE is established for the undelivered elements, whichever is earlier.

We base our VSOE for certain product elements of an arrangement upon the pricing in comparable transactions when the element is sold separately. We primarily base our VSOE for term and perpetual support services upon customer renewal history where the services are sold separately. We also base VSOE for professional services and installation services for emulation hardware systems upon the price charged when the services are sold separately.

In accordance with Emerging Issues Task Force (EITF) Issue No. 06-03, “How Taxes Collected from Customers and Remitted to Governmental Authorities Should be Presented in the Income Statement (That is, Gross versus Net Presentation),” our policy is to present the Condensed Consolidated Statement of Operations net of taxes collected from customers and remitted to governmental authorities.

**Fair Value Measurement**

We adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 157, “Fair Value Measurements” (SFAS 157) on February 1, 2008. SFAS 157 defines fair value, establishes a framework for measuring
fair value, and expands disclosure about fair value measurements. The adoption of SFAS 157 did not impact our consolidated financial position, results of operations, or cash flows. Pursuant to the Financial Accounting Standards Board (FASB) Staff Position (FSP) No. FAS 157-2, “Effective Date of FASB Statement No. 157”, which delayed the adoption of SFAS 157 for nonfinancial assets and liabilities until fiscal years beginning after November 15, 2008, we did not adopt SFAS 157 for nonfinancial assets and liabilities. We are currently evaluating the effect of the adoption of SFAS 157 for nonfinancial assets and liabilities and the impact it will have on our consolidated financial position, results of operations, and cash flows.

We also adopted the provisions of SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities” (SFAS 159) on February 1, 2008. SFAS 159 requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. We did not elect to apply the fair value option to any financial instruments or other items upon adoption of SFAS 159. As a result, the adoption of SFAS 159 did not impact our consolidated financial position, results of operations, or cash flows.

(3) Recent Accounting Pronouncements—In July 2008, the EITF issued EITF 08-3, “Accounting by Lessees for Nonrefundable Maintenance Deposits” (EITF 08-3) which is effective for fiscal years beginning on or after December 15, 2008. EITF 08-3 clarifies that lessees should account for nonrefundable maintenance deposits as deposit assets if it is probable that maintenance activities will occur and the deposit is therefore realizable. Amounts on deposit that are not probable of being used to fund future maintenance activities should be charged to expense. We are currently evaluating the effect of EITF 08-3 and the impact it will have on our consolidated financial position, results of operations, and cash flows.

In May 2008, the FASB issued FSP No. APB 14-1, “Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)” (FSP APB 14-1), which is effective for fiscal years beginning after December 15, 2008 and must be applied retrospectively to all periods presented. FSP APB 14-1 clarifies that convertible debt instruments that may be settled in cash upon conversion are not addressed by paragraph 12 of Accounting Principles Board (APB) Opinion No. 14, “Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants”, and thus, that issuers of such instruments should separately account for the liability and equity components in a manner that will reflect the entity’s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. Based on a preliminary analysis, we have determined that the new guidance will affect our 6.25% Convertible Subordinated Debentures (6.25% Debentures) due 2026. As a result of the retrospective adoption of FSP APB 14-1, our opening retained earnings will decrease and additional paid in capital will increase. However, we are still assessing the magnitude of the changes and the impact on earnings per share.

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles” (SFAS 162) which is effective 60 days following the SEC’s approval of the Public Company Accounting Oversight Board’s related amendments to AU Section 411, “The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles”. SFAS 162 identifies the sources of generally accepted accounting principles (GAAP) and provides a framework, or hierarchy, for selecting the principles to be used in preparing U.S. GAAP financial statements for nongovernmental entities. We do not anticipate that the adoption of SFAS 162 will have a significant impact on our consolidated financial position, results of operations, or cash flows.

In April 2008, the FASB issued FSP FAS 142-3, “Determination of the Useful Life of Intangible Assets” (FSP FAS 142-3), which is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. FSP FAS 142-3 amends guidance in SFAS No. 142, “Goodwill and Other Intangible Assets” regarding estimating the useful lives of intangible assets. FSP FAS 142-3 requires additional disclosures related to renewing or extending the terms of recognized intangible assets. In estimating the useful life of a recognized intangible asset, FSP FAS 142-3 requires companies to consider their historical experience in renewing or extending similar arrangements together with the asset’s intended use, regardless of whether the arrangements have explicit renewal or extension provisions. We are currently evaluating the effect of FSP FAS 142-3 and the impact it will have on our consolidated financial position, results of operations, and cash flows.

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative and Hedging Activities” (SFAS 161) which is effective for fiscal years beginning on or after November 15, 2008. SFAS 161 requires companies with derivative instruments to disclose information about how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” (SFAS 133), and how derivative instruments and related hedged items affect a company’s financial position, financial performance, and cash flows. We do not anticipate that the adoption of SFAS 161 will have a significant impact on our consolidated financial position, results of operations, or cash flows.

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements” (SFAS 160) which is effective for fiscal years beginning on or after December 15, 2008. SFAS 160 will require
noncontrolling interests (previously referred to as minority interests) to be treated as a separate component of equity, not as a liability or other item outside of permanent equity. We are currently evaluating the effect of SFAS 160 and the impact it will have on our consolidated financial position, results of operations, and cash flows.

In December 2007, the FASB issued SFAS No. 141(R), “Business Combinations” (SFAS 141(R)). SFAS 141(R) requires most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at “full fair value”. This standard also requires all business combinations to be accounted for by applying the acquisition method and for an acquirer to be identified for each business combination. SFAS 141(R) is effective for fiscal years beginning on or after December 15, 2008. We are currently evaluating the effect of SFAS 141(R) and the impact it will have on our consolidated financial position, results of operations, and cash flows.

(4) Change in Accounting for Research and Development Credits—The French Finance Act for 2008 (the FFA) was created to increase foreign investment and improve the business environment in France. The FFA included several changes to the research credit program, two of which were changes to the method used to calculate the research credit and the amounts available for credit. The research credit is for certain research costs incurred in France and can be applied against current income tax liabilities due in France for a period of three years or refunded by the tax authority three years after being filed in a tax declaration if the company is in a tax loss situation. Additionally, due to the changes in its calculation, it is expected that there will be an increase in the amount of credit that will be earned which led us to re-evaluate our accounting for this research and development credit.

Prior to the quarter ended July 31, 2008, we accounted for the French research and development credits as an income tax credit which resulted in the treatment of the credit as reduction of income tax expense. For our interim tax calculations this resulted in the credit impacting our overall annual effective tax rate applied to the quarterly periods. However, the research credit can be recovered irrespective of whether we pay income taxes in France and can be predictably determined as research expenditures are incurred. Effective this quarter, we are changing the accounting treatment of the French research credit to account for it as a subsidy from the government versus an income tax credit and to record the credits as earned as a reduction of research and development costs. We have determined that the credits are earned as the qualifying research expenditures are made.

In accordance with FAS 154, “Accounting Changes and Error Corrections”, the change in accounting principle is reported through retrospective application to all prior periods. Due to the methodology used to allocate intra-period income tax expense to each quarter, there are changes to research and development expense, total operating expense, operating income (loss), net income (loss), and net income (loss) per share for each of the prior periods as illustrated in the table below. However, there will be no impact to the previously reported annual amounts of net income, earnings per share, or retained earnings.

The impact of the change on Research and development expense, Total operating expenses, Operating income (loss), Income (loss) before income taxes and minority interest, Income tax expense (benefit), Net income (loss), and Net income (loss) per share for the periods presented and the three months ended April 30, 2008 and 2007 is as follows:
We believe the revised presentation is preferable based on our assessment that the French research credits are solely based on our research and development spending within France and can be recovered irrespective of whether we pay income tax in France.

<table>
<thead>
<tr>
<th></th>
<th>Three months ended</th>
<th></th>
<th>Six months ended</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Research and development expense, prior to change</strong></td>
<td>$65,497</td>
<td>$65,468</td>
<td>$59,190</td>
<td>$124,658</td>
</tr>
<tr>
<td>Impact of accounting change of French research credit</td>
<td>(1,115)</td>
<td>(405)</td>
<td>(331)</td>
<td>(736)</td>
</tr>
<tr>
<td><strong>Research and development expense, as revised</strong></td>
<td>$64,382</td>
<td>$65,063</td>
<td>$58,859</td>
<td>$123,922</td>
</tr>
<tr>
<td><strong>Total operating expense, prior to change</strong></td>
<td>$177,125</td>
<td>$170,949</td>
<td>$159,891</td>
<td>$330,840</td>
</tr>
<tr>
<td>Impact of accounting change of French research credit</td>
<td>(1,115)</td>
<td>(405)</td>
<td>(331)</td>
<td>(736)</td>
</tr>
<tr>
<td><strong>Total operating expense, as revised</strong></td>
<td>$176,010</td>
<td>$170,544</td>
<td>$159,560</td>
<td>$330,104</td>
</tr>
<tr>
<td><strong>Operating income (loss), prior to change</strong></td>
<td>$(31,780)</td>
<td>$6,231</td>
<td>$4,886</td>
<td>$11,117</td>
</tr>
<tr>
<td>Impact of accounting change of French research credit</td>
<td>$1,115</td>
<td>405</td>
<td>331</td>
<td>736</td>
</tr>
<tr>
<td><strong>Operating income (loss), as revised</strong></td>
<td>$(30,665)</td>
<td>$6,636</td>
<td>$5,217</td>
<td>$11,853</td>
</tr>
<tr>
<td><strong>Income (loss) before income tax and minority interest, prior to change</strong></td>
<td>$(33,567)</td>
<td>$2,941</td>
<td>$1,052</td>
<td>$3,993</td>
</tr>
<tr>
<td>Impact of accounting change of French research credit</td>
<td>1,115</td>
<td>405</td>
<td>331</td>
<td>736</td>
</tr>
<tr>
<td><strong>Income (loss) before income tax and minority interest, as revised</strong></td>
<td>$(32,452)</td>
<td>$3,346</td>
<td>$1,383</td>
<td>$4,729</td>
</tr>
<tr>
<td><strong>Income tax expense (benefit), prior to change</strong></td>
<td>$(6,079)</td>
<td>$1,034</td>
<td>$762</td>
<td>$1,796</td>
</tr>
<tr>
<td>Impact of accounting change of French research credit</td>
<td>(1,470)</td>
<td>131</td>
<td>129</td>
<td>260</td>
</tr>
<tr>
<td><strong>Income tax expense (benefit), as revised</strong></td>
<td>$(7,549)</td>
<td>$1,165</td>
<td>$891</td>
<td>$2,056</td>
</tr>
<tr>
<td><strong>Net income (loss), prior to change</strong></td>
<td>$(27,488)</td>
<td>$1,907</td>
<td>$290</td>
<td>$2,197</td>
</tr>
<tr>
<td>Impact of accounting change of French research credit</td>
<td>2,585</td>
<td>274</td>
<td>202</td>
<td>476</td>
</tr>
<tr>
<td><strong>Net income (loss), as revised</strong></td>
<td>$(24,903)</td>
<td>$2,181</td>
<td>$492</td>
<td>$2,673</td>
</tr>
<tr>
<td><strong>Basic EPS, prior to change</strong></td>
<td>$(0.30)</td>
<td>0.02</td>
<td>0.00</td>
<td>0.03</td>
</tr>
<tr>
<td>Impact of accounting change of French research credit</td>
<td>0.03</td>
<td>0.00</td>
<td>0.01</td>
<td>0.00</td>
</tr>
<tr>
<td><strong>Basic EPS, as revised</strong></td>
<td>$(0.27)</td>
<td>0.02</td>
<td>0.01</td>
<td>0.03</td>
</tr>
<tr>
<td><strong>Diluted EPS, prior to change</strong></td>
<td>$(0.30)</td>
<td>0.02</td>
<td>0.00</td>
<td>0.02</td>
</tr>
<tr>
<td>Impact of accounting change of French research credit</td>
<td>0.03</td>
<td>0.00</td>
<td>0.01</td>
<td>0.01</td>
</tr>
<tr>
<td><strong>Diluted EPS, as revised</strong></td>
<td>$(0.27)</td>
<td>0.02</td>
<td>0.01</td>
<td>0.03</td>
</tr>
</tbody>
</table>

**Weighted average number of shares outstanding:**

<table>
<thead>
<tr>
<th></th>
<th>Basic</th>
<th>Diluted</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>90,750</td>
<td>87,526</td>
</tr>
<tr>
<td></td>
<td>90,750</td>
<td>89,351</td>
</tr>
</tbody>
</table>

(5) **Reclassification of Interest Income and Gain (Loss) On Receivables Sold**—Term receivables from customers resulting from the sale of software licenses bear no interest. In accordance with APB Opinion No. 21, “Interest on Receivables and Payables,” we impute interest on term receivables based on prevailing market rates and record this as a discount against the receivables. In our Annual Report on Form 10-K for the fiscal year ended January 31, 2008, we reclassified the interest income resulting from the accretion of the discount of long-term installment receivables from Other income, net, to finance fee revenues included as a component of System and software revenues in the Consolidated Statement of Operations. Prior to the fourth quarter of the year ended January 31, 2008, we reported interest income resulting from the accretion of the discount of long-term installment receivables in interest income, a component of Other income, net, in the Condensed Consolidated Statement of Operations for all periods presented. Along with this change in classification, we have also reclassified the gain or loss on the sale of receivables from Other income, net, to Other general expense (income), net, a component of Operating expense. The gain or loss on the sale of receivables consists of two components: (i) the discount on sold receivables, which is the difference between the undiscounted balance of the receivables and the net proceeds received from the financing institution, previously
We believe the revised presentation is preferable based on our assessment that the significance of the sale of term licenses that result in long-term receivables has been increasing and the business has become one of our central operations. The impact of the reclassifications on System and software revenues, Other general expense (income), net, and Other income, net, for the three and six months ended July 31, 2007 was as follows:

<table>
<thead>
<tr>
<th></th>
<th>Three Month Ended</th>
<th></th>
<th>Six Month Ended</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>System and software revenue, prior to reclassification</td>
<td>$123,691</td>
<td></td>
<td>$237,549</td>
<td></td>
</tr>
<tr>
<td>Finance fee revenue</td>
<td>4,193</td>
<td>8,220</td>
<td></td>
<td></td>
</tr>
<tr>
<td>System and software revenue, after reclassification</td>
<td>$127,884</td>
<td></td>
<td>$245,769</td>
<td></td>
</tr>
<tr>
<td>Other general expense (income), net, prior to reclassification</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Unaccreted discount on receivables sold</td>
<td>—</td>
<td>—</td>
<td>(1,076)</td>
<td>—</td>
</tr>
<tr>
<td>Discount on sold receivables</td>
<td>14</td>
<td></td>
<td>860</td>
<td></td>
</tr>
<tr>
<td>Other general expense (income), net, after reclassification</td>
<td>$14</td>
<td></td>
<td>(216)</td>
<td></td>
</tr>
<tr>
<td>Other income, net, prior to reclassification</td>
<td>$5,830</td>
<td></td>
<td>$11,371</td>
<td></td>
</tr>
<tr>
<td>Interest income on long-term installment receivables</td>
<td>(4,193)</td>
<td></td>
<td>(8,220)</td>
<td></td>
</tr>
<tr>
<td>Unaccreted discount on receivables sold</td>
<td>—</td>
<td></td>
<td>(1,076)</td>
<td>—</td>
</tr>
<tr>
<td>Discount on sold receivables</td>
<td>14</td>
<td></td>
<td>860</td>
<td></td>
</tr>
<tr>
<td>Other income, net, after reclassification</td>
<td>$1,651</td>
<td></td>
<td>2,935</td>
<td></td>
</tr>
</tbody>
</table>

(6) Fair Value Measurement—Effective February 1, 2008, we adopted SFAS 157 for financial assets and liabilities measured at fair value on a recurring basis, as discussed in Note 2, “Summary of Significant Accounting Policies-Fair Value Measurement”. On a quarterly basis, we measure cash equivalents, short-term investments and derivatives at fair value. SFAS 157 established a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources. Unobservable inputs reflect our market assumptions. SFAS 157 classifies these two types of inputs into the following fair-value hierarchy:

- Level 1—Quoted prices for identical instruments in active markets;
- Level 2—Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-derived valuations whose significant inputs are observable; and
- Level 3—One or more significant inputs to the valuation model are unobservable.

The following table presents information about financial assets and liabilities required to be carried at fair value on a recurring basis as of July 31, 2008:

<table>
<thead>
<tr>
<th>Assets:</th>
<th>Fair Value at Jul 31, 2008</th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash equivalents</td>
<td>$41,196</td>
<td>$41,196</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>11,363</td>
<td>11,363</td>
<td>—</td>
<td>—</td>
</tr>
<tr>
<td>Foreign currency exchange contracts</td>
<td>2,018</td>
<td>—</td>
<td>2,018</td>
<td>—</td>
</tr>
<tr>
<td>Total</td>
<td>$54,577</td>
<td>$52,559</td>
<td>$2,018</td>
<td>—</td>
</tr>
</tbody>
</table>

We use a market approach to determine the fair value of cash equivalents and short-term investments. Cash equivalents include certificates of deposit, commercial paper, and other highly liquid investments with original maturities of ninety days or less. Short-term investments include certificates of deposit, commercial paper, and other highly liquid investments with original maturities in excess of 90 days at the time of purchase and less than one year from the balance sheet date.
We use an income approach to determine the fair value of our foreign currency exchange contracts. For foreign currency exchange contracts designated as cash flow hedges, which are linked to a specific transaction, we report the net gains and losses in Accumulated other comprehensive income in Stockholders’ equity until the forecasted transaction occurs or the hedge is no longer effective. Once the forecasted transaction occurs or the hedge is no longer effective, we reclassify the gains or losses attributable to the foreign currency exchange contract to our Condensed Consolidated Statement of Operations. For foreign currency exchange contracts entered into to offset the variability in exchange rates on certain short-term monetary assets and liabilities, we recognize changes in fair value currently in Other income, net, in our Condensed Consolidated Statement of Operations. See further discussion in Note 9, “Derivative Instruments and Hedging Activities”.

(7) Business Combinations—In May 2008, our board of directors announced a cash offer to acquire all of the issued or to be issued ordinary shares of Flomerics Group, PLC (Flomerics), a publicly traded company headquartered in Surrey, UK. On July 9, 2008, we obtained greater than 50% of the then outstanding ordinary shares of Flomerics at which point we began including Flomerics in our results of operations. As of July 31, 2008, we had acquired 93.9% of the outstanding ordinary shares of Flomerics. Flomerics is a market leader in the computer simulation of mechanical engineering design processes including heat transfer and fluid flow simulation. We are integrating the acquired technology into our Mechanical Analysis Division. The total purchase price as of July 31, 2008, including acquisition costs, was $52,181. Net tangible assets acquired, net of minority interests, were $11,365, including cash of $11,850. The allocation of the remaining purchase price among intangible assets and in-process research and development has not been determined. The unallocated purchase price of $40,816 is included in long-term assets in our Condensed Consolidated Balance Sheet as of July 31, 2008. Minority interest in the amount of $89 was excluded from our current period earnings related to Flomerics’ results of operations since July 9, 2008. As of July 31, 2008, we had $5,910 in an escrow account for the purchase of the remaining minority interest, which is classified as Restricted cash on our Condensed Consolidated Balance Sheet. We expect to complete the acquisition of the remaining minority interest in the third quarter of fiscal 2009.

On May 12, 2008, we acquired all of the assets and assumed certain liabilities of Ponte Solutions, Inc., a privately held company based in Mountain View, California that develops and markets yield analysis software. The acquisition was an investment aimed at expanding our Design-for-Manufacturing capabilities and will be integrated into our Calibre product family. The total purchase price, including acquisition costs, was $5,686. The excess of liabilities assumed over tangible assets acquired was $431, including cash of $39. We allocated the cost of the acquisition on the basis of the estimated fair value of assets acquired and liabilities assumed. The purchase accounting allocations resulted in goodwill of $2,847, technology of $1,320, other identified intangible assets of $650, and a charge for in-process research and development of $1,300. We are amortizing the technology to Cost of revenues and the other identified intangible assets to Operating expenses over three years.

The separate results of operations for the acquisitions during the six months ended July 31, 2008 were not material compared to our overall results of operations and accordingly pro forma financial statements of the combined entities have been omitted. The results of operations of the acquired companies are included in our consolidated financial statements from the date of the respective acquisitions forward.

For many of our acquisitions, payment of a portion of the purchase price is contingent upon the acquired business’ achievement of certain revenue and product performance goals. These contingent payments, or earn-outs, are accrued when the performance goals are met and the contingent consideration is issued or issuable. We recorded expenses related to earn-outs of $1,061 for the six months ended July 31, 2008 based on related revenues derived from products and technologies acquired in prior acquisitions. We made earn-out payments of $2,194 for the six months ended July 31, 2008.

On June 8, 2007, we acquired 100% of the common stock of Sierra Design Automation, Inc. (Sierra), a privately held company based in Santa Clara, California, which is a provider of high-performance place and route software solutions. The acquisition was an investment aimed at expanding our Design-for-Manufacturing capabilities and increasing revenue growth. Upon completion of the merger transaction, the outstanding shares of Sierra were converted into the right to receive consideration from us totaling $90,000, of which $45,000 was payable in cash and $45,000 was payable in the form of 3,097 shares of our common stock valued as provided in the merger agreement at $14.53 per share which was the average closing price reported by NASDAQ for the 10 trading-day period ending three days before the closing. Cash of $3,717 and 256 shares of our common stock with a value of $3,721 were withheld pro rata from the former Sierra shareholders and deposited in an indemnity escrow account. These amounts are subject to standard representations and warranties and will generally be released in October 2008 if we have made no claims of
exchange rate fluctuation as they were booked in local currencies. For the six months ended July 31, 2008, approximately one-fourth of European and ninety percent of Japanese revenues were subject to exchange rate fluctuation as they were booked in local currencies. We allocated the cost of the acquisition on the basis of the estimated fair value of assets acquired and liabilities assumed. The purchase accounting allocations resulted in a charge for in-process research and development of $4,100, goodwill of $45,932, technology of $9,400, other identified intangible assets of $17,200, and deferred tax assets of $1,801. We are amortizing the technology to Cost of revenues and the other identified intangible assets to Technology acquired in prior acquisitions. We made earn-out payments of $1,829 for the six months ended July 31, 2007.

In accounting for the Sierra transaction, we are required to value the shares of our common stock issued in the transaction at $13.85 per share which was the average closing price reported by NASDAQ for the five day period beginning with the two day period preceding the measurement date through the two days succeeding the measurement date. In addition, the cash and common stock withheld from the two Sierra founders of $3,797, which is subject to a continued employment requirement, is considered compensation expense to be recognized over the service period and is not included in the acquisition cost. The common stock withheld from the two Sierra founders was valued at $13.61 per share. After this adjustment, the total purchase price of Sierra including transaction costs was $84,818. The excess of tangible assets acquired over liabilities assumed was $6,385, including $9,716 of acquired cash. We recorded earn-outs of $894 for the six months ended July 31, 2007 based on related revenues derived from products and technologies acquired in prior acquisitions. We recorded earn-out payments of $1,829 for the six months ended July 31, 2007.

We recorded earn-outs of $894 for the six months ended July 31, 2007 based on related revenues derived from products and technologies acquired in prior acquisitions. We recorded earn-out payments of $1,829 for the six months ended July 31, 2007.

(8) **Long-Term Investments**—In January 2008, we agreed to purchase $2,000 of Series D Preferred Stock of Calypto Design Systems, Inc. (Calypto). Calypto is an electronic design automation company with two main products: (i) SLEC, an equivalence checking tool and (ii) PowerPro, a power reduction tool. The Series D Preferred Stock is convertible into common shares at our option at any time. We purchased $1,000 of the Series D Preferred Stock in January 2008. During the three months ended July 31, 2008, we purchased the remaining $1,000 of the Series D Preferred Stock as a result of Calypto substantially meeting certain booking and development milestones established at the time of our initial purchase.

As of July 31, 2008, we controlled 30.3% of the voting stock of Calypto, which increased from 24.3% as of April 30, 2008 as a result of our additional $1,000 investment, and 20% of the participating membership of the board of directors. We have determined our investment in Calypto to be “in-substance common stock” as described in EITF 02-14, “Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock”. Accordingly, we have accounted for our investment in Calypto pursuant to the equity method of accounting, in accordance with APB Opinion No. 18, “The Equity Method of Accounting for Certain Investments in Debt and Equity Securities”. We record our interest in the equity method gains or losses of Calypto in the subsequent quarter following incurrence because it is not practical to obtain Calypto’s financial statements prior to the issuance of our consolidated financial statements. During the three months ended July 31, 2008, we recorded a loss of $475 in Other income, net, in our Condensed Consolidated Statement of Operations for our equity in the losses of Calypto from our initial investment in January 2008 through April 30, 2008. For the six months ended July 31, 2008, we recorded a loss of $643 for our equity in the losses of Calypto from our initial investment in January 2008 through April 30, 2008.

(9) **Derivative Instruments and Hedging Activities**—We are exposed to fluctuations in foreign currency exchange rates. To manage the volatility, we aggregate exposures on a consolidated basis to take advantage of natural offsets. The primary exposures that do not currently have natural offsets are the Japanese yen, where we are in a long position, and the euro and the British pound, where we are in a short position. Most large European revenue contracts are denominated and paid to us in the U.S. dollar while our European expenses, including substantial research and development operations, are paid in local currencies causing a short position in the euro and the British pound. In addition, we experience greater inflows than outflows of Japanese yen as almost all Japanese-based customers contract and pay us in Japanese yen. While these exposures are aggregated on a consolidated basis to take advantage of natural offsets, substantial exposure remains.

We generated nearly two-thirds of our revenues and approximately one-third of our expenses outside of the U.S. for the six months ended July 31, 2008. For the six months ended July 31, 2008, approximately one-fourth of European and ninety percent of Japanese revenues were subject to exchange rate fluctuation as they were booked in local currencies. For the six months ended July 31, 2007, approximately one-fourth of European and ninety-five percent of Japanese revenues were subject to exchange rate fluctuation.
For exposures that are not offset, we enter into short-term foreign currency forward and option contracts to partially offset these anticipated exposures. We formally document all relationships between foreign currency forward and option contracts and hedged items as well as our risk management objectives and strategies for undertaking various hedge transactions. All hedges designated as cash flow hedges are linked to forecasted transactions, and we assess, both at inception of the hedge and on an ongoing basis, the effectiveness of the foreign currency forward and option contracts in offsetting changes in the cash flows of the hedged items. We report the effective portions of the net gains or losses on foreign currency forward and option contracts as a component of Accumulated other comprehensive income in Stockholders’ equity. Accumulated other comprehensive income associated with hedges of forecasted transactions is reclassified to the Condensed Consolidated Statement of Operations in the same period the forecasted transaction occurs. We discontinue hedge accounting prospectively when we determine that a foreign currency forward or option contract is not highly effective as a hedge under the requirements of SFAS 133. To the extent a forecasted transaction is no longer deemed probable of occurring, we prospectively discontinue hedge accounting treatment and we reclassify deferred amounts to Other income, net.

We had $355,589 of notional value foreign currency forward and option contracts outstanding as of July 31, 2008 and $387,606 outstanding as of January 31, 2008. Notional amounts do not quantify risk or represent our assets or liabilities but are used in the calculation of cash settlements under the contracts. The fair value of foreign currency forward and option contracts, recorded in Other receivables in the Condensed Consolidated Balance Sheet, was $2,018 as of July 31, 2008 and $687 as of January 31, 2008.

The following provides a summary of activity in Accumulated other comprehensive income for our net unrealized gain relating to our hedging program:

<table>
<thead>
<tr>
<th>As of July 31</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning balance</td>
<td>$ 26</td>
<td>$ 1,596</td>
</tr>
<tr>
<td>Change in fair value of cash flow hedges</td>
<td>2,575</td>
<td>492</td>
</tr>
<tr>
<td>Hedge ineffectiveness recognized in earnings</td>
<td>(14)</td>
<td>6</td>
</tr>
<tr>
<td>Net gain transferred to earnings</td>
<td>(595)</td>
<td>(1,621)</td>
</tr>
<tr>
<td>Ending balance</td>
<td>$1,992</td>
<td>$ 473</td>
</tr>
</tbody>
</table>

The hedge-related balance in Accumulated other comprehensive income as of July 31, 2008 represents a net unrealized gain on foreign currency forward and option contracts relating to hedges of forecasted revenues and expenses expected to occur during fiscal 2009. We will transfer these amounts to the Condensed Consolidated Statement of Operations upon recognition of the related revenue and recording of the respective expenses. We expect substantially all of the balance in Accumulated other comprehensive income to be reclassified to the Condensed Consolidated Statement of Operations within the next twelve months. We transferred a deferred loss of $2,321 to System and software revenues relating to foreign currency forward and option contracts hedging revenues for the six months ended July 31, 2008 compared to a deferred gain of $405 for the six months ended July 31, 2007. We transferred a deferred gain of $2,916 to Operating expenses relating to foreign currency forward and option contracts commission and other expenses for the six months ended July 31, 2008 compared to $1,216 for the six months ended July 31, 2007.

We enter into foreign currency contracts to offset the earnings impact relating to the variability in exchange rates on certain short-term monetary assets and liabilities denominated in non-functional currencies. We do not designate these foreign currency contracts as hedges. We recognize changes in the fair value of these foreign currency contracts currently in earnings in Other income, net, to offset the remeasurement of the related assets and liabilities.

In accordance with SFAS 133, we exclude changes in fair value relating to time value of foreign currency forward contracts from our assessment of hedge effectiveness. We recorded income relating to time value in interest income, a component of Other income, net, of $681 for the three months ended July 31, 2008 and $1,344 for the six months ended July 31, 2008 compared to $538 for the three months ended July 31, 2007 and $1,094 for the six months ended July 31, 2007. We recorded expense related to time value in Interest expense of $354 for the three months ended July 31, 2008 and $1,063 for the six months ended July 31, 2008 compared to $501 for the three months ended July 31, 2007 and $953 for the six months ended July 31, 2007.

(10) Short-Term Borrowings—In June 2005, we entered into a syndicated, senior, unsecured, four-year revolving credit facility that replaced an existing three-year revolving credit facility. In April 2008, we extended this revolving credit facility by two years until June 1, 2011. In May 2008, we increased the maximum borrowing capacity from $120,000 to $140,000 and retained an option to increase it by an additional $10,000 in the future. Under this revolving credit facility, we have the option to pay interest based on: (i) LIBOR with varying maturities which are commensurate with the borrowing period we select, plus a spread of between 1.0% and 1.6%, or (ii) prime plus a spread of between 0.0%
and 0.6%, based on a pricing grid tied to a financial covenant. As a result, our interest expense associated with borrowings under this revolving credit facility will vary with market interest rates. In addition, commitment fees are payable on the unused portion of the revolving credit facility at rates between 0.25% and 0.35% based on a pricing grid tied to a financial covenant. We paid commitment fees of $83 for the three months ended July 31, 2008 and $158 for the six months ended July 31, 2008 compared to $76 for the three months ended July 31, 2007 and $151 for the six months ended July 31, 2007. This revolving credit facility contains certain financial and other covenants, including financial covenants requiring the maintenance of specified liquidity ratios, leverage ratios, and minimum tangible net worth as well as restrictions on the payment of cash dividends. We had no borrowings during the six months ended July 31, 2008 and 2007.

As of July 31, 2008 and January 31, 2008, there was no balance outstanding against this revolving credit facility.

Short-term borrowings of $2,473 as of July 31, 2008 and $10,449 as of January 31, 2008 represent amounts collected from customers on accounts receivable previously sold on a non-recourse basis to financial institutions. These amounts are remitted to the financial institutions during the quarter following the period end.

We generally have other short-term borrowings, including multi-currency lines of credit, capital leases, and other borrowings. Interest rates are generally based on the applicable country’s prime lending rate, depending on the currency borrowed. Other short-term borrowings outstanding under these facilities were $3,696 as of July 31, 2008 and $3,729 as of January 31, 2008.

6.25% Debentures due 2026: In March 2006, we issued $200,000 of 6.25% Debentures in a private offering pursuant to SEC Rule 144A under the Securities Act of 1933. Interest on the 6.25% Debentures is payable semi-annually in March and September. The 6.25% Debentures are convertible, under certain circumstances, into our common stock at a conversion price of $17.968 per share for a total of 9,183 shares as of July 31, 2008. These circumstances generally include:

- The market price of our common stock exceeding 120% of the conversion price;
- The market price of the 6.25% Debentures declining to less than 98% of the value of the common stock into which the 6.25% Debentures are convertible;
- A call for the redemption of the 6.25% Debentures;
- Specified distributions to holders of our common stock;
- If a fundamental change, such as a change of control, occurs; or
- During the ten trading days prior to, but not on, the maturity date.

Upon conversion, in lieu of shares of our common stock, for each $1,000 principal amount of the 6.25% Debentures a holder will receive an amount of cash equal to the lesser of: (i) $1,000 or (ii) the conversion value of the number of shares of our common stock equal to the conversion rate. If such conversion value exceeds $1,000, we will also deliver, at our election, cash or common stock, or a combination of cash and common stock with a value equal to the excess. If a holder elects to convert their 6.25% Debentures in connection with a fundamental change in the company that occurs prior to March 6, 2011, the holder will also be entitled to receive a make whole premium upon conversion in some circumstances. The 6.25% Debentures rank pari passu with the Floating Rate Convertible Subordinated Debentures (Floating Rate Debentures) due 2023. We may redeem some or all of the 6.25% Debentures for cash on or after March 6, 2011. The holders, at their option, may redeem some or all of the 6.25% Debentures for cash on March 1, 2013, 2016, or 2021. During the six months ended July 31, 2008, we did not repurchase any 6.25% Debentures. The principal amount of $165,000 remains outstanding as of July 31, 2008.

Floating Rate Debentures due 2023: In August 2003, we issued $110,000 of Floating Rate Debentures in a private offering pursuant to SEC Rule 144A under the Securities Act of 1933. Interest on the Floating Rate Debentures is payable quarterly in February, May, August, and November at a variable interest rate equal to 3-month LIBOR plus 0.6%. The Floating Rate Debentures are convertible, under certain circumstances, into our common stock at a conversion price of $17.968 per share for a total of 9,183 shares as of July 31, 2008.

Notes Payable—Notes payable consisted of the following:

<table>
<thead>
<tr>
<th>Notes Payable</th>
<th>July 31, 2008</th>
<th>January 31, 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>6.25% Debentures due 2026</td>
<td>$165,000</td>
<td>$165,000</td>
</tr>
<tr>
<td>Floating Rate Debentures due 2023</td>
<td>36,102</td>
<td>36,102</td>
</tr>
<tr>
<td>Notes Payable</td>
<td>$201,102</td>
<td>$201,102</td>
</tr>
</tbody>
</table>

6.25% Debentures due 2026: In March 2006, we issued $200,000 of 6.25% Debentures in a private offering pursuant to SEC Rule 144A under the Securities Act of 1933. Interest on the 6.25% Debentures is payable semi-annually in March and September. The 6.25% Debentures are convertible, under certain circumstances, into our common stock at a conversion price of $17.968 per share for a total of 9,183 shares as of July 31, 2008. These circumstances generally include:
1.65%. The effective interest rate was 4.67% for the six months ended July 31, 2008 and 7.01% for the six months ended July 31, 2007. The Floating Rate Debentures are convertible, under certain circumstances, into our common stock at a conversion price of $23.40 per share, for a total of 1,543 shares as of July 31, 2008. These circumstances generally include:

- The market price of our common stock exceeding 120% of the conversion price;
- The market price of the Floating Rate Debentures declining to less than 98% of the value of the common stock into which the Floating Rate Debentures are convertible; or
- A call for redemption of the Floating Rate Debentures or certain other corporate transactions.

The conversion price may also be adjusted based on certain future transactions, such as stock splits or stock dividends. Effective August 2007, we may redeem some or all of the Floating Rate Debentures for cash at 102.42% of the face amount, with the premium reducing to 1.61% on August 6, 2008, 0.81% on August 6, 2009, and 0% on August 6, 2010. The holders, at their option, may redeem some or all of the Floating Rate Debentures for cash on August 6, 2010, 2013, or 2018. During the six months ended July 31, 2008, we did not repurchase any Floating Rate Debentures. The principal amount of $36,102 remains outstanding as of July 31, 2008.

(12) Commitments and Contingencies

Leases
We lease a majority of our field sales offices and research and development facilities under non-cancelable operating leases. In addition, we lease certain equipment used in our research and development activities. This equipment is generally leased on a month-to-month basis after meeting a six-month lease minimum. There have been no significant changes to the future minimum lease payments due under non-cancelable operating leases as disclosed in our Annual Report on Form 10-K for the fiscal year ended January 31, 2008.

Income Taxes
As of July 31, 2008, we had a liability of $53,130 for income taxes associated with uncertain income tax positions. All of these liabilities are classified as long-term liabilities in our Condensed Consolidated Balance Sheet, as we generally do not anticipate the settlement of the liabilities will require payment of cash within the next twelve months. Further, certain liabilities may result in the reduction of deferred tax assets rather than settlement in cash. We are not able to reasonably estimate the timing of any cash payments required to settle these liabilities and do not believe that the ultimate settlement of these obligations will materially affect our liquidity.

Contractual Obligations
In conjunction with the acquisition of undeveloped 22nm technology we acquired under a joint development agreement entered into in the three months ended July 31, 2008, we are required to make payments of $2,500 during fiscal 2009, $5,000 during fiscal 2010, and annual payments of $2,500 each during fiscal 2011 through fiscal 2013. See further discussion of the joint development agreement in Note 18, “In-Process Research and Development”.

Indemnifications
Our license and service agreements generally include a limited indemnification provision for claims from third parties relating to our intellectual property. These indemnification provisions are accounted for in accordance with SFAS No. 5, “Accounting for Contingencies” (SFAS 5). The indemnification is generally limited to the amount paid by the customer or a set cap. As of July 31, 2008, we were not aware of any material liabilities arising from these indemnifications.

Legal Proceedings
From time to time we are involved in various disputes and litigation matters that arise from the ordinary course of business. These include disputes and lawsuits relating to intellectual property rights, contracts, distributorships, and employee relations matters. Periodically, we review the status of various disputes and litigation matters and assess each potential exposure. When we consider the potential loss from any dispute or legal matter probable and the amount or the range of loss can be estimated, we will accrue a liability for the estimated loss in accordance with SFAS 5. Legal proceedings are subject to uncertainties and the outcomes are difficult to predict. Because of such uncertainties, we base accruals only on the best information available at the time. As additional information becomes available, we reassess the potential liability related to pending claims and litigation matters and may revise estimates. We believe that the outcome of current litigation, individually and in the aggregate, will not have a material effect on our results of operations.
Stock Option Plans and Stock Plan

We have two common stock option plans which provide for the granting of incentive stock options, nonqualified stock options (NQSOs), stock appreciation rights, restricted stock, restricted stock units, and performance-based awards. The two common stock option plans are administered by the Compensation Committee of our Board of Directors and permit accelerated vesting of outstanding options upon the occurrence of certain changes in control of our company.

We also have a stock plan that provides for the sale of common stock to our officers, key employees, and non-employee consultants. This plan allows for shares to be awarded at no purchase price as a stock bonus or with a purchase price as a NQSO.

Options under the above three plans generally expire ten years from the date of grant and become exercisable over four years from the date of grant or from the commencement of employment, at prices generally not less than the fair market value at the date of grant.

We also have a Director’s Stock Plan which was amended in June 2007 to provide for the annual grant to each non-employee director of either an option for 21 shares of common stock or 7 shares of restricted stock, each vesting over a period of five years but with accelerated vesting upon any termination of service. During the three and six months ended July 31, 2008, there were 14 shares of restricted stock with a fair market value of $214 issued under this plan. Options granted under this plan are included in the table below.

At July 31, 2008, a total of 7,614 shares of common stock were available for future grant under the above stock option and stock plans.

Stock options outstanding, the weighted average exercise price and transactions involving the stock option plans are summarized as follows:

<table>
<thead>
<tr>
<th></th>
<th>Shares</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at January 31, 2008</td>
<td>19,693</td>
<td>$14.18</td>
</tr>
<tr>
<td>Granted</td>
<td>414</td>
<td>$12.37</td>
</tr>
<tr>
<td>Exercised</td>
<td>(631)</td>
<td>$ 8.77</td>
</tr>
<tr>
<td>Forfeited</td>
<td>(190)</td>
<td>$13.70</td>
</tr>
<tr>
<td>Expired</td>
<td>(897)</td>
<td>$12.37</td>
</tr>
<tr>
<td>Balance at July 31, 2008</td>
<td>18,389</td>
<td>$14.41</td>
</tr>
</tbody>
</table>

Employee Stock Purchase Plans

We have an employee stock purchase plan (ESPP) for U.S. employees and an ESPP for certain foreign subsidiary employees. The ESPPs generally provide for overlapping two-year offerings starting every six months on January 1 and July 1 of each year with purchases every six months during those offerings. Each eligible employee may purchase up to sixteen hundred shares of stock on each purchase date at prices no less than 85% of the lesser of the fair market value of the shares at the beginning of the two-year offering period or on the applicable purchase date. At July 31, 2008, 7,303 shares remain available for future purchase under the ESPPs.

Stock-Based Compensation Expense

We estimate the fair value of stock options and purchase rights under our ESPPs in accordance with SFAS No. 123 (revised 2004), “Share-Based Payment,” using a Black-Scholes option-pricing model. The Black-Scholes option-pricing model incorporates several highly subjective assumptions including expected volatility, expected term, and interest rates. We include the following elements in reaching our determination of expected volatility:

- Historical volatility of our shares of common stock;
- Historical volatility of shares of comparable companies;
- Implied volatility of the option features in our convertible subordinated debentures; and
- Implied volatility of traded options of comparable companies.
We base the expected term of our stock options on historical experience. Using the Black-Scholes option-pricing model, the weighted average fair values are summarized as follows:

<table>
<thead>
<tr>
<th></th>
<th>Three Months Ended July 31</th>
<th>Six Months Ended July 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Options Granted</td>
<td>$ 6.91</td>
<td>$ 6.82</td>
</tr>
<tr>
<td>Restricted Stock</td>
<td>$ 15.29</td>
<td>$ 13.61</td>
</tr>
<tr>
<td>Granted</td>
<td>$ 4.63</td>
<td>$ 4.20</td>
</tr>
</tbody>
</table>

The calculations used the following assumptions:

<table>
<thead>
<tr>
<th>Stock Option Plans</th>
<th>Three Months Ended July 31</th>
<th>Six Months Ended July 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk-free interest rate</td>
<td>3.4%</td>
<td>4.9%</td>
</tr>
<tr>
<td>Dividend yield</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Expected life (in years)</td>
<td>5.0 - 6.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Volatility (weighted average)</td>
<td>47%</td>
<td>55%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Employee Stock Purchase Plans</th>
<th>Three Months Ended July 31</th>
<th>Six Months Ended July 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk-free interest rate</td>
<td>4.6%</td>
<td>4.9%</td>
</tr>
<tr>
<td>Dividend yield</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>Expected life (in years)</td>
<td>1.25</td>
<td>1.25</td>
</tr>
<tr>
<td>Volatility (range)</td>
<td>34% - 45%</td>
<td>45%</td>
</tr>
<tr>
<td>Volatility (weighted average)</td>
<td>43%</td>
<td>45%</td>
</tr>
</tbody>
</table>

**Net Income (Loss) Per Share**—We compute basic net income (loss) per share using the weighted average number of common shares outstanding during the period. We compute diluted net income (loss) per share using the weighted average number of common shares and potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of common shares issuable upon exercise of employee stock options, purchase rights from ESPPs, and warrants using the treasury stock method. Potentially dilutive common shares also include common shares issuable upon conversion of the convertible subordinated debentures, if dilutive.

The following provides the computation of basic and diluted net income (loss) per share:

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31</th>
<th>Six months ended July 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income (loss)</td>
<td>$ (17,192)</td>
<td>$ 2,181</td>
</tr>
<tr>
<td>Weighted average shares used to calculate basic net income (loss) per share</td>
<td>91,352</td>
<td>87,526</td>
</tr>
<tr>
<td>Employee stock options and employee stock purchase plans</td>
<td>—</td>
<td>1,825</td>
</tr>
<tr>
<td>Weighted average common and potential common shares used to calculate diluted net income (loss) per share</td>
<td>91,352</td>
<td>89,351</td>
</tr>
<tr>
<td>Basic net income (loss) per share</td>
<td>$ (0.19)</td>
<td>$ 0.02</td>
</tr>
<tr>
<td>Diluted net income (loss) per share</td>
<td>$ (0.19)</td>
<td>$ 0.02</td>
</tr>
</tbody>
</table>

We excluded from the computation of diluted net income (loss) per share options and warrants to purchase 18,482 shares of common stock for the three and six months ended July 31, 2008 compared to 10,877 for the three months ended July 31, 2007 and 10,594 for the six months ended July 31, 2007. The options and warrants were anti-dilutive either because we incurred a net loss for the period, the warrant price was greater than the average market price of the common stock during the period, or the option was determined to be anti-dilutive as a result of applying the treasury stock method in accordance with SFAS No. 128, “Earnings per Share” (SFAS 128).

We excluded from the computation of diluted net income (loss) per share the effect of the conversion of the Floating Rate Debentures and the 6.25% Debentures as they were anti-dilutive. If the Floating Rate Debentures had been dilutive, our diluted net income (loss) per share would have included additional earnings of $283 for the three months.
ended July 31, 2008 and $585 for the six months ended July 31, 2008 and $551 for the three months ended July 31, 2007 and $1,101 for the six months ended July 31, 2007. Also included would have been incremental common shares of 1,543 for the three and six months ended July 31, 2008 and 1,985 for the three months ended July 31, 2007 and 2,044 for the six months ended July 31, 2007. In accordance with SFAS 128, we assume that the 6.25% Debentures will be settled in common stock for purposes of calculating the dilutive effect of the 6.25% Debentures. If the effect of the 6.25% Debentures had been dilutive, our diluted net income (loss) per share would have included additional earnings of $2,643 for the three and six months ended July 31, 2008 compared to $3,203 for the three and six months ended July 31, 2007. Dilutive net income (loss) per share would have included no incremental shares for the three and six months ended July 31, 2008 and no incremental shares for the three and six months ended July 31, 2007, as the stock price was below the conversion rate. The conversion features of the 6.25% Debentures, which allow for settlement in cash, common stock, or a combination of cash and common stock, are further described in Note 11, “Notes Payable.”

(15) Comprehensive Income (Loss) — The following provides a summary of comprehensive income (loss):

<table>
<thead>
<tr>
<th>Six Months Ended July 31,</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income (loss)</td>
<td>$(42,095)</td>
<td>$ 2,673</td>
</tr>
<tr>
<td>Change in unrealized gain (loss) on derivative instruments</td>
<td>1,966</td>
<td>(1,123)</td>
</tr>
<tr>
<td>Change in accumulated translation adjustment</td>
<td>2,322</td>
<td>5,608</td>
</tr>
<tr>
<td>Comprehensive income (loss)</td>
<td>$(37,807)</td>
<td>$ 7,158</td>
</tr>
</tbody>
</table>

(16) Special Charges — The following is a summary of the major elements of the special charges:

<table>
<thead>
<tr>
<th>Three months ended July 31,</th>
<th>Six months ended July 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee severance and related costs</td>
<td>$ 730</td>
</tr>
<tr>
<td>Excess leased facility costs</td>
<td>1,513</td>
</tr>
<tr>
<td>Other costs</td>
<td>992</td>
</tr>
<tr>
<td>Total special charges</td>
<td>$ 3,235</td>
</tr>
</tbody>
</table>

During the six months ended July 31, 2008, we recorded special charges of $12,885. These charges primarily consisted of costs incurred for employee terminations and were due to our reduction of personnel resources driven by modifications of business strategy or business emphasis.

We rebalanced our workforce by 130 employees during the six months ended July 31, 2008. The reduction impacted several employee groups. Employee severance costs of $8,844 included severance benefits, notice pay, and outplacement services. The total rebalance charge represents the aggregate of numerous unrelated rebalance plans, none of which was individually material to our financial position or results of operations. We determined the termination benefit amount based on employee status, years of service, and local statutory requirements. We communicated termination benefits to the affected employees prior to the end of the quarter in which we recorded the charge. Approximately 58% of these costs were paid during the six months ended July 31, 2008 and we expect to pay the remainder during the fiscal year ending January 31, 2009. There have been no significant modifications to the amount of these charges.

Excess leased facility costs of $2,956 during the six months ended July 31, 2008 were primarily due to the abandonment of five leased facilities and a change in the estimate of sublease income of a previously abandoned leased facility.

Other special charges for the six months ended July 31, 2008 included costs of $93 related to the closure of a division, costs of $1,073 related to advisory fees incurred in response to the unsolicited offer by Cadence Design Systems, Inc. to acquire us, and other charges of ($81).

During the six months ended July 31, 2007, we recorded special charges of $4,045. These charges primarily consisted of costs incurred for employee terminations and were due to our reduction of personnel resources driven by modifications of business strategy or business emphasis.

We rebalanced our workforce by 116 employees during the six months ended July 31, 2007. The reduction impacted several employee groups. Employee severance costs of $4,683 included severance benefits, notice pay, and
outplacement services. The total rebalance charge represents the aggregate of numerous unrelated rebalance plans, none of which was individually material to our financial position or results of operations. We determined the termination benefit amount based on employee status, years of service, and local statutory requirements. We communicated termination benefits to the affected employees prior to the end of the quarter in which we recorded the charge. These costs were paid during the fiscal year ended January 31, 2008. There have been no significant modifications to the amount of these charges.

The reduction of excess leased facility costs of $737 during the six months ended July 31, 2007 resulted from the re-occupancy of a previously abandoned leased facility in the three months ended July 31, 2007 and the termination of an abandoned facility lease in a lease buyout in the three months ended April 30, 2007. The cost of the lease buyout was less than the remaining balance of the accrual, resulting in an adjustment to special charges.

Other special charges for the six months ended July 31, 2007 included fees of $100 for the termination of a service agreement related to a subsidiary that was legally merged with one of our other subsidiaries located in the same country.

Accrued special charges are included in Accrued liabilities and Other long-term liabilities in the Condensed Consolidated Balance Sheets. The following table shows changes in accrued special charges during the six months ended July 31, 2008:

<table>
<thead>
<tr>
<th></th>
<th>Accrued special charges as of January 31, 2008</th>
<th>Charges during the six months ended July 31, 2008</th>
<th>Payments during the six months ended July 31, 2008</th>
<th>Accrued special charges as of July 31, 2008 (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee severance and related costs</td>
<td>$3,903</td>
<td>$8,844</td>
<td>$(6,952)</td>
<td>$5,795</td>
</tr>
<tr>
<td>Excess leased facility costs</td>
<td>3,507</td>
<td>2,956</td>
<td>(504)</td>
<td>5,959</td>
</tr>
<tr>
<td>Other costs</td>
<td>—</td>
<td>1,085</td>
<td>(143)</td>
<td>942</td>
</tr>
<tr>
<td>Total special charges</td>
<td>$7,410</td>
<td>$12,885</td>
<td>$(7,599)</td>
<td>$12,696</td>
</tr>
</tbody>
</table>

(1) Of the $12,696 total accrued special charges at July 31, 2008, $3,887 represented the long-term portion of accrued lease termination fees and other facility costs, net of sublease income. The remaining balance of $8,809 represented the short-term portion of the accrued lease termination fees and other facility costs.

(17) **Other Income, Net**—Other income, net was comprised of the following:

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31, 2008</th>
<th>Six months ended July 31, 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income</td>
<td>$1,351</td>
<td>$1,894</td>
</tr>
<tr>
<td>Gain (loss) on hedge ineffectiveness</td>
<td>(9)</td>
<td>(8)</td>
</tr>
<tr>
<td>Foreign exchange gain (loss)</td>
<td>(73)</td>
<td>(131)</td>
</tr>
<tr>
<td>Equity in losses of unconsolidated entities</td>
<td>(475)</td>
<td>—</td>
</tr>
<tr>
<td>Other, net</td>
<td>(166)</td>
<td>(104)</td>
</tr>
<tr>
<td>Other income, net</td>
<td>$628</td>
<td>$1,651</td>
</tr>
</tbody>
</table>

(18) **In-Process Research and Development**—We incurred $13,985 of in-process research and development charges related to undeveloped technology acquired through a joint development agreement addressing technological challenges of integrated circuit design at 22 nanometer geometries. This agreement was signed during the three and six months ended July 31, 2008. We based the value of the charge on the present value of the four year payment obligation as defined in the agreement. The joint development agreement provides access to technology which has not yet reached technological feasibility and provides no alternative future use. The technology is expected to be the basis for a new offering in the Calibre® product family once development is completed.

Other in-process research and development charges for the three and six months ended July 31, 2008 and 2007 relate to acquisitions of businesses. See further discussion of these amounts in Note 7, “Business Combinations”.

(19) **Related Party Transactions**—Certain members of our board of directors also serve on the board of directors of certain of our customers. We recognized revenue from these customers of $18,048 for the three months ended July 31, 2008 and $26,631 for the six months ended July 31, 2008, representing 9.9% of our total revenues for the three months ended July 31, 2008 and 7.4% for the six months ended July 31, 2008. We recognized revenue from these customers
During the six months ended July 31, 2007, we acquired Sierra using a combination of cash and stock. Common stock with a fair value of $39,831 was issued in connection with the acquisition of Sierra which included both an initial payment and a holdback payment.

We operate exclusively in the electronic design automation industry. We market our products and services worldwide, primarily to large companies in the military/aerospace, communications, computer, consumer electronics, semiconductor, networking, multimedia, and transportation industries. We sell and license our products through our direct sales force in North America, Europe, Japan, and the Pacific Rim and through distributors where third parties can extend our sales reach more effectively or efficiently. Our CODMs review our consolidated results within one operating segment. In making operating decisions, our CODMs primarily consider consolidated financial information accompanied by disaggregated information by geographic region.

(20) **Supplemental Cash Flow Information**—The following provides information concerning supplemental disclosures of cash flow activities:

<table>
<thead>
<tr>
<th>Six months ended July 31</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash paid, net for:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest (1)</td>
<td>$7,503</td>
<td>$9,375</td>
</tr>
<tr>
<td>Income taxes</td>
<td>$1,938</td>
<td>$6,042</td>
</tr>
</tbody>
</table>

(1) Cash paid for interest for the six months ended July 31, 2007 included $102 for the premium on the Floating Rate Debentures.

During the six months ended July 31, 2007, we acquired Sierra using a combination of cash and stock. Common stock with a fair value of $39,831 was issued in connection with the acquisition of Sierra which included both an initial payment and a holdback payment.

(21) **Segment Reporting**—SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information” (SFAS 131) requires disclosures of certain information regarding operating segments, products and services, geographic areas of operation, and major customers. To determine what information to report under SFAS 131, we reviewed our Chief Operating Decision Makers’ (CODM) method of analyzing the operating segments to determine resource allocations and performance assessments. Our CODMs are the Chief Executive Officer, President, and Chief Financial Officer.

We operate exclusively in the electronic design automation industry. We market our products and services worldwide, primarily to large companies in the military/aerospace, communications, computer, consumer electronics, semiconductor, networking, multimedia, and transportation industries. We sell and license our products through our direct sales force in North America, Europe, Japan, and the Pacific Rim and through distributors where third parties can extend our sales reach more effectively or efficiently. Our CODMs review our consolidated results within one operating segment. In making operating decisions, our CODMs primarily consider consolidated financial information accompanied by disaggregated information by geographic region.
We eliminate all intercompany revenues and expenses in computing Revenues, Operating income (loss), and Income (loss) before income tax and minority interest. The corporate component of Operating income (loss) represents research and development, corporate marketing and selling, corporate general and administration, other general expense (income), special charges, and in-process research and development charges. Geographic information is as follows:

We segregate revenue into six categories of similar products and services. Each category, with the exception of Finance Fees, includes both product and related support revenues. Revenue information is as follows:

<table>
<thead>
<tr>
<th>Revenues:</th>
<th>Three months ended July 31, 2008</th>
<th>Three months ended July 31, 2007</th>
<th>Six months ended July 31, 2008</th>
<th>Six months ended July 31, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>$64,734</td>
<td>$114,428</td>
<td>$136,115</td>
<td>$205,996</td>
</tr>
<tr>
<td>Europe</td>
<td>58,382</td>
<td>42,448</td>
<td>111,564</td>
<td>89,313</td>
</tr>
<tr>
<td>Japan</td>
<td>33,893</td>
<td>19,938</td>
<td>68,434</td>
<td>50,111</td>
</tr>
<tr>
<td>Pacific Rim</td>
<td>25,395</td>
<td>33,119</td>
<td>45,498</td>
<td>59,003</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$182,404</td>
<td>$209,933</td>
<td>$361,611</td>
<td>$404,423</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Operating Income (Loss):</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>$32,195</td>
<td>$73,962</td>
<td>$67,088</td>
<td>$129,575</td>
</tr>
<tr>
<td>Europe</td>
<td>31,661</td>
<td>16,954</td>
<td>54,099</td>
<td>39,449</td>
</tr>
<tr>
<td>Japan</td>
<td>23,832</td>
<td>11,466</td>
<td>48,234</td>
<td>32,964</td>
</tr>
<tr>
<td>Pacific Rim</td>
<td>18,596</td>
<td>26,368</td>
<td>32,017</td>
<td>46,159</td>
</tr>
<tr>
<td>Corporate</td>
<td>(136,191)</td>
<td>(122,114)</td>
<td>(262,010)</td>
<td>(236,294)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ (29,907)</td>
<td>$6,636</td>
<td>$60,572</td>
<td>$11,853</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income (Loss) Before Income Tax and Minority Interest:</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>$28,655</td>
<td>$70,202</td>
<td>$61,071</td>
<td>$122,149</td>
</tr>
<tr>
<td>Europe</td>
<td>32,148</td>
<td>17,445</td>
<td>54,995</td>
<td>39,805</td>
</tr>
<tr>
<td>Japan</td>
<td>23,815</td>
<td>11,444</td>
<td>48,220</td>
<td>32,915</td>
</tr>
<tr>
<td>Pacific Rim</td>
<td>18,496</td>
<td>26,369</td>
<td>32,195</td>
<td>46,154</td>
</tr>
<tr>
<td>Corporate</td>
<td>(136,191)</td>
<td>(122,114)</td>
<td>(262,010)</td>
<td>(236,294)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$ (33,077)</td>
<td>$3,346</td>
<td>$65,529</td>
<td>$4,729</td>
</tr>
</tbody>
</table>

We segregate revenue into six categories of similar products and services. Each category, with the exception of Finance Fees, includes both product and related support revenues. Revenue information is as follows:

<table>
<thead>
<tr>
<th>Revenues:</th>
<th>Three months ended July 31, 2008</th>
<th>Three months ended July 31, 2007</th>
<th>Six months ended July 31, 2008</th>
<th>Six months ended July 31, 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Integrated System Design</td>
<td>$40,810</td>
<td>$40,350</td>
<td>$75,235</td>
<td>$85,258</td>
</tr>
<tr>
<td>IC Design to Silicon</td>
<td>53,745</td>
<td>77,943</td>
<td>119,488</td>
<td>148,879</td>
</tr>
<tr>
<td>Scalable Verification</td>
<td>44,417</td>
<td>48,368</td>
<td>85,871</td>
<td>86,956</td>
</tr>
<tr>
<td>New &amp; Emerging Products</td>
<td>27,649</td>
<td>27,861</td>
<td>49,831</td>
<td>51,944</td>
</tr>
<tr>
<td>Services &amp; Other</td>
<td>11,526</td>
<td>11,218</td>
<td>22,258</td>
<td>23,166</td>
</tr>
<tr>
<td>Finance Fees</td>
<td>4,257</td>
<td>4,193</td>
<td>8,928</td>
<td>8,220</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$182,404</td>
<td>$209,933</td>
<td>$361,611</td>
<td>$404,423</td>
</tr>
</tbody>
</table>
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

(All numerical references in thousands, except for percentages, per share data, and number of employees)

Overview

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes included elsewhere in this Form 10-Q. Certain of the statements below contain forward-looking statements. These statements are predictions based upon our current expectations about future trends and events. Actual results could vary materially as a result of certain factors, including but not limited to, those expressed in these statements. In particular, we refer you to the risks discussed in Part II, Item 1A. “Risk Factors” and in our other Securities and Exchange Commission (SEC) filings, which identify important risks and uncertainties that could cause our actual results to differ materially from those contained in the forward-looking statements.

We urge you to consider these factors carefully in evaluating the forward-looking statements contained in this Form 10-Q. All subsequent written or spoken forward-looking statements attributable to our company or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The forward-looking statements included in this Form 10-Q are made only as of the date of this Form 10-Q. We do not intend, and undertake no obligation, to update these forward-looking statements.

THE COMPANY

We are a supplier of electronic design automation (EDA) systems — advanced computer software and emulation hardware systems used to automate the design, analysis, and testing of electronic hardware and embedded systems software in electronic systems and components. We market our products and services worldwide, primarily to large companies in the military/aerospace, communications, computer, consumer electronics, semiconductor, networking, multimedia, and transportation industries. Through the diversification of our customer base among these various customer markets, we attempt to reduce our exposure to fluctuations within each market. We sell and license our products through our direct sales force and a channel of distributors and sales representatives. In addition to our corporate offices in Wilsonville, Oregon, we have sales, support, software development, and professional service offices worldwide.

BUSINESS ENVIRONMENT

Our revenue has historically fluctuated quarterly and has generally been the highest in the fourth quarter of our fiscal year due to our customers’ corporate calendar year-end spending trends.

Business for the first half of fiscal 2009 slowed from the levels achieved during fiscal 2008, with bookings down 10% compared to the first half of fiscal 2008. IC Design to Silicon represented 35% of bookings for the first six months of fiscal 2009 compared to 40% for the first six months of fiscal 2008. Bookings are the value of executed orders during a period for which revenue has been or will be recognized within six months for products and within twelve months for professional services and training. The ten largest transactions for the six months ended July 31, 2008 accounted for approximately 40% of total system and software bookings compared to 35% for the six months ended July 31, 2007. The number of new customers during the six months ended July 31, 2008 was down 30% from the levels experienced during the six months ended July 31, 2007.

We will continue our strategy of developing high quality tools with number one market share potential, rather than being a broad-line supplier with undifferentiated product offerings. This strategy allows us to focus investment in areas where customer needs are greatest and we have the opportunity to build significant market share.

License Model Mix

License model trends can have a material impact on various aspects of our business. See “Summary of Significant Accounting Policies-Revenue Recognition” in the Notes to our condensed consolidated financial statements included in Part I, Item 1. “Financial Statements” for a description of the types of product licenses we sell. As the mix shifts among perpetual licenses, fixed term licenses (term) with upfront revenue recognition, and term licenses with revenue that is recognized over a period of time (which includes ratable due and payable and cash-based revenue recognition), revenues, earnings, cash flow, and days sales outstanding are either positively or negatively affected. The year ended January 31, 2008 marked the seventh consecutive year in which, as a percentage of product revenue, term revenue increased while perpetual license revenue decreased. This trend continued during the six months ended July 31, 2008 and we believe this trend will continue for the remainder of fiscal 2009. Our customers continue to move toward the term license model, which provides them with greater flexibility for product usage, including the option to share products between multiple locations and remix tool use at regular intervals from a fixed product list. As such, most of our larger customers have converted their existing installed base from perpetual to term licenses.
Product Developments

During the second quarter of fiscal 2009, we continued to execute our strategy of focusing on challenges encountered by customers, as well as building upon our well-established product families. We believe that customers, faced with leading-edge design challenges in creating new products, generally choose the best EDA products in each category to build their design environment. Through both internal development and strategic acquisitions, we have focused on areas where we believe we can build a leading market position or extend an existing leading market position.

During the six months ended July 31, 2008, we launched a number of new or improved products, which are chronologically listed below:

First Quarter

• In February 2008, we announced the Questa® Multi-view Verification Components product and the inFact™ intelligent testbench automation tool – two new solutions that speed up verification and improve verification coverage of today’s System on Chip (SoC) designs.

• In March 2008, we announced the Questa Codelink™ product, an addition to the Questa Functional Verification Platform designed to speed the validation of application-specific integrated circuits containing one or more embedded processors.

• In April 2008, we announced with Agilent Technologies, Inc. a jointly developed solution that can improve productivity for the design of radio frequency circuits on printed circuit boards (PCBs). We expect the solution to cut PCB design cycle times up to half and improve the quality of mixed-technology designs.

Second Quarter

• In May 2008, we acquired substantially all of the assets of Ponte Solutions, Inc. (Ponte), a developer of integrated circuit (IC) design for manufacturing products. The acquisition was an investment aimed at expanding our Design-for-Manufacturing capabilities and will be integrated into our Calibre® product family.

• In June 2008, we announced our IC implementation strategy to aid customers with the challenges of moving to smaller process nodes. This strategy included the merger of our Calibre physical verification and Design-for-Manufacturing platform, the Olympus-SoC™ place-and-route system, and our Design-for-Test and Yield Learning solution into a single Design-to-Silicon division.

• In June 2008, we announced that inFact™, our award-winning intelligent testbench automation tool, has been enhanced to enable large simulations to be automatically distributed across up to 1000 CPUs.

• Also in June 2008, we announced our Veloce® family of hardware-assisted verification products and the iSolve™ Multimedia product to accelerate the verification of multimedia products.

• In July 2008, we announced that our virtual prototyping tool, SystemVision™, supports Design for Six Sigma methodologies to achieve cost-effective design innovation by a model-driven development process in the automotive industry.

• Also in July 2008, we acquired Flomerics Group, PLC (Flomerics), the market share leader in thermal analysis for electronics application and a technical leader in engineering fluid dynamics. We are integrating the acquired technology into our Mechanical Analysis Division.

We believe that the development and commercialization of EDA software tools is usually a multi-year process with limited customer adoption in the first years of tool availability. Once tools are adopted, however, their life spans tend to be long. We believe that our relatively young and diverse product lines are positioned for growth over the long-term.


• Total revenues were $182,404 for the three months ended July 31, 2008 and $361,611 for the six months ended July 31, 2008, a decrease of 13% from the three months ended July 31, 2007 and 11% from the six months ended July 31, 2007. The decreases primarily occurred in IC Design to Silicon, in our Calibre product family.

• System and software revenues were $95,830 for the three months ended July 31, 2008 and $192,673 for the six months ended July 31, 2008, a decrease of 25% from the three months ended July 31, 2007 and 22% from the six months ended July 31, 2007. Product revenue split by license model for the second quarter of fiscal 2009 was 63% term with upfront revenue recognition, 20% perpetual, and 17% term with ratable revenue recognition, which includes due and payable revenue recognition. Product revenue split by license model for the second quarter of fiscal 2008 was 63% term with upfront revenue recognition, 23% perpetual, and 14% term with ratable revenue recognition.
• Finance fee revenues, included in System and software revenues, were $4,257 for the three months ended July 31, 2008 and $8,928 for the six months ended July 31, 2008, an increase of 2% from the three months ended July 31, 2007 and 9% from the six months ended July 31, 2007.

• Service and support revenues were $86,574 for the three months ended July 31, 2008 and $168,938 for the six months ended July 31, 2008, an increase of 6% from the three and six months ended July 31, 2007.

• Net loss was $17,192 for the three months ended July 31, 2008 and $42,095 for the six months ended July 31, 2008 compared to a net income of $2,181 for the three months ended July 31, 2007 and $2,673 for the six months ended July 31, 2007.

• Trade accounts receivable, net, decreased to $239,339 as of July 31, 2008, down 28% from $332,641 as of January 31, 2008. Average days sales outstanding increased to 118 days as of July 31, 2008 from 105 days as of January 31, 2008.

• Cash provided by operating activities was $43,137 during the six months ended July 31, 2008 compared to cash provided by operating activities of $5,483 for the six months ended July 31, 2007. As of July 31, 2008, cash, cash equivalents, and short-term investments were $102,036, down 19% from $126,215 as of January 31, 2008.

Critical Accounting Policies
We base our discussion and analysis of our financial condition and results of operations upon our condensed consolidated financial statements which we have prepared in accordance with United States (U.S.) generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, and contingencies as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We evaluate our estimates on an on-going basis. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe that the accounting for revenue recognition, valuation of trade accounts receivable, valuation of deferred tax assets, income tax reserves, goodwill, intangible assets and long-lived assets, special charges, and accounting for stock-based compensation are the critical accounting estimates and judgments used in the preparation of our consolidated financial statements. For a discussion of our critical accounting policies, see Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies” in our Annual Report on Form 10-K for the year ended January 31, 2008.

RESULTS OF OPERATIONS
Revenues and Gross Margins

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31,</th>
<th>Six months ended July 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
<td>Change</td>
</tr>
<tr>
<td>System and software revenues</td>
<td>$95,830</td>
<td>(25%)</td>
</tr>
<tr>
<td>Gross margin percent</td>
<td>93%</td>
<td>92%</td>
</tr>
<tr>
<td>Service and support revenues</td>
<td>$86,574</td>
<td>6%</td>
</tr>
<tr>
<td>Gross margin percent</td>
<td>6%</td>
<td>72%</td>
</tr>
<tr>
<td>Total revenues</td>
<td>$182,404</td>
<td>(13%)</td>
</tr>
<tr>
<td>Gross margin percent</td>
<td>83%</td>
<td>84%</td>
</tr>
</tbody>
</table>

System and Software
We derive System and software revenues from the sale of licenses of software products and emulation hardware systems. System and software revenues decreased in the three and six months ended July 31, 2008 compared to the three and six months ended July 31, 2007 primarily in the following categories:

• Decreases in IC Design to Silicon, primarily from our Calibre product family;
These declines were primarily due to: (i) lower term license revenues primarily as a result of revenue recognized on one large term deal in the three months ended July 31, 2007 and two large term deals in the six months ended July 31, 2007 and (ii) lower perpetual license revenues as a result of decreased business. Total revenues were favorably impacted by approximately 3% due to foreign currency fluctuations during the three months ended July 31, 2008 and 2% during the six months ended July 31, 2008, as more fully described under “Geographic Revenues Information” below.

System and software revenues include finance fee revenues for the amortization of the interest component of our term license installment agreements of $4,257 for the three months ended July 31, 2008 and $8,928 for the six months ended July 31, 2008 compared to $4,193 for the three months ended July 31, 2007 and $8,220 for the six months ended July 31, 2007.

System and software gross margin percentage increased for the three months ended July 31, 2008 compared to the three months ended July 31, 2007 due to an increase in the gross margin of our automotive cabling products which grew in large part as a result of one term deal in the three months ended July 31, 2008. This increase was partially offset by declining gross margins of our emulation products resulting from a revenue decline that exceeded the decline in cost of sales.

System and software gross margin percentage decreased for the six months ended July 31, 2008 compared to the six months ended July 31, 2007 due to declining gross margins of our emulation products resulting from revenue declines that exceeded the decline in cost of sales.

The write-down of emulation hardware system inventory was $388 for the three months ended July 31, 2008 and $596 for the six months ended July 31, 2008 compared to $552 for the three months ended July 31, 2007 and $799 for the six months ended July 31, 2007. These reserves reduced inventory to the amount that was expected to ship within twelve months for our Veloce® emulation hardware systems and six months for all other inventory on the assumption that any excess would be obsolete.

Amortization of purchased technology to System and software cost of revenues was $1,992 for the three months ended July 31, 2008 and $5,230 for the six months ended July 31, 2008 compared to $2,332 for the three months ended July 31, 2007 and $5,374 for the six months ended July 31, 2007. We amortize purchased technology costs over two to five years to System and software cost of revenues. The decrease in amortization for the three and six months ended July 31, 2008 was primarily due to certain assets being fully amortized during the period between August 1, 2007 and July 31, 2008. This decrease for the six months ended July 31, 2008 was partially offset by the full amortization of certain purchased technology totaling $1,358 in the three months ended April 30, 2008 due to the closure of our intellectual property division and amortization of certain intangible assets acquired in acquisitions between August 1, 2007 and July 31, 2008.

**Service and Support**

We derive service and support revenues from software and hardware post-contract maintenance or support services and professional services, which include consulting, training, and other services. The increase in service and support revenues for the three and six months ended July 31, 2008 compared to the three and six months ended July 31, 2007 was primarily due to growth in the installed base of customers under support contracts, specifically in IC Design to Silicon, led by our Calibre product family and our Olympus-SoC place and route product. Additionally, we had growth in revenues from New and Emerging Markets, specifically in our Design-for-Test product, and Scalable Verification, led by our ModelSim products. Increases in our consulting and training revenues also contributed to the revenue growth in service and support revenues. Total revenues were positively impacted by approximately 3% due to foreign currency fluctuations during the three months ended July 31, 2008 and 2% during the six months ended July 31, 2008, as more fully described under “Geographic Revenues Information” below.

Professional service revenues totaled $9,042 for the three months ended July 31, 2008 and $18,333 for the six months ended July 31, 2008 compared to $7,644 for the three months ended July 31, 2007 and $15,517 for the six months ended July 31, 2007.

The service and support gross margin percentage remained flat for the three and six months ended July 31, 2008 as compared to the three and six months ended July 31, 2007.
Geographic Revenues Information

Revenue by Geography

Revenues decreased in North America for the three and six months ended July 31, 2008 compared to the three and six months ended July 31, 2007 primarily due to decreases in software product revenues.

Revenues outside of North America represented 65% of total revenues for the three months ended July 31, 2008 and 62% for the six months ended July 31, 2008 compared to 45% for the three months ended July 31, 2007 and 49% for the six months ended July 31, 2007. Approximately one-fourth of European revenues were booked in local currencies during the three months ended July 31, 2008 compared to approximately one-third of European revenues during the three months ended July 31, 2007. Approximately one-fourth of European revenues were booked in local currencies during the six months ended July 31, 2008 and 2007. The effects of exchange rate differences from the European currencies to the U.S. dollar positively impacted European revenues by approximately 2% for the three and six months ended July 31, 2008. Exclusive of currency effects, higher European revenues for the three and six months ended July 31, 2008 were primarily due to increased software product revenues.

Approximately all Japanese revenues were recorded in Japanese yen during the three months ended July 31, 2008 compared to approximately ninety-five percent of Japanese revenues during the three months ended July 31, 2007. Approximately ninety percent of Japanese revenues were recorded in Japanese yen during the six months ended July 31, 2008 compared to approximately ninety-five percent of Japanese revenues during the six months ended July 31, 2007. The effects of exchange rate differences from the Japanese yen to the U.S. dollar positively impacted Japanese revenues by approximately 15% for the three months ended July 31, 2008 and 12% for the six months ended July 31, 2008. Exclusive of currency effects, higher Japanese revenues for the three and six months ended July 31, 2008 were primarily due to increased software product revenues.

Revenues decreased in the Pacific Rim for the three and six months ended July 31, 2008 compared to the three and six months ended July 31, 2007, primarily due to decreases in software product revenues.

We generate more than half of our revenues outside of North America and expect this to continue in the future. Revenue results will continue to be impacted by future foreign currency fluctuations.

Operating Expenses

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31,</th>
<th></th>
<th>Six months ended July 31,</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
<td>Change</td>
<td>2007</td>
<td></td>
</tr>
<tr>
<td>Research and development</td>
<td>$ 64,251</td>
<td>(1%)</td>
<td>$ 65,063</td>
<td>4%</td>
</tr>
<tr>
<td>Marketing and selling</td>
<td>72,799</td>
<td>(3%)</td>
<td>75,139</td>
<td>1%</td>
</tr>
<tr>
<td>General and administration</td>
<td>24,099</td>
<td></td>
<td>23,957</td>
<td>1%</td>
</tr>
<tr>
<td>Other general expense (income), net</td>
<td>(273)</td>
<td>(2,050%)</td>
<td>14</td>
<td>(437)</td>
</tr>
<tr>
<td>Amortization of intangible assets</td>
<td>2,537</td>
<td>11%</td>
<td>2,279</td>
<td>36%</td>
</tr>
<tr>
<td>Special charges</td>
<td>3,235</td>
<td>40,538%</td>
<td>(8)</td>
<td>12,885</td>
</tr>
<tr>
<td>In-process research and development</td>
<td>15,285</td>
<td>273%</td>
<td>4,100</td>
<td>4,100</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>$181,933</td>
<td>7%</td>
<td>$170,544</td>
<td>8%</td>
</tr>
</tbody>
</table>

Research and Development

For the three months ended July 31, 2008 compared to the three months ended July 31, 2007, the decrease in research and development costs was primarily due to decreased variable compensation and an increase in research and development credits to offset costs incurred in France. The increase in research and development credits were due to changes in the calculations of credits as further discussed in Note 4, “Change in Accounting for Research and Development Credits”. These decreases were partially offset by:

- The year-over-year effect of increases in annual salary costs;
For the six months ended July 31, 2008 compared to the six months ended July 31, 2007, the increase in research and development costs was primarily due to:

- The year-over-year effect of increases in annual salary costs;
- The acquisition of Sierra in the second quarter of fiscal 2008;
- Increased stock based compensation under SFAS 123(R); and
- A weakening of the U.S. dollar.

These increases were partially offset by decreased variable compensation and an increase in research and development credits to offset costs incurred in France.

**Marketing and Selling**

For the three months ended July 31, 2008 compared to the three months ended July 31, 2007, the decrease in marketing and selling costs was primarily due to:

- Decreased variable compensation and
- Decreased travel costs.

These decreases were partially offset by:

- The year-over-year effect of increases in annual salary costs;
- Increased stock based compensation under SFAS 123(R); and
- A weakening of the U.S. dollar.

For the six months ended July 31, 2008 compared to the six months ended July 31, 2007, the increase in marketing and selling costs was primarily due to:

- A weakening of the U.S. dollar;
- The year-over-year effect of increases in annual salary costs; and
- Increased stock based compensation under SFAS 123(R).

These increases were partially offset by decreased variable compensation.

**General and Administration**

For the three and six months ended July 31, 2008 compared to the three and six months ended July 31, 2007, general and administration costs were relatively flat as decreases in variable compensation were more than offset by increases in stock-based compensation under SFAS 123(R), salary costs and increased costs resulting from the acquisition of Flomerics in the second quarter of fiscal 2009.
**Other General Expense (Income), Net**

Other general expense (income), net represents the net gain on the sale of qualifying receivables to certain financing institutions on a non-recourse basis. The gain on the sale of long-term receivables consists of two components: (i) the difference between the gross balance of the receivables and the net proceeds received from the financing institution, referred to as the discount on sold receivables and (ii) interest income representing the unaccreted discount on the receivables, which is recognized once the receivables are sold.

The discount on sold receivables was $684 during the three months ended July 31, 2008 and $1,738 during the six months ended July 31, 2008 compared to $14 during the three months ended July 31, 2007 and $860 during the six months ended July 31, 2007. The interest income recognized on sold receivables was $957 during the three months ended July 31, 2008 and $2,175 during the six months ended July 31, 2008 compared to $1,076 during the six months ended July 31, 2007. These increases were due to an increase in the overall sale of receivables, which resulted in higher unaccreted interest income on the receivables at the time of sale. This was partially offset by lower discount rates applied to sold receivables.

**Amortization of Intangible Assets**

For the three and six months ended July 31, 2008 compared to the three and six months ended July 31, 2007, the increase in amortization of intangible assets was primarily due to amortization of certain intangible assets acquired in acquisitions between August 1, 2007 and July 31, 2008. This increase is partially offset by certain assets being fully amortized during the period between August 1, 2007 and July 31, 2008.

**Special Charges**

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31,</th>
<th>Six months ended July 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee severance and related costs</td>
<td>$730</td>
<td>2%</td>
</tr>
<tr>
<td>Excess leased facility costs</td>
<td>1,513</td>
<td>310%</td>
</tr>
<tr>
<td>Other costs</td>
<td>992</td>
<td>99,300%</td>
</tr>
<tr>
<td>Total special charges</td>
<td>$3,235</td>
<td>40,538%</td>
</tr>
</tbody>
</table>

We recorded special charges of $3,235 during the three months ended July 31, 2008 and $12,885 during the six months ended July 31, 2008. These charges primarily consisted of costs incurred for employee terminations and were due to our reduction of personnel resources driven by modifications of business strategy or business emphasis.

We rebalanced our workforce by 20 employees during the three months ended July 31, 2008 and 130 employees during the six months ended July 31, 2008. The reduction impacted several employee groups. Employee severance costs of $730 during the three months ended July 31, 2008 and $8,844 during the six months ended July 31, 2008 included severance benefits, notice pay, and outplacement services. The total rebalance charge represents the aggregate of numerous unrelated rebalance plans, none of which was individually material to our financial position or results of operations. We determined the termination benefit amount based on employee status, years of service, and local statutory requirements. We communicated termination benefits to the affected employees prior to the end of the quarter in which we recorded the charge. Approximately 58% of these costs were paid during the six months ended July 31, 2008 and we expect to pay the remainder during the fiscal year ending January 31, 2009. There have been no significant modifications to the amount of these charges.

Excess leased facility costs of $1,513 during the three months ended July 31, 2008 and $2,956 during the six months ended July 31, 2008 were primarily due to the abandonment of five leased facilities and a change in the estimate of sublease income of a previously abandoned leased facility.

Other special charges of $992 during the three months ended July 31, 2008 included costs of $1,073 related to fees incurred in response to the unsolicited offer by Cadence Design Systems, Inc. to acquire us, and other charges of ($81). Other special charges of $1,085 during the six months ended July 31, 2008 included costs of $93 related to the closure of a division, costs of $1,073 related to fees incurred in response to the unsolicited offer by Cadence Design Systems, Inc. to acquire us, and other charges of ($81).

We recorded a reduction in special charges of $8 during the three months ended July 31, 2007 and special charges of $4,045 during the six months ended July 31, 2007. These charges primarily consisted of costs incurred for employee terminations and were due to our reduction of personnel resources driven by modifications of business strategy or business emphasis.
We rebalanced our workforce by 15 employees during the three months ended July 31, 2007 and 116 employees during the six months ended July 31, 2007. The reduction impacted several employee groups. Employee severance costs of $714 during the three months ended July 31, 2007 and $4,683 during the six months ended July 31, 2007 included severance benefits, notice pay, and outplacement services. The total rebalance charge represents the aggregate of numerous unrelated rebalance plans, none of which was individually material to our financial position or results of operations. We determined the termination benefit amount based on employee status, years of service, and local statutory requirements. We communicated termination benefits to the affected employees prior to the end of the quarter in which we recorded the charge. These costs were paid during the fiscal year ended January 31, 2008. There have been no significant modifications to the amount of these charges.

The reduction of excess leased facility costs of $721 during the three months ended July 31, 2007 and $737 during the six months ended July 31, 2007 resulted from the re-occupancy of a previously abandoned leased facility in the three months ended July 31, 2007 and the termination of an abandoned facility lease in a lease buyout in the three months ended April 30, 2007. The cost of the lease buyout was less than the remaining balance of the accrual, resulting in an adjustment to special charges.

The reduction of special charges of $1 during the three months ended July 31, 2007 resulted from a change in the estimate of the lease buyout in the prior quarter. Other special charges for the six months ended July 31, 2007 included fees of $100 for the termination of a service agreement related to a subsidiary that was legally merged with one of our other subsidiaries located in the same country.

**In-Process Research and Development**

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31,</th>
<th></th>
<th></th>
<th>Six months ended July 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td>In-process research and development</td>
<td>$15,285</td>
<td>273%</td>
<td>$4,100</td>
<td>$15,285</td>
</tr>
</tbody>
</table>

The total in-process research and development of $15,285 for the three and six months ended July 31, 2008 consisted of $1,300 assigned to one program, Litho-Etch, resulting from the Ponte asset acquisition and $13,985 resulting from undeveloped technology acquired through the joint development agreement addressing technological challenges of IC design at 22 nanometer (nm) geometries. As of July 31, 2008, we had not yet determined the amount of the charge for in-process research and development related to the Flomerics acquisition. The total acquired in-process research and development of $4,100 for the three and six months ended July 31, 2007 was assigned entirely to one program, Next Generation Pinnacle, resulting from the Sierra acquisition.

We based the value of the Ponte in-process research and development on the excess earnings method which measures the value of an asset by calculating the present value of related future economic benefits, such as cash earnings. In determining the value of this in-process research and development, the assumed commercialization date for the product was the fourth quarter of fiscal 2009. The modeled cash flow was discounted back to the net present value and was based on estimates of revenues and operating profits related to the project. Significant assumptions used in the valuation of this in-process research and development included: stage of development of the project, future revenues, estimated life of the product’s underlying technology, future operating expenses, and a discount rate of 18% to reflect present value and the risk associated with the development of technology. These estimates are subject to change, given the uncertainties of the development process, and no assurance can be given that deviations from these estimates will not occur or that we will realize any anticipated benefits of the acquisition. The risks associated with the acquired research and development are considered high, and no assurance can be made that these products will generate any benefit or meet market expectations.

We based the value of the undeveloped technology acquired through the 22 nm joint development agreement on the present value of the four year payment stream as defined in the agreement. The joint development agreement provides access to technology which has not yet reached technological feasibility and provides no alternative future use. The technology is expected to be the basis for a new offering in the Calibre product family once development is completed. The product release date has yet to be determined. The risks associated with the in-process research and development are considered high and no assurance can be made that any resulting products will generate any benefit or meet market demand.

The fee related to the development agreement includes guaranteed payments of $2,500 during fiscal 2009, $5,000 during fiscal 2010, and $2,500 each during fiscal 2011 through fiscal 2013.
Other Income, Net

The decline in interest income for the three and six months ended July 31, 2008 as compared to the three and six months ended July 31, 2007 was primarily due to lower interest income earned on our cash, cash equivalents, and short-term investments, partially offset by increased interest income for the time value of foreign currency contracts.

We recognized a loss of $9 for the three months ended July 31, 2008 and a gain of $14 for the six months ended July 31, 2008 resulting from the ineffectiveness of derivative instruments that met the criteria for hedge accounting treatment under the requirements of SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” compared to a loss of $8 for the three months ended July 31, 2007 and a loss of $6 for the six months ended July 31, 2007.

The improvements of foreign currency exchange gain (loss) for the three and six months ended July 31, 2008 as compared to the three and six months ended July 31, 2007 were primarily due to the favorable movement of exchange rates on foreign exchange contracts relating to certain short-term balance sheet positions in Europe.

We recognized a loss of $475 for the three months ended July 31, 2008 and a loss of $643 for the six months ended July 31, 2008 resulting from a long-term investment accounted for under the equity method.

Interest Expense

For the three and six months ended July 31, 2008 compared to the three and six months ended July 31, 2007, the decrease in interest expense was due largely to the purchase and retirement during fiscal 2008 of $13,748 of the Floating Rate Convertible Subordinated Debentures (Floating Rate Debentures) due 2023 and $35,000 of the 6.25% Convertible Subordinated Debentures (6.25% Debentures) due 2026.

Provision for Income Taxes

We recorded an income tax benefit of $15,796 for the three months ended July 31, 2008 and $23,345 for the six months ended July 31, 2008 and income tax expense of $1,165 for the three months ended July 31, 2007 and $2,056 for the six months ended July 31, 2007. Generally, the provision for income taxes is the result of the mix of profits (losses) earned by us and our subsidiaries in tax jurisdictions with a broad range of income tax rates, withholding taxes (primarily in certain foreign jurisdictions), and changes in tax reserves. On a quarterly basis, we evaluate our provision for income tax expense (benefit) based on our projected results of operations for the full year and record an adjustment in the current quarter. For the six months ended July 31, 2008, our effective tax rate was 36%, after considering discrete items totaling $1,425 of tax expense. Without discrete items, our effective tax rate for the six months ended July 31, 2008 was 38%. For fiscal 2009, we project a 46% effective tax rate, after the inclusion of discrete items. This differs from tax computed at the U.S. federal statutory rate primarily due to:

- Projected losses in the U.S. for which no tax benefit will be recognized;
- Non-deductible incentive stock option and employees stock purchase plan compensation expense;

### Other Income, Net

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31,</th>
<th>Six months ended July 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income</td>
<td>$1,351</td>
<td>(29%)</td>
</tr>
<tr>
<td>Gain (loss) on hedge ineffectiveness</td>
<td>(9)</td>
<td>13%</td>
</tr>
<tr>
<td>Foreign currency exchange gain (loss)</td>
<td>(73)</td>
<td>(44%)</td>
</tr>
<tr>
<td>Equity in losses of unconsolidated entities</td>
<td>(475)</td>
<td>—</td>
</tr>
<tr>
<td>Other, net</td>
<td>(166)</td>
<td>60%</td>
</tr>
<tr>
<td>Other income, net</td>
<td>$628</td>
<td>(62%)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31,</th>
<th>Six months ended July 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest expense</td>
<td>$3,798</td>
<td>(23%)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income tax expense (benefit)</th>
<th>Three months ended July 31,</th>
<th>Six months ended July 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax expense (benefit)</td>
<td>$(15,796)</td>
<td>(1,456%)</td>
</tr>
</tbody>
</table>
• Withholding taxes in certain foreign jurisdictions; and
• Increases in foreign tax reserves.

These differences are offset by:
• The benefit of lower tax rates on earnings of foreign subsidiaries; and
• The application of tax incentives for research and development in certain jurisdictions.

The effective tax rate for the remainder of fiscal 2009 could change significantly if actual results are different than current outlook-based projections. Our current projected tax rate for fiscal 2009 of 46% increased from 31% projected as of the end of the first quarter of fiscal 2009 primarily as a result of the change in accounting for the refundable credit for French-based research and development as well as the recognition of in-process research and development expense in the second quarter for which a current year tax benefit is not expected. See Note 4, “Change in Accounting for Research and Development Credits” for further discussion.

We have not provided for U.S. income taxes on the undistributed earnings of foreign subsidiaries because they are considered permanently re-invested outside of the U.S. If repatriated, some of these earnings would generate foreign tax credits, which may reduce the federal tax liability associated with any future foreign dividend.

Under SFAS No. 109, “Accounting for Income Taxes” (SFAS 109), we determined deferred tax assets and liabilities based on differences between the financial reporting and tax basis of assets and liabilities. We then measured the difference using the enacted tax rates and laws that will be in effect when we expect differences to reverse. SFAS 109 provides for the recognition of deferred tax assets without a valuation allowance if realization of such assets is more likely than not. Since 2004, we have determined it is uncertain whether our U.S. entity will generate sufficient taxable income and foreign source income to utilize foreign tax credit carryforwards, research and experimentation credit carryforwards, and net operating loss carryforwards before expiration. Accordingly, we recorded valuation allowances in fiscal 2008 against the portion of those deferred tax assets for which realization is not more likely than not. We expect to continue applying valuation allowances in fiscal 2009, to the extent net deferred tax assets are generated, consistent with prior years. A portion of the valuation allowances for deferred tax assets relates to certain of the tax attributes acquired from IKOS Systems, Inc. in 2002 and 0-In Design Automation, Inc. in 2004 for which subsequently recognized tax benefits will be applied directly to reduce goodwill. Valuation allowances relating to non-U.S. taxing jurisdictions were based on the historical earnings patterns which indicated uncertainty that we will have sufficient income in the appropriate jurisdictions to realize the full value of the assets. We will continue to evaluate the realizability of the deferred tax assets on a periodic basis.

We are subject to income taxes in the U.S. and in numerous foreign jurisdictions in the ordinary course of business and, as a result, there are many transactions and calculations where the ultimate tax determination is uncertain. The statute of limitations for adjustments to our historic tax obligations will vary from jurisdiction to jurisdiction. In some cases it may be extended or be unlimited. Further, attribute carryforwards may be subject to adjustment after the expiration of the statute of limitations of the year such attribute was originated. Our larger jurisdictions generally provide for a statute of limitations from three to five years. In the U.S., the statute of limitations remains open for fiscal years 2002 and forward. We are currently under examination in various jurisdictions, including the U.S. The examinations are in different stages and timing of their resolution is difficult to predict. The examination in the U.S. by the Internal Revenue Service (IRS) pertains to our 2002, 2003, 2004, 2005, and 2006 tax years. In March 2007, the IRS issued a Revenue Agent’s Report for 2002 through 2004 in which adjustments were asserted totaling $146,600 of additional taxable income. The adjustments primarily concern transfer pricing arrangements related to intellectual property rights acquired in acquisitions which were transferred to a foreign subsidiary. We disagree with the adjustments, and we are in the process of contesting the adjustments with the Appeals Office of the IRS. Our statute of limitations remains open for years on and after 2003 in Ireland and 2004 in Japan.

We have reserves for potential tax liabilities to address potential exposures involving tax positions that are being challenged or that could be challenged by taxing authorities even though we believe the positions we have taken are appropriate. We believe our tax reserves are adequate to cover potential liabilities. We review the tax reserves as circumstances warrant and adjust the reserves as events occur that affect our potential liability for additional taxes. It is often difficult to predict the final outcome or timing of resolution of any particular tax matter; and various events, some of which cannot be predicted, such as clarifications of tax law by administrative or judicial means, may occur and would require us to increase or decrease our reserves and effective tax rate. We recorded additional reserves in the six months ended July 31, 2008, and expect to record additional reserves in future periods, with respect to tax positions taken for the current year; however, it is reasonably possible that reserves for prior years’ tax positions will decrease by a range of $0 to $4,000 due to settlements or expirations of the statute of limitations within the next twelve months. Uncertain tax positions that resolve in our favor will have a
positive impact on our effective tax rate, except to the extent such resolution results in a reduction to goodwill or the booking of deferred tax assets subject to a valuation allowance. Certain reductions in our reserves may require cash payments. Please refer to “Liquidity and Capital Resources” in this Item 2, for additional discussion. Accrued tax-related interest and penalties were $314 for the three months ended July 31, 2008 and $2,781 for the six months ended July 31, 2008.

**Effects of Foreign Currency Fluctuations**

We generated nearly two-thirds of our revenues and approximately one-third of our expenses outside of the U.S. for the three and six months ended July 31, 2008 as compared to approximately half of our revenues and approximately one-third of our expenses for the three and six months ended July 31, 2007. For the three months ended July 31, 2008, approximately one-fourth of European and approximately all Japanese revenues were subject to exchange rate fluctuations, as they were booked in local currencies, compared to approximately one-third of European and approximately ninety-five percent of Japanese revenues for the three months ended July 31, 2007. For the six months ended July 31, 2008, approximately one-fourth of European and approximately ninety percent of all Japanese revenues were subject to exchange rate fluctuations, as they were booked in local currencies, compared to approximately one-fourth of European and approximately ninety-five percent of Japanese revenues for the six months ended July 31, 2007. Most large European revenue contracts are denominated and paid to us in the U.S. dollar while our European expenses, including substantial research and development operations, are paid in local currencies causing a short position in the euro and the British pound. In addition, we experience greater inflows than outflows of Japanese yen as almost all Japanese-based customers contract and pay us in Japanese yen. While these exposures are aggregated on a consolidated basis to take advantage of natural offsets, substantial exposure remains.

For exposures that are not offset, we enter into short-term foreign currency forward and option contracts to partially offset these anticipated exposures. We generally enter into option contracts at contract strike rates that are different than current market rates. As a result, any unfavorable currency movements below the strike rates will not be offset by the foreign currency option contract and could negatively affect operating results. These contracts address anticipated future cash flows for periods up to one year and do not hedge 100% of the potential exposures related to these currencies. As a result, the effects of currency fluctuations could have a substantial effect on our overall results of operations.

Foreign currency translation adjustment, a component of Accumulated other comprehensive income reported in the Stockholders’ equity section of our Condensed Consolidated Balance Sheets, increased to $40,104 as of July 31, 2008 from $37,782 as of January 31, 2008. This increase reflects the increase in the value of net assets denominated in foreign currencies as a result of the weakening of the U.S. dollar since January 31, 2008.

**LIQUIDITY AND CAPITAL RESOURCES**

<table>
<thead>
<tr>
<th></th>
<th>As of</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>July 31, 2008</td>
</tr>
<tr>
<td>Current assets</td>
<td>$ 432,713</td>
</tr>
<tr>
<td>Cash, cash equivalents, and short-term investments</td>
<td>$ 102,036</td>
</tr>
</tbody>
</table>

Cash provided by operating activities | $ 43,137 | $ 5,483 |
Cash used in investing activities, excluding short-term investments | $ 74,469 | $ 57,437 |
Cash provided by financing activities | $ 6,915 | $ 13,049 |

**Cash, Cash Equivalents, and Short-Term Investments**

Cash provided by operating activities for the six months ended July 31, 2008 was $43,137 compared to $5,483 for the six months ended July 31, 2007. The increase in cash flows from operating activities was primarily due to changes in Trade accounts receivable and Term receivables, long-term. The increase was partially offset by:

- A net loss for the six months ended July 31, 2008 compared to net income for the six months ended July 31, 2007;
- Change from an income tax payable to an income tax receivable;
- Changes in Accounts payable and accrued liabilities; and
- Changes in Deferred revenue.
We have entered into agreements to sell qualifying accounts receivable from time to time to certain financing institutions on a non-recourse basis. For the six months ended July 31, 2008, we sold trade receivables of $19,984 and term receivables of $19,022 for net proceeds of $37,268. For the six months ended July 31, 2007, we sold trade receivables of $7,446 and term receivables of $6,906 for net proceeds of $13,493. We continue to evaluate the economics of the sale of accounts receivable and do not have a set target for the sale of accounts receivable for the remainder of fiscal 2009.

Excluding short-term investments, cash used in investing activities for the six months ended July 31, 2008 primarily consisted of cash paid for the acquisition of businesses and equity interests of $48,786 and capital expenditures of $19,773. Cash paid for acquisitions of business and equity interests consisted of $45,092 paid for the acquisition of businesses, $1,500 paid for equity interests in unconsolidated entities, and $2,194 paid for earn-outs related to prior-year acquisitions. Excluding short-term investments, cash used in investing activities for the six months ended July 31, 2007 consisted of cash paid for the acquisition of businesses of $37,283, including payments of earn-outs and transaction costs related to prior-year acquisitions of $1,932, and capital expenditures of $20,154.

Additionally, cash used in investing activities, excluding short-term investments, for the six months ended July 31, 2008 included $5,910 of cash that has been restricted for the purchase of the remaining outstanding ordinary shares and options of Flomerics.

Cash provided by financing activities for the six months ended July 31, 2008 included:

• Common stock issuances of $14,362 for stock option exercises and stock purchased under our Employee Stock Purchase Plans; and
• $7,472 used for net repayments of short-term borrowings.

Cash provided by financing activities for the six months ended July 31, 2007 included:

• Common stock issuances of $15,967 for stock option exercises and stock purchased under our Employee Stock Purchase Plans; and
• $3,401 used for the repurchase of the Floating Rate Debentures, as more fully described in “Capital Resources”.

### Trade Accounts and Term Receivables

<table>
<thead>
<tr>
<th></th>
<th>As of</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade accounts receivable, net</td>
<td>$ 239,339</td>
<td>$ 332,641</td>
</tr>
<tr>
<td>Term receivables, long-term</td>
<td>$ 119,092</td>
<td>$ 134,059</td>
</tr>
<tr>
<td>Average days sales outstanding in trade accounts receivable</td>
<td>118 days</td>
<td>105 days</td>
</tr>
<tr>
<td>Average days sales outstanding in trade accounts receivable, excluding current portion of term receivables</td>
<td>47 days</td>
<td>55 days</td>
</tr>
</tbody>
</table>

### Trade Accounts Receivable, Net

The increase in the average days sales outstanding in trade accounts receivable was primarily due to decreased revenue in our perpetual and term arrangements for the three months ended July 31, 2008 as compared to the three months ended January 31, 2008. This increase is partially offset by improved collections of trade accounts receivable and an increased sale of receivables for the three months ended July 31, 2008 as compared to the three months ended January 31, 2008.

Excluding the current portion of term receivables of $144,058 as of July 31, 2008 and $157,077 as of January 31, 2008, average days sales outstanding were 47 as of July 31, 2008 compared to 55 as of January 31, 2008.

### Term Receivables, Long-Term

The balance is attributable to multi-year term license sales agreements. We include amounts for term agreements that are due within one year in Trade accounts receivable, net, and balances that are due in more than one year in Term receivables, long-term. We use term agreements as a standard business practice and have a history of successfully collecting under the original payment terms without making concessions on payments, products, or services. The decrease from January 31, 2008 was primarily due to decreased revenue in our term agreements for the three months ended July 31, 2008 as compared to the three months ended January 31, 2008.
Property, Plant, and Equipment, net

The increase in Property, plant, and equipment, net was due to normal capital purchases, offset by depreciation and disposals. The increase did not include any individually significant projects and was primarily due to infrastructure improvements within facilities and information technology. In addition, the acquisition of Flomerics included property, plant, and equipment that contributed to the overall increase.

Accrued Payroll and Related Liabilities

The decrease in Accrued payroll and related liabilities primarily reflects the payment of annual bonus and sales commission accruals offset by incremental accruals for annual bonuses and sales commissions for the six months ended July 31, 2008. Accruals for bonuses were lower as of July 31, 2008 as compared to January 31, 2008 due to seasonality in our business, which generally results in higher bonus accruals at the end of our fiscal year. The sales commission accruals were lower as of July 31, 2008 as compared to January 31, 2008 due to lower revenues in the three months ended July 31, 2008 as compared to the three months ended January 31, 2008.

Deferred Revenue

Deferred revenue consists primarily of prepaid annual software support services. The decrease in deferred revenue was primarily due to normal amortization of prepayments on existing contracts during the period. This decrease is partially offset by the addition of deferred revenues from the acquisition of Flomerics in the three months ended July 31, 2008.

Income Taxes

As of July 31, 2008, we had a liability of $53,130 for income taxes associated with uncertain income tax positions. All of these liabilities are classified as long-term liabilities in our Condensed Consolidated Balance Sheet, as we generally do not anticipate the settlement of the liabilities will require payment of cash within the next twelve months. Further, certain liabilities may result in the reduction of deferred tax assets rather than settlement in cash. We are not able to reasonably estimate the timing of any cash payments required to settle these liabilities and do not believe that the ultimate settlement of these obligations will materially affect our liquidity.

Capital Resources

Expenditures for property, plant, and equipment decreased to $19,773 for the six months ended July 31, 2008 compared to $20,154 for the six months ended July 31, 2007. We expect expenditures for property, plant, and equipment for fiscal 2009 will be approximately $36,000 compared to $38,000 for fiscal 2008.

In July 2008, we acquired Flomerics which resulted in a net cash payment of $39,476. The cash payment for the acquisition of Flomerics was net of $11,850 of cash held by Flomerics and acquired by us in the transaction. In May 2008, we acquired substantially all of the assets of Ponte for a net cash payment of $5,616. The cash payment for the acquisition of the Ponte assets was net of $39 of cash held by Ponte and acquired by us in the transaction. Additionally, during the six months ended July 31, 2008, we paid $2,194 for earn-outs related to prior acquisitions.

In conjunction with the acquisition of undeveloped 22nm technology we acquired under a joint development agreement entered into in the three months ended July 31, 2008, we are required to make payments of $2,500 during fiscal 2009, $5,000 during fiscal 2010, and annual payments of $2,500 each during fiscal 2011 through fiscal 2013. See further discussion of the joint development agreement in Note 18, “In-Process Research and Development”.

In June 2007, we acquired Sierra which resulted in a net cash payment of $34,733, net of cash held by Sierra of $9,716. In March 2007, we acquired the technology of Dynamic Soft Analysis, Inc. which resulted in a net cash payment of $618. Additionally, during the six months ended July 31, 2007 we paid $1,829 for earn-outs and $103 for transaction and other costs related to prior acquisitions.
In March 2006, we issued $200,000 of 6.25% Debentures in a private offering pursuant to SEC Rule 144A under the Securities Act of 1933. Interest on the 6.25% Debentures is payable semi-annually in March and September. The 6.25% Debentures are convertible, under certain circumstances, into our common stock at a conversion price of $17.968 per share for a total of 9,183 shares at July 31, 2008. These circumstances generally include:

- The market price of our common stock exceeding 120% of the conversion price;
- The market price of the 6.25% Debentures declining to less than 98% of the value of the common stock into which the 6.25% Debentures are convertible;
- A call for the redemption of the 6.25% Debentures;
- Specified distributions to holders of our common stock;
- If a fundamental change, such as a change of control, occurs; or
- During the ten trading days prior to, but not on, the maturity date.

Upon conversion, in lieu of shares of our common stock, for each $1,000 principal amount of the 6.25% Debentures a holder will receive an amount of cash equal to the lesser of: (i) $1,000 or (ii) the conversion value of the number of shares of our common stock equal to the conversion rate. If such conversion value exceeds $1,000, we will also deliver, at our election, cash or common stock, or a combination of cash and common stock with a value equal to the excess. If a holder elects to convert their 6.25% Debentures in connection with a fundamental change in the company that occurs prior to March 6, 2011, the holder will also be entitled to receive a make whole premium upon conversion in some circumstances. The 6.25% Debentures rank pari passu with the Floating Rate Debentures. We may redeem some or all of the 6.25% Debentures for cash on or after March 6, 2011. The holders, at their option, may redeem some or all of the 6.25% Debentures for cash on March 1, 2013, 2016, or 2021. During the six months ended July 31, 2008, we did not repurchase any 6.25% Debentures. The principal amount of $165,000 remains outstanding as of July 31, 2008.

In August 2003, we issued $110,000 of Floating Rate Debentures in a private offering pursuant to SEC Rule 144A under the Securities Act of 1933. Interest on the Floating Rate Debentures is payable quarterly in February, May, August, and November at a variable interest rate equal to 3-month LIBOR plus 1.65%. The effective interest rate was 4.67% for the six months ended July 31, 2008 and 7.01% for the six months ended July 31, 2007. The Floating Rate Debentures are convertible, under certain circumstances, into our common stock at a conversion price of $23.40 per share for a total of 1,543 shares as of July 31, 2008. These circumstances generally include:

- The market price of our common stock exceeding 120% of the conversion price;
- The market price of the Floating Rate Debentures declining to less than 98% of the value of the common stock into which the Floating Rate Debentures are convertible; or
- A call for redemption of the Floating Rate Debentures or certain other corporate transactions.

The conversion price may also be adjusted based on certain future transactions, such as stock splits or stock dividends. We may redeem some or all of the Floating Rate Debentures for cash at 102.42% of the face amount, with the premium reducing to 1.61% on August 6, 2008, 0.81% on August 6, 2009, and 0% on August 6, 2010. The holders, at their option, may redeem some or all of the Floating Rate Debentures for cash on August 6, 2010, 2013, or 2018. During the six months ended July 31, 2008, we did not repurchase any Floating Rate Debentures. The principal amount of $36,102 remains outstanding as of July 31, 2008.

During the six months ended July 31, 2007, we purchased on the open market and retired Floating Rate Debentures with a principal balance of $3,400, for a total purchase price of $3,502. In connection with this purchase, we incurred a before tax net loss on the early extinguishment of debt of $164, which included a $102 premium on the repurchased Floating Rate Debentures as well as the write-off of $62 of unamortized deferred debt issuance costs.

We may elect to purchase or otherwise retire some or all of the debentures with cash, stock, or other assets from time to time in the open market or privately negotiated transactions, either directly or through intermediaries, or by tender offer when we believe that market conditions are favorable to do so. Such purchases may have a material effect on our liquidity, financial condition, and results of operations.
In June 2005, we entered into a syndicated, senior, unsecured, four-year revolving credit facility that replaced an existing three-year revolving credit facility. In April 2008, we extended this revolving credit facility by two years to June 1, 2011. In May 2008, we increased the maximum borrowing capacity from $120,000 to $140,000 and retained an option to increase it by an additional $10,000 in the future. Under this revolving credit facility, we have the option to pay interest based on: (i) LIBOR with varying maturities which are commensurate with the borrowing period we select, plus a spread of between 1.0% and 1.6% or (ii) prime plus a spread of between 0.0% and 0.6%, based on a pricing grid tied to a financial covenant. As a result, our interest expense associated with borrowings under this revolving credit facility will vary with market interest rates. In addition, commitment fees are payable on the unused portion of the revolving credit facility at rates between 0.25% and 0.35% based on a pricing grid tied to a financial covenant. We paid commitment fees of $83 for the three months ended July 31, 2008 and $158 for the six months ended July 31, 2008 compared to $76 for the three months ended July 31, 2007 and $151 for the six months ended July 31, 2007. This revolving credit facility contains certain financial and other covenants, including financial covenants requiring the maintenance of specified liquidity ratios, leverage ratios, and minimum tangible net worth as well as restrictions on the payment of cash dividends. We had no borrowings during the six months ended July 31, 2008 and 2007. As of July 31, 2008 and January 31, 2008, there was no balance outstanding against this revolving credit facility.

Our primary ongoing cash requirements will be for product development, operating activities, capital expenditures, debt service, and acquisition opportunities that may arise. Our primary sources of liquidity are cash generated from operations and borrowings under the revolving credit facility. We anticipate that:

- Current cash balances;
- Anticipated cash flows from operating activities, including the effects of financing customer term receivables;
- Amounts available under existing revolving credit facilities; or
- Other available financing sources, such as the issuance of debt or equity securities, will be sufficient to meet our working capital needs on a short-term and long-term basis.

Our sources of liquidity could be adversely affected by a decrease in demand for our products or a deterioration of our financial ratios.

**OFF-BALANCE SHEET ARRANGEMENTS**

We do not have off-balance sheet arrangements, financings, or other similar relationships with unconsolidated entities or other persons, also known as special purpose entities. In the ordinary course of business, we lease certain real properties, primarily field sales offices, research and development facilities, and equipment.

**OUTLOOK FOR FISCAL 2009**

We expect revenues for the third quarter of fiscal 2009 to be approximately $220 million with net income per share in the range of $0.03 to $0.08. We expect revenues for the fiscal year ending January 31, 2009 to be approximately $915 million with net income per share in the range of $0.22 to $0.27.
Item 3. Quantitative and Qualitative Disclosures about Market Risk

(All numerical references in thousands, except for rate data, and percentages)

INTEREST RATE RISK

We are exposed to interest rate risk primarily through our investment portfolio, short-term borrowings, and long-term notes payable. We do not use derivative financial instruments for speculative or trading purposes.

We place our investments in instruments that meet high quality credit standards, as specified in our investment policy. The policy also limits the amount of credit exposure to any one issuer and type of instrument. We do not expect any material loss with respect to our investment portfolio.

The table below presents the carrying amount and related weighted-average fixed interest rates for our investment portfolio. The carrying amount approximates fair value as of July 31, 2008. In accordance with our investment policy, all short-term investments mature in twelve months or less.

<table>
<thead>
<tr>
<th>Principal (notional) amounts in United States dollars</th>
<th>Carrying Amount</th>
<th>Average Fixed Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash equivalents – fixed rate</td>
<td>$41,196</td>
<td>2.32%</td>
</tr>
<tr>
<td>Short-term investments – fixed rate</td>
<td>11,363</td>
<td>2.51%</td>
</tr>
<tr>
<td>Restricted cash – fixed rate</td>
<td>5,910</td>
<td>2.09%</td>
</tr>
<tr>
<td><strong>Total fixed rate interest bearing instruments</strong></td>
<td><strong>$58,469</strong></td>
<td><strong>2.33%</strong></td>
</tr>
</tbody>
</table>

We had convertible subordinated debentures of $165,000 outstanding with a fixed interest rate of 6.25% as of July 31, 2008. For fixed rate debt, interest rate changes affect the fair value of the debentures but do not affect earnings or cash flow.

We had floating rate convertible subordinated debentures of $36,102 outstanding with a variable interest rate of 3-month LIBOR plus 1.65% as of July 31, 2008. For variable interest rate debt, interest rate changes affect earnings and cash flow. If the interest rates on the variable rate borrowings were to increase or decrease by 1% for the year and the level of borrowings outstanding remained constant, annual interest expense would increase or decrease by approximately $361.

As of July 31, 2008, we had a syndicated, senior, unsecured, revolving credit facility, which expires on June 1, 2011. Borrowings under the revolving credit facility are permitted to a maximum of $140,000. Under this revolving credit facility, we have the option to pay interest based on: (i) LIBOR with varying maturities which are commensurate with the borrowing period we select, plus a spread of between 1.0% and 1.6%, or (ii) prime plus a spread of between 0.0% and 0.6%, based on a pricing grid tied to a financial covenant. As a result, our interest expense associated with borrowings under this revolving credit facility will vary with market interest rates. In addition, commitment fees are payable on the unused portion of the revolving credit facility at rates between 0.25% and 0.35% based on a pricing grid tied to a financial covenant. We paid commitment fees of $83 for the three months ended July 31, 2008 and $158 for the six months ended July 31, 2008 compared to $76 for the three months ended July 31, 2007 and $151 for the six months ended July 31, 2007. This revolving credit facility contains certain financial and other covenants, including financial covenants requiring the maintenance of specified liquidity ratios, leverage ratios, and minimum tangible net worth as well as restrictions on the payment of cash dividends. We had no borrowings during the six months ended July 31, 2008 and 2007. As of July 31, 2008 and January 31, 2008, there was no balance outstanding against this revolving credit facility.

We had short-term borrowings of $3,696 outstanding as of July 31, 2008 with variable rates based on market indexes. For variable rate debt, interest rate changes generally do not affect the fair market value, but do affect future earnings and cash flow. If the interest rates on the variable rate borrowings were to increase or decrease by 1% for the year and the level of borrowings outstanding remained constant, annual interest expense would increase or decrease by approximately $37.

FOREIGN CURRENCY RISK

We transact business in various foreign currencies and have established a foreign currency hedging program to hedge certain foreign currency forecasted transactions and exposures from existing assets and liabilities. Our derivative instruments consist of short-term foreign currency forward and option contracts. We enter into contracts with counterparties who are major financial institutions and believe the risk related to default is remote. We do not hold or issue derivative financial instruments for trading purposes.
We enter into foreign currency option contracts for forecasted revenues and expenses between our foreign subsidiaries. These instruments provide us the right to sell/purchase foreign currencies to/from third parties at future dates with fixed exchange rates. As of July 31, 2008, we had the following options outstanding:

- Japanese yen with contract values totaling $87,991 at a weighted average contract rate of 117.11 to hedge forecasted revenue exposures;
- Euro with contract values totaling $84,482 at a weighted average contract rate of 1.52 to hedge forecasted expense exposures; and
- British pound with contract values totaling $32,591 at a weighted average contract rate of 2.10 to hedge forecasted expense exposures.

We enter into foreign currency forward contracts to protect against currency exchange risk associated with expected future cash flows and existing assets and liabilities. Our practice is to hedge a majority of our existing material foreign currency transaction exposures.

The following table provides information as of July 31, 2008 about our foreign currency forward contracts. The information provided is in United States dollar equivalent amounts. The table presents the notional amounts, at contract exchange rates, and the weighted average contractual foreign currency exchange rates. These contracts mature within the year ending January 31, 2009.

<table>
<thead>
<tr>
<th>Currency</th>
<th>Notional Amount</th>
<th>Weighted Average Contract Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Euro</td>
<td>$57,454</td>
<td>0.65</td>
</tr>
<tr>
<td>Japanese Yen</td>
<td>35,341</td>
<td>105.89</td>
</tr>
<tr>
<td>British Pound</td>
<td>14,823</td>
<td>0.51</td>
</tr>
<tr>
<td>Swedish Krona</td>
<td>10,625</td>
<td>5.97</td>
</tr>
<tr>
<td>Indian Rupee</td>
<td>10,194</td>
<td>42.72</td>
</tr>
<tr>
<td>Taiwan Dollar</td>
<td>6,634</td>
<td>30.22</td>
</tr>
<tr>
<td>Canadian Dollar</td>
<td>4,391</td>
<td>1.00</td>
</tr>
<tr>
<td>Swiss Franc</td>
<td>3,044</td>
<td>1.02</td>
</tr>
<tr>
<td>Danish Krone</td>
<td>2,136</td>
<td>4.71</td>
</tr>
<tr>
<td>Polish Zloty</td>
<td>1,748</td>
<td>2.03</td>
</tr>
<tr>
<td>Singapore Dollar</td>
<td>1,213</td>
<td>1.35</td>
</tr>
<tr>
<td>Other</td>
<td>2,922</td>
<td>—</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$150,525</strong></td>
<td></td>
</tr>
</tbody>
</table>
Item 4. Controls and Procedures

(1) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934 (Exchange Act), that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level as of the end of the period covered by this report.

(2) Changes in Internal Controls Over Financial Reporting

There has been no change in our internal control over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.
PART II. OTHER INFORMATION

Item 1A. Risk Factors

The forward-looking statements contained under “Outlook for Fiscal 2009” in Part I, Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and all other statements contained in this report that are not statements of historical fact, including without limitation, statements containing the words “believes,” “expects,” “projections” and words of similar meaning, constitute forward-looking statements that involve a number of risks and uncertainties that are difficult to predict. Moreover, from time to time, we may issue other forward-looking statements. Forward-looking statements regarding financial performance in future periods, including the statements under “Outlook for Fiscal 2009,” do not reflect potential impacts of mergers or acquisitions or other significant transactions or events that have not been announced as of the time the statements are made. Actual outcomes and results may differ materially from what is expressed or forecast in forward-looking statements. We disclaim any obligation to update forward-looking statements to reflect future events or revised expectations. Our business faces many risks, and set forth below are some of the factors that could cause actual results to differ materially from the results expressed or implied by our forward-looking statements. Forward-looking statements should be considered in light of these factors.

Weakness in the United States (U.S.) and international economies may harm our business.

The Company’s revenue levels are generally dependent on the level of technology capital spending, which includes worldwide expenditures for electronic design automation (EDA) software, hardware, and consulting services. The U.S. and international economies are cyclical and experience periodic economic downturns, which could have a material adverse affect on our results of operations. Weakness in these economies could materially adversely impact the timing and receipt of orders for our products and our results of operations. Weakness could also result in reduced growth, or even negative growth, in the revenue we obtain upon renewals of software term contracts with existing customers.

Our forecasts of our revenues and earnings outlook may be inaccurate.

Our revenues, particularly new software license revenues, are difficult to forecast. We use a “pipeline” system, a common industry practice, to forecast revenues and trends in our business. Sales personnel monitor the status of potential business and estimate when a customer will make a purchase decision, the dollar amount of the sale and the products or services to be sold. These estimates are aggregated periodically to generate a sales pipeline. Our pipeline estimates may prove to be unreliable either in a particular quarter or over a longer period of time, in part because the “conversion rate” of the pipeline into contracts can be very difficult to estimate and requires management judgment. A variation in the conversion rate could cause us to plan or budget incorrectly and materially adversely impact our business or our planned results of operations. In particular, a slowdown in customer spending or weak economic conditions generally can reduce the conversion rate in a particular quarter as purchasing decisions are delayed, reduced in amount or cancelled. The conversion rate can also be affected by the tendency of some of our customers to wait until the end of a fiscal quarter attempting to obtain more favorable terms.

Our business could be impacted by fluctuations in quarterly results of operations due to customer seasonal purchasing patterns, the timing of significant orders, and the mix of licenses and products purchased by our customers.

We have experienced, and may continue to experience, varied quarterly operating results. Various factors affect our quarterly operating results and some of these are not within our control, including customer demand and the timing of significant orders. We typically experience seasonality in demand for our products, due to the purchasing cycles of our customers, with revenues in the fourth quarter generally being the highest. In fiscal 2009, we expect revenues to be unusually back-end loaded in the second half of the year, due primarily to planned renewals of existing term contracts with large customers. If these planned contract renewals are delayed or the average size of renewed contracts do not increase as we anticipate, we could fail to meet investors’ expectations, which could have a material adverse impact on our stock price.

Our revenues are also affected by the mix of licenses entered into where we recognize software revenues as payments become due and payable, on a cash basis, or ratably over the license term as compared to revenues recognized at the beginning of the license term. We recognize revenues ratably over the license term, for instance, when the customer is provided with rights to unspecified or unreleased future products. A shift in the license mix toward increased ratable, due and payable and/or cash-based revenue recognition could result in increased deferral of software revenues to future periods and would decrease current revenues, which could result in us not meeting near-term revenue expectations.

The gross margin on our software is greater than that for our hardware emulation systems, software support and professional services. Therefore, our gross margin may vary as a result of the mix of products and services sold. We also have a significant amount of fixed or relatively fixed costs, such as employee costs and purchased technology amortization, and
costs which are committed in advance and can only be adjusted periodically. As a result, a small failure to reach planned revenues would likely have a relatively large negative effect on resulting earnings. If anticipated revenues do not materialize as expected, our gross margins and operating results could be materially adversely impacted.

*We face intense competition in the EDA industry.*

Competition in the EDA industry is intense, which can lead to, among other things, price reductions, longer selling cycles, lower product margins, loss of market share, and additional working capital requirements. If our competitors offer significant discounts on certain products, we may need to lower our prices or offer other favorable terms in order to compete successfully. Any such changes would likely reduce margins and could materially adversely impact our operating results. Any broad-based changes to our prices and pricing policies could cause new software license and service revenues to decline or be delayed as the sales force implements and our customers adjust to the new pricing policies. Some of our competitors may bundle certain software products at low prices for promotional purposes or as a long-term pricing strategy. These practices could significantly reduce demand for our products or constrain prices we can charge.

We currently compete primarily with two large companies: Cadence Design Systems, Inc. (Cadence) and Synopsys, Inc. We also compete with numerous smaller companies and compete with manufacturers of electronic devices that have developed their own EDA products internally.

*Our international operations and the effects of foreign currency fluctuations expose us to additional risks.*

We generate nearly two-thirds of our revenues from customers outside the U.S. and we generate approximately one-third of our expenses outside the U.S. Significant changes in currency exchange rates could have an adverse impact on us. For further discussion of foreign currency effects, see “Effects of Foreign Currency Fluctuations” discussion in Part I, Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” In addition, international operations subject us to other risks including longer receivables collection periods, changes in a specific country’s or region’s economic or political conditions, trade protection measures, local labor laws, import or export licensing requirements, loss or modification of exemptions for taxes and tariffs, limitations on repatriation of earnings, and difficulties with licensing and protecting our intellectual property rights.

We derive a substantial portion of our revenues from relatively few product groups.

We derive a substantial portion of our revenues from sales of relatively few product groups and related support services. As such, any factor adversely affecting sales of these products, including the product release cycles, market acceptance, product competition, performance and reliability, reputation, price competition, and economic and market conditions, would likely harm our operating results.

We are subject to the cyclical nature of the integrated circuit (IC) and electronics systems industries.

Purchases of our products and services are highly dependent upon new design projects initiated by customers in the IC and electronics systems industries. These industries are highly cyclical and are subject to constant and rapid technological change, rapid product obsolescence, price erosion, evolving standards, short product life cycles, and wide fluctuations in product supply and demand. The IC and electronics systems industries regularly experience significant downturns, often connected with, or in anticipation of, maturing product cycles within such companies or a decline in general economic conditions. These downturns could cause diminished product demand, production overcapacity, high inventory levels, and accelerated erosion of average selling prices.

Customer payment defaults could harm our business.

We use fixed-term license agreements as a standard business practice with customers we believe are credit-worthy. These multi-year, multi-element term license agreements have payments spread over the license term and are typically about three years in length for semiconductor companies and about four years in length for military and aerospace companies. The complexity of these agreements tends to increase the risk associated with collectibility from customers that can arise for a variety of reasons including ability to pay, product dissatisfaction, disagreements, and disputes. If we are unable to collect under these agreements, our results of operations could be materially adversely impacted. We use these fixed-term license agreements as a standard business practice and have a history of successfully collecting under the original payment terms without making concessions on payments, products, or services. If we no longer had a history of collecting without providing concessions on the terms of the agreements, then revenue would be required to be recognized as the payments become due and payable over the license term. This change could have a material impact on our results.
IC and printed circuit board (PCB) technology evolves rapidly.

The complexity of ICs and PCBs continues to rapidly increase. In response to this increasing complexity, new design tools and methodologies must be invented or acquired quickly to remain competitive. If we fail to quickly respond to new technological developments, our products could become obsolete or uncompetitive, which could materially adversely impact our business.

Errors or defects in our products and services could expose us to liability and harm our reputation.

Our customers use our products and services in designing and developing products that involve a high degree of technological complexity and have unique specifications. Due to the complexity of the systems and products with which we work, some of our products and designs can be adequately tested only when put to full use in the marketplace. As a result, our customers or their end users may discover errors or defects in our software or the systems we design, or the products or systems incorporating our designs 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 resolve the problems resulting from errors or defects; and
- Increased support or service costs.

In addition, we include third party technology in our products and we rely on those third parties to provide support services to us. Failure of those third parties to provide necessary support services could materially adversely impact our business.

Long sales cycles and delay in customer completion of projects make the timing of our revenues difficult to predict.

We have a lengthy sales cycle that generally extends between three and six months. A lengthy customer evaluation and approval process is generally required due to the complexity and expense associated with our products and services. Consequently, we may incur substantial expenses and devote significant management effort and expense to develop potential relationships that do not result in agreements or revenues 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 due to customers’ budgetary constraints, internal acceptance review procedures, timing of budget cycles, or timing of competitive evaluation processes.

Disruptions of our indirect sales channel could affect our future operating results.

Our indirect sales channel is comprised primarily of independent distributors and sales representatives. Our relationships with these channel participants are important elements of our marketing and sales efforts. Our financial results could be adversely affected if our contracts with channel participants were terminated, if our relationships with channel participants were to deteriorate, if any of our competitors enter into strategic relationships with or acquire a significant channel participant, or if the financial condition of our channel participants were to weaken. In addition, we recently changed from a territory-based sales organization to an account-based organization with an increased emphasis upon our distributors and sales representatives. If this transition takes longer than expected to fully implement, it could adversely affect our financial results in the short-term.

Any loss of our leadership position in certain segments of the EDA market could harm our business.

The industry in which we compete is characterized by very strong leadership positions in specific segments of the EDA market. For example, one company may enjoy a large percentage of sales in the physical verification segment of the market while another will have a similarly strong position in mixed-signal simulation. These strong leadership positions can be maintained for significant periods of time as the software is difficult to master and customers are disinclined to make changes once their employees, as well as others in the industry, have developed familiarity with a particular software product. For these reasons, much of our profitability arises from niche areas in which we are the leader. Conversely, it is difficult for us to achieve significant profits in niche areas where other companies are the leaders. If for any reason we lose our leadership position in a niche, we could be materially adversely impacted.

Accounting rules governing revenue recognition are complex and may change.

The accounting rules governing software revenue recognition are complex and have been subject to authoritative interpretations that have generally made it more difficult to recognize software revenues at the beginning of the license period. If this trend continues, new and revised standards and interpretations could materially adversely impact our ability to meet near-term revenue expectations.
If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings.

Under U.S. generally accepted accounting principles, we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, reduced future cash flow estimates, and slower growth rates in our industry. We could be required to record a significant charge to earnings in our financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, which could materially adversely impact our results of operations.

We may have additional tax liabilities.

Significant judgments and estimates are required in determining the provision for income taxes and other tax liabilities. Our tax expense may be impacted if our intercompany transactions, which are required to be computed on an arm’s-length basis, are challenged and successfully disputed by the tax authorities. Also, our tax expense could be impacted depending on the applicability of withholding taxes on software licenses and related intercompany transactions in certain jurisdictions. In determining the adequacy of income taxes, we assess the likelihood of adverse outcomes resulting from the Internal Revenue Service (IRS) and other tax authorities’ examinations. The IRS and tax authorities in countries where we do business regularly examine our tax returns. The ultimate outcome of these examinations cannot be predicted with certainty. Should the IRS or other tax authorities assess additional taxes as a result of examinations, we may be required to record charges to operations that could have a material impact on the results of operations, financial position or cash flows. We were issued a Revenue Agent’s Report in March 2007. See “Provision for Income Taxes” in Part I, Item 2. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for additional discussion.

Forecasting our income tax rate is complex and subject to uncertainty.

The computation of income tax expense is complex as it is based on the laws of numerous taxing jurisdictions and requires significant judgment on the application of complicated rules governing accounting for tax provision under U.S. generally accepted accounting principles. Income tax expense (benefit) for interim quarters is based on a forecast of our global tax rate for the year, which includes forward looking financial projections, including the expectations of profit and loss by jurisdiction, and contains numerous assumptions. Various items cannot be accurately forecasted, and may be treated as discrete accounting. Examples of items which could cause variability in the rate include tax deductions for stock option expense, application of transfer pricing rules and changes in our valuation allowance for deferred tax assets. Future events, such as changes in our business and the tax law in the jurisdictions where we do business, could also affect our rate. For these reasons, our global tax rate may be materially different than our forecast.

There are limitations on the effectiveness of controls.

We do not expect that disclosure controls or internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Failure of our control systems to prevent error or fraud could materially adversely impact us.

We may not realize revenues as a result of our investments in research and development.

We incur substantial expense to develop new software products. Research and development activities are often performed over long periods of time. This effort may not yield a successful product offering or the product may not satisfy customer requirements. As a result, we could realize little or no revenues related to our investment in research and development.

We may acquire other companies and may not successfully integrate them.

The industry in which we compete has seen significant consolidation in recent years. During this period, we have acquired numerous businesses and have frequently been in discussions with potential acquisition candidates, and we may acquire other businesses in the future. While we expect to carefully analyze all potential transactions before committing to them, we cannot assure that any transaction that is completed will result in long-term benefits to us or our shareholders or that we 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 we acquire another business, it could materially adversely impact us:

- Difficulties in combining previously separate businesses into a single unit;
The substantial diversion of management’s attention from ongoing business when integrating the acquired business;

The discovery after the acquisition has been completed of previously unknown liabilities assumed with the acquired business;

The failure to realize anticipated benefits, such as cost savings and increases in revenues;

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;

Unanticipated litigation in connection with or as a result of an acquisition, including claims from terminated employees, customers, or third parties;

Adverse impacts on existing relationships with suppliers and customers; and

Failure to understand and compete effectively in markets in which we have limited experience.

Acquired businesses may not perform as projected, which could result in impairment of acquisition-related intangible assets. Additional challenges include integration of sales channels, training and education of the sales force for new product offerings, integration of product development efforts, integration of systems of internal controls, and integration of information systems. Accordingly, in any acquisition there will be uncertainty as to the achievement and timing of projected synergies, cost savings, and sales levels for acquired products. All of these factors could impair our ability to forecast, meet revenues and earnings targets, and manage effectively our business for long-term growth. We cannot assure that we can effectively meet these challenges.

Supply problems for our emulation hardware systems could harm our business.

The success of our emulation hardware systems depends on our ability to:

- Procure hardware components on a timely basis from a limited number of suppliers;
- Create stable software for use on the product;
- Assemble and ship hardware and software systems on a timely basis with appropriate quality control;
- Develop distribution and shipment processes;
- Manage inventory and related obsolescence issues; and
- Develop processes to deliver customer support for hardware.

Our inability to be successful in any of the foregoing could materially adversely impact us.

We generally commit to purchase component parts from suppliers based on sales forecasts of our emulation hardware system. If we cannot change or be released from these non-cancelable purchase commitments, and if orders for our products do not materialize, we could incur significant costs related to the purchase of excess components which could become obsolete before we could use them. Additionally, a delay in production of the components or inaccuracy in our sales forecast could materially adversely impact our operating results if we are unable to timely ship ordered products or provide replacement parts under warranty or maintenance contracts.

We may not adequately protect our proprietary rights or we may fail to obtain software or other intellectual property licenses.

Our success depends, in large part, upon our proprietary technology. We generally rely on patents, copyrights, trademarks, trade secret laws, licenses, and restrictive agreements to establish and protect our proprietary rights in technology and products. Despite precautions we may take to protect our intellectual property, we cannot assure that third parties will not try to challenge, invalidate, or circumvent these protections. The companies in the EDA industry, as well as entities and persons outside the industry, are obtaining patents at a rapid rate. Many of these entities have substantially larger patent portfolios than we have. As a result, we may on occasion be forced to engage in costly patent litigation to protect our rights or defend our customers’ rights. We may also need to settle these claims on terms that are unfavorable; such settlements could result in the payment of significant damages or royalties, or force us to stop selling or redesign one or more products. We cannot assure that the rights granted under our patents will provide us with any competitive advantage, that patents will be issued on any of our pending applications, or that future patents will be sufficiently broad to protect our technology. Furthermore, the laws of foreign countries may not protect our proprietary rights in those countries to the same extent as U.S. law protects these rights in the U.S.
Some of our products include software or other intellectual property licensed from third parties, and we may have to seek new licenses or renew existing licenses for software and other intellectual property in the future. Failure to obtain software or other intellectual property licenses or rights from third parties on favorable terms could materially adversely impact us.

**Litigation may materially adversely impact us.**

Litigation may result in monetary damages, injunctions against future product sales, and substantial unanticipated legal costs and divert the efforts of management personnel, any and all of which could materially adversely impact us.

**Third parties may claim infringement or misuse of intellectual property rights.**

We periodically receive notices from others claiming infringement, or other misuse of their intellectual property rights or breach of our agreements with them. We expect the number of such claims will increase as the number of products and competitors in our industry segments grows, the functionality of products overlap, the use and support of third-party code (including open source code) becomes more prevalent in the software industry and the volume of issued software patents continues to increase. Responding to any such claim, regardless of its validity, could:

- Be time-consuming, costly and/or result in litigation;
- Divert management’s time and attention from developing our business;
- Require us to pay monetary damages or enter into royalty and licensing agreements that we would not normally find acceptable;
- Require us to stop selling or to redesign certain of our products;
- Require us to release source code to third parties, possibly under open source license terms;
- Require us to satisfy indemnification obligations to our customers; or
- Otherwise adversely affect our business, results of operations, financial condition, or cash flows.

**Our failure to attract and retain key employees may harm us.**

We depend on the efforts and abilities of our senior management, our research and development staff, and a number of other key management, sales, support, technical and services personnel. Competition for experienced, high-quality personnel is intense, and we cannot assure that we can continue to recruit and retain such personnel. Cadence’s public announcement of its unsolicited proposal to acquire all of our outstanding shares, even though subsequently withdrawn, created uncertainty for our employees, which may in the short-term adversely affect our ability to retain key employees and hire new employees. Our failure to hire and retain such personnel could impair our ability to develop new products and manage our business effectively.

**Terrorist attacks and other acts of violence or war may materially adversely impact the markets on which our securities trade, the markets in which we operate, our operations, and our profitability.**

Terrorist attacks may negatively affect our operations and investment in our business. These attacks or armed conflicts may directly impact our physical facilities or those of our suppliers or customers. Furthermore, these attacks may make travel more difficult and expensive and ultimately affect our revenues.

Any armed conflict entered into by the U.S. could have an adverse impact on our revenues and our ability to deliver products to our customers. Political and economic instability in some regions of the world may also result from an armed conflict and could negatively impact our business. We currently have operations in Pakistan, Egypt, and Israel, countries that may be particularly susceptible to this risk. The consequences of any armed conflict are unpredictable, and we may not be able to foresee events that could have an adverse impact on us.

More generally, any of these events could cause consumer confidence and spending to decrease or result in increased volatility in the U.S. and worldwide financial markets and economy. They also could result in economic recession in the U.S. or abroad. Any of these occurrences could have a significant impact on our operating results, revenues, and costs and could result in volatility of the market price for our common stock.

**Our articles of incorporation, Oregon law, and our shareholder rights plan may have anti-takeover effects.**

Our board of directors has the authority, without action by the shareholders, to designate and issue up to 1,200,000 shares of incentive stock in one or more series and to designate the rights, preferences, and privileges of each series without any further vote or action by the shareholders. Additionally, the Oregon Control Share Act and the Business Combination Act limit the ability of parties who acquire a significant amount of voting stock to exercise control over us. These provisions may have the
effect of lengthening the time required to acquire control of us through a proxy contest or the election of a majority of the board of
directors. In February 1999, we adopted a shareholder rights plan, which has the effect of making it more difficult for a person to
acquire control of us in a transaction not approved by our board of directors. The potential issuance of incentive stock, the provisions
of the Oregon Control Share Act and the Business Combination Act, and our shareholder rights plan could have the effect of
delaying, deferring, or preventing a change of control of us, could discourage bids for our common stock at a premium over the
market price of our common stock and could materially adversely impact the market price of, and the voting and other rights of the
holders of, our common stock.

We have a substantial level of indebtedness.
As of July 31, 2008, we had $207 million of outstanding indebtedness, which includes $36 million of Floating Rate Convertible
Subordinated Debentures (Floating Rate Debentures) due 2023, $165 million of 6.25% Convertible Subordinated Debentures (6.25%
Debentures) due 2026, and $6 million in short-term borrowings. This level of indebtedness among other things could:

• Make it difficult for us to satisfy our payment obligations on our debt;
• Make it difficult for us to incur additional indebtedness or obtain any necessary financing in the future for working capital,
capital expenditures, debt service, acquisitions, or general corporate purposes;
• Limit our flexibility in planning for or reacting to changes in our business;
• Reduce funds available for use in our operations;
• Make us more vulnerable in the event of a downturn in our business;
• Make us more vulnerable in the event of an increase in interest rates if we must incur new debt to satisfy our obligations
under the Floating Rate Debentures and 6.25% Debentures; or
• Place us at a possible competitive disadvantage relative to less leveraged competitors and competitors that have greater access
capital resources.

If we experience a decline in revenues, we could have difficulty paying amounts due on our indebtedness. Any default under our
indebtedness could have a material adverse impact on our business, operating results, and financial condition.

Our stock price could become more volatile, and your investment could lose value.
All of the factors discussed in this section could affect our stock price. The timing of announcements in the public market regarding
new products, product enhancements, or technological advances by our competitors or us, and any announcements by us of
acquisitions, major transactions, or management changes could also affect our stock price. Our stock price is subject to speculation in
the press and the analyst community, changes in recommendations or earnings estimates by financial analysts, changes in investors’
or analysts’ valuation measures for our stock, our credit ratings, and market trends unrelated to our performance. As a result of
Cadence’s unsolicited acquisition proposal, and its subsequent withdrawal, the future trading price of our stock in the short-term may
be subject to wide price fluctuations. A significant drop in our stock price could also expose us to the risk of securities class actions
lawsuits, which could result in substantial costs and divert management’s attention and resources, which could adversely affect our
business.

48
Item 4. Submission of Matters to a Vote of Security Holders

Our 2008 Annual Meeting of Shareholders was held pursuant to notice at 5:00 p.m. Pacific time on June 19, 2008 at our offices in Wilsonville, Oregon to consider and vote upon:

Proposal 1 To elect directors to serve for the ensuing year and until their successors are elected;
Proposal 2 To amend the Company’s 1989 Employee Stock Purchase Plan and Foreign Subsidiary Employee Stock Purchase Plan to increase the number of shares reserved for issuance under each of the plans; and
Proposal 3 To ratify the appointment of KPMG LLP as the Company’s independent registered public accounting firm for the fiscal year ending January 31, 2009.

The results of the voting on these proposals were as follows:

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<thead>
<tr>
<th>Proposal 1</th>
<th>For</th>
<th>Withheld</th>
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<tbody>
<tr>
<td>Election of Directors</td>
<td></td>
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<tr>
<td>Marsha B. Congdon</td>
<td>79,164,126</td>
<td>7,146,986</td>
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<td>Gregory K. Hinckley</td>
<td>83,096,210</td>
<td>3,214,902</td>
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<tr>
<td>Kevin C. McDonough</td>
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<td>7,006,468</td>
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<tr>
<td>Walden C. Rhines</td>
<td>82,874,232</td>
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<td>Fontaine K. Richardson</td>
<td>80,144,714</td>
<td>6,166,398</td>
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<tr>
<td>Sir Peter Bonfield</td>
<td>81,584,618</td>
<td>4,726,494</td>
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<tr>
<td>James R. Fiebig</td>
<td>81,445,314</td>
<td>4,865,798</td>
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<tr>
<td>Patrick B. McManus</td>
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<tr>
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<th>For</th>
<th>Against</th>
<th>Abstentions</th>
<th>Broker Non-Votes</th>
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<th>Proposal 3</th>
<th>For</th>
<th>Against</th>
<th>Abstentions</th>
<th>Broker Non-Votes</th>
</tr>
</thead>
<tbody>
<tr>
<td>86,179,521</td>
<td>43,444</td>
<td>88,146</td>
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<td></td>
</tr>
</tbody>
</table>
Item 6. Exhibits

10.I Form of Indemnity Agreement entered into between the Company and each of its executive officers and current and future directors.

10.J Form of Severance Agreements entered into between the Company and certain executive officers.

10.K Retention Bonus Plan entered into between the Company and designated key employees of the Company.

18. Letter from Independent Registered Public Accounting Firm re: Change in Accounting Principle.

31.1 Certification of Chief Executive Officer of Registrant Pursuant to SEC Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer of Registrant Pursuant to SEC Rule 13a-14(a)/15d-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32 Certifications of Chief Executive Officer and Chief Financial Officer of Registrant Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
SIGNATURES

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

Dated: September 4, 2008

MENTOR GRAPHICS CORPORATION
(Registrant)

/S/ MARIA M. POPE
Maria M. Pope
Vice President and Chief Financial Officer

51
INDEMNITY AGREEMENT

THIS INDEMNITY AGREEMENT (this “Agreement”) is made as of _______, 2008, by and between Mentor Graphics Corporation, an Oregon corporation (the “Company”), and __________ (“Indemnitee”).

RECITALS

WHEREAS, highly competent persons have become more reluctant to serve publicly-held corporations as directors, officers or in other capacities unless they are provided with adequate protection through insurance or adequate indemnification against inordinate risks of claims and actions against them arising out of their service to and activities on behalf of the corporation.

WHEREAS, the Board of Directors of the Company (the “Board”) has determined that, in order to attract and retain qualified individuals, the Company will attempt to maintain on an ongoing basis, at its sole expense, liability insurance to protect persons serving the Company and its subsidiaries from certain liabilities. Although the furnishing of such insurance has been a customary and widespread practice among U.S.-based corporations and other business enterprises, the Company believes that, given current market conditions and trends, such insurance may be available to it in the future only at higher premiums and with more exclusions. At the same time, directors, officers and other persons in service to corporations or business enterprises are being increasingly subjected to expensive and time-consuming litigation relating to, among other things, matters that traditionally would have been brought only against the Company or business enterprise itself. The Company’s amended and restated articles of incorporation (the “Articles”) permit, and the Company’s bylaws (the “Bylaws”) require, indemnification of the officers and directors of the Company. Indemnitee may also be entitled to indemnification pursuant to applicable provisions of the Oregon Business Corporation Act (the “Act”). The Articles, Bylaws and the Act expressly provide that the indemnification provisions set forth therein are not exclusive, and thereby contemplate that contracts may be entered into between the Company and members of the board of directors, officers and other persons in order to protect such persons against claims and expenses arising from their services on behalf of the Company.

WHEREAS, the uncertainties relating to such insurance and to indemnification have increased the difficulty of attracting and retaining such persons.

WHEREAS, the Board has determined that the increased difficulty in attracting and retaining such persons is detrimental to the best interests of the Company’s stockholders and that the Company should act to assure such persons that there will be increased certainty of such protection in the future.

WHEREAS, it is reasonable, prudent and necessary for the Company contractually to obligate itself to indemnify, hold harmless, exonerate and to advance expenses on behalf of, such persons to the fullest extent permitted by applicable law so that they will serve or continue to serve the Company free from undue concern that they will not be so protected against liabilities.

WHEREAS, this Agreement is a supplement to and in furtherance of the Bylaws of the Company and any resolutions adopted pursuant thereto, and shall not be deemed a substitute therefor, nor to diminish or abrogate any rights of Indemnitee thereunder.

WHEREAS, Indemnitee does not regard the protection available under the Bylaws and liability insurance as adequate in the present circumstances, and may not be willing to serve as an employee or director without adequate protection, and the Company desires Indemnitee to serve in such capacity. Indemnitee is willing to serve, continue to serve and to take on additional service for or on behalf of the Company on the condition that he be so indemniﬁed.

NOW, THEREFORE, in consideration of the premises and the covenants contained herein, the Company and Indemnitee do hereby covenant and agree as follows:

TERMS AND CONDITIONS

1. SERVICES TO THE COMPANY. Indemnitee will agree to serve or to continue to serve as an employee or director of the Company for so long as Indemnitee is duly elected or appointed or until Indemnitee tenders his resignation. Nothing contained in this Agreement shall be construed as giving Indemnitee any right to be retained in the employ of the Company or any of its subsidiaries or affiliated entities.
2. DEFINITIONS. As used in this Agreement:

(a) References to “agent” shall mean any individual who is or was a director, officer, or employee of the Company or a Subsidiary of the Company or other individual authorized by the Company to act for the Company, to include such individual serving in such capacity as a director, officer, employee, fiduciary or other official of another corporation, partnership, limited liability company, joint venture, trust or other Enterprise (as defined below) at the request of, for the convenience of, or to represent the interests of, the Company or a subsidiary of the Company.

(b) The terms “Beneficial Owner” and “Beneficial Ownership” shall have the meanings set forth in Rule 13d-3 promulgated under the Exchange Act (as defined below) as in effect on the date hereof.

(c) A “Change in Control” shall be deemed to occur upon the earliest to occur after the date of this Agreement of any of the following events:

   (i) Acquisition of Stock by Third Party. Any Person (as defined below) is or becomes the Beneficial Owner, directly or indirectly, of securities of the Company representing fifteen percent (15%) or more of the combined voting power of the Company’s then outstanding securities entitled to vote generally in the election of directors, unless (1) the change in the relative Beneficial Ownership of the Company’s securities by any Person results solely from a reduction in the aggregate number of outstanding shares of securities entitled to vote generally in the election of directors, or (2) such acquisition was approved in advance by the Continuing Directors (as defined below) and such acquisition would not constitute a Change in Control under part (iii) of this definition;

   (ii) Change in Board of Directors. Individuals who, as of the date hereof, constitute the Board, and any new director whose election by the Board or nomination for election by the Company’s stockholders was approved by a vote of at least two thirds of the directors then still in office who were directors on the date hereof or whose election for nomination for election was previously so approved (collectively, the “Continuing Directors”), cease for any reason to constitute at least a majority of the members of the Board;

   (iii) Corporate Transactions. The effective date of a reorganization, merger or consolidation of the Company (a “Business Combination”), in each case, unless, immediately following such Business Combination: (1) all or substantially all of the Persons who were the Beneficial Owners of securities entitled to vote generally in the election of directors immediately prior to such Business Combination beneficially own, directly or indirectly, more than 51% of the combined voting power of the then outstanding securities of the Company entitled to vote generally in the election of directors resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction owns the Company or all or substantially all of the Company’s assets either directly or through one or more Subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination, of the securities entitled to vote generally in the election of directors; (2) no Person (excluding any corporation resulting from such Business Combination) is the Beneficial Owner, directly or indirectly, of 15% or more of the combined voting power of the then outstanding securities entitled to vote generally in the election of directors of such corporation except to the extent that such ownership existed prior to such Business Combination; and (3) at least a majority of the Board of Directors of the corporation resulting from such Business Combination were Continuing Directors at the time of the execution of the initial agreement, or of the action of the Board of Directors, providing for such Business Combination;

   (iv) Liquidation. The approval by the stockholders of the Company of a complete liquidation of the Company or an agreement or series of agreements for the sale or disposition by the Company of all or substantially all of the Company’s assets, other than factoring the Company’s current receivables or escrows due (or, if such approval is not required, the decision by the Board to proceed with such a liquidation, sale, or disposition in one transaction or a series of related transactions); or

   (v) Other Events. There occurs any other event of a nature that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A (or a response to any similar item on any similar schedule or form) promulgated under the Exchange Act, whether or not the Company is then subject to such reporting requirement.

(d) “Corporate Status” describes the status of an individual who is or was a director, officer, trustee, general partner, managing member, fiduciary, employee or agent of the Company or of any other Enterprise which such individual is or was serving at the request of the Company.

(e) “Oregon Court” shall mean a Circuit Court of the State of Oregon.
(f) “Disinterested Director” shall mean a director of the Company who is not and was not a party to the Proceeding (as defined below) in respect of which indemnification is sought by Indemnitee.

(g) “Enterprise” shall mean the Company and any other corporation, constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger to which the Company (or any of its wholly owned subsidiaries) is a party, limited liability company, partnership, joint venture, trust, employee benefit plan or other enterprise of which Indemnitee is or was serving at the request of the Company as a director, officer, trustee, general partner, managing member, fiduciary, employee or agent.


(i) “Expenses” shall include all direct and indirect costs, fees and expenses of any type or nature whatsoever, including, without limitation, all attorneys’ fees and costs, retainers, court costs, transcript costs, fees of experts, witness fees, travel expenses, fees of private investigators and professional advisors, duplicating costs, printing and binding costs, telephone charges, postage, delivery service fees, fax transmission charges, secretarial services and all other disbursements, obligations or expenses in connection with prosecuting, defending, preparing to prosecute or defend, investigating, being or preparing to be a witness in, settlement or appeal of, or otherwise participating in, a Proceeding, including, without limitation, reasonable compensation for time spent by the Indemnitee for which he or she is not otherwise compensated by the Company or any third party. Expenses also shall include Expenses incurred in connection with any appeal resulting from any Proceeding, including, without limitation, the principal, premium, security for, and other costs relating to any cost bond, supersedeas bond, or other appeal bond or its equivalent. Expenses, however, shall not include amounts paid in settlement by Indemnitee or the amount of judgments or fines against Indemnitee.

(j) “Independent Counsel” shall mean a law firm or a member of a law firm with significant experience in matters of corporation law and neither presently is, nor in the past five years has been, retained to represent: (i) the Company or Indemnitee in any matter material to either such party (other than as “Independent Counsel” under this Agreement or under similar indemnification agreements); or (ii) any other party to the Proceeding giving rise to a claim for indemnification hereunder. Notwithstanding the foregoing, the term “Independent Counsel” shall not include any person who, under the applicable standards of professional conduct then prevailing, would have a conflict of interest in representing either the Company or Indemnitee in an action to determine Indemnitee’s rights under this Agreement.

(k) References to “fines” shall include any excise tax assessed on Indemnitee with respect to any employee benefit plan; references to “serving at the request of the Company” shall include any service as a director, officer, employee, agent or fiduciary of the Company which imposes duties on, or involves services by, such director, officer, employee, agent or fiduciary with respect to an employee benefit plan, its participants or beneficiaries; and if Indemnitee acted in good faith and in a manner Indemnitee reasonably believed to be in the best interests of the participants and beneficiaries of an employee benefit plan, Indemnitee shall be deemed to have acted in a manner “not opposed to the best interests of the Company” as referred to in this Agreement.

(l) The term “Person” shall have the meaning as set forth in Sections 13(d) and 14(d) of the Exchange Act as in effect on the date hereof; provided, however, that “Person” shall exclude: (i) the Company; (ii) any Subsidiary of the Company; (iii) any employment benefit plan of the Company or of a Subsidiary of the Company or of any corporation owned, directly or indirectly, by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company; and (iv) any trustee or other fiduciary holding securities under an employee benefit plan of the Company or of a Subsidiary of the Company or of a corporation owned directly or indirectly by the stockholders of the Company in substantially the same proportions as their ownership of stock of the Company.

(m) A “Potential Change in Control” shall be deemed to have occurred if: (i) the Company enters into an agreement or arrangement, the consummation of which would result in the occurrence of a Change in Control; (ii) any Person or the Company publicly announces an intention to take or consider taking actions which, if consummated, would constitute a Change in Control; (iii) any Person who is or becomes the Beneficial Owner, directly or indirectly, of securities of the Company representing five percent (5%) or more of the combined voting power of the Company’s then outstanding securities entitled to vote generally in the election of directors increases his Beneficial Ownership of such securities by five percent (5%) or more over the percentage so owned by such Person on the date hereof unless such acquisition was approved in advance by the Board; or (iv) the Board adopts a resolution to the effect that, for purposes of this Agreement, a Potential Change in Control has occurred.
(n) The term “Proceeding” shall include any threatened, pending or completed action, suit, arbitration, mediation, alternate dispute resolution mechanism, investigation, inquiry, administrative hearing or any other actual, threatened or completed proceeding, whether brought in the right of the Company or otherwise and whether of a civil (including intentional or unintentional tort claims), criminal, administrative or investigative nature, in which Indemnitee was, is, will or might be involved as a party or otherwise by reason of the fact that Indemnitee is or was a director, officer, employee or agent of the Company, by reason of any action (or failure to act) taken by him or of any action (or failure to act) on his part while acting as a director, officer, employee or agent of the Company, or by reason of the fact that he is or was serving at the request of the Company as a director, officer, trustee, general partner, managing member, fiduciary, employee or agent of any other Enterprise, in each case whether or not serving in such capacity at the time any liability or expense is incurred for which indemnification, reimbursement, or advancement of expenses can be provided under this Agreement.

(o) The term “Subsidiary,” with respect to any Person, shall mean any corporation or other entity of which a majority of the voting power of the voting equity securities or equity interest is owned, directly or indirectly, by that Person.

(p) In connection with any merger or consolidation, references to the “Company” shall include not only the resulting or surviving company, but also any constituent company or constituent of a constituent company, which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, employees or agents. The intent of this provision is that a person who is or was a director of such constituent company after the date hereof or is or was serving at the request of such constituent company as a director, officer, employee, trustee or agent of another company, partnership, joint venture, trust, employee benefit plan or other Enterprise after the date hereof, shall stand in the same position under this Agreement with respect to the resulting or surviving company as the person would have under this Agreement with respect to such constituent company if its separate existence had continued.

3. INDEMNITY IN THIRD-PARTY PROCEEDINGS. The Company shall indemnify, hold harmless and exonerate Indemnitee in accordance with the provisions of this Section 3 if Indemnitee was, is, or is threatened to be made, a party to or a participant (as a witness or otherwise) in any Proceeding, other than a Proceeding by or in the right of the Company to procure a judgment in its favor. Pursuant to this Section 3, Indemnitee shall be indemnified, held harmless and exonerated against all Expenses, judgments, liabilities, fines, penalties and amounts paid in settlement (including, without limitation, all interest, assessments and other charges paid or payable in connection with or in respect of such Expenses, judgments, fines, penalties and amounts paid in settlement) actually and reasonably incurred by Indemnitee or on his behalf in connection with such Proceeding or any claim, issue or matter therein, if Indemnitee acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Company and, in the case of a criminal Proceeding, had no reasonable cause to believe that his conduct was unlawful.

4. INDEMNITY IN PROCEEDINGS BY OR IN THE RIGHT OF THE COMPANY. The Company shall indemnify, hold harmless and exonerate Indemnitee in accordance with the provisions of this Section 4 if Indemnitee was, is, or is threatened to be made, a party to or a participant (as a witness or otherwise) in any Proceeding by or in the right of the Company to procure a judgment in its favor. Pursuant to this Section 4, Indemnitee shall be indemnified, held harmless and exonerated against all Expenses actually and reasonably incurred by him or on his behalf in connection with such Proceeding or any claim, issue or matter therein, if Indemnitee acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Company. No indemnification, hold harmless or exoneration for Expenses shall be made under this Section 4 in respect of any claim, issue or matter as to which Indemnitee shall have been finally adjudged by a court to be liable to the Company, unless and only to the extent that any court in which the Proceeding was brought or the Oregon Court shall determine upon application that, despite the adjudication of liability but in view of all the circumstances of the case, Indemnitee is fairly and reasonably entitled to indemnification, to be held harmless or to exoneration.

5. INDEMNIFICATION FOR EXPENSES OF A PARTY WHO IS WHOLLY OR PARTLY SUCCESSFUL. Notwithstanding any other provisions of this Agreement, to the extent that Indemnitee is a party to (or a participant in) and is successful, on the merits or otherwise, in any Proceeding or in defense of any claim, issue or matter therein, in whole or in part, the Company shall indemnify, hold harmless and exonerate Indemnitee against all Expenses actually and reasonably incurred by him in connection therewith. If Indemnitee is not wholly successful in such Proceeding but is successful, on the merits or otherwise, as to one or more but less than all claims, issues or matters in such Proceeding, the Company shall indemnify, hold harmless and exonerate Indemnitee against all Expenses actually and reasonably incurred by him or on his behalf in connection with such successfully resolved claim, issue or matter. If the Indemnitee is not wholly successful in such Proceeding, the Company also shall indemnify, hold harmless and exonerate Indemnitee against all Expenses reasonably incurred in connection with a claim, issue or matter related to any claim, issue, or matter on which the Indemnitee was successful. For purposes of this Section and without limitation, the termination of any claim, issue or matter in such a Proceeding by dismissal, with or without prejudice, shall be deemed to be a successful result as to such claim, issue or matter.
6. INDEMNIFICATION FOR EXPENSES OF A WITNESS. Notwithstanding any other provision of this Agreement, to the extent that Indemnitee is, by reason of his Corporate Status, a witness in any Proceeding to which Indemnitee is not a party, he shall be indemnified, held harmless and exonerated against all Expenses actually and reasonably incurred by him or on his behalf in connection therewith.

7. ADDITIONAL INDEMNIFICATION, AND EXONERATION RIGHTS.

(a) Notwithstanding any limitation in Sections 3, 4, or 5, the Company shall indemnify, hold harmless and exonerate Indemnitee if Indemnitee is a party to or threatened to be made a party to any Proceeding (including a Proceeding by or in the right of the Company to procure a judgment in its favor) against all Expenses, judgments, fines, penalties and amounts paid in settlement (including all interest, assessments and other charges paid or payable in connection with or in respect of such Expenses, judgments, fines, penalties and amounts paid in settlement) actually and reasonably incurred by Indemnitee in connection with the Proceeding. No indemnification, hold harmless or exoneration rights shall be available under this Section 7(a) on account of Indemnitee’s conduct which constitutes a breach of Indemnitee’s duty of loyalty to the Company or its stockholders or is an act or omission not in good faith or which involves intentional misconduct or a knowing violation of the law. No indemnification, hold harmless or exoneration rights shall be available under this Section 7(a) on account of Indemnitee’s conduct which constitutes a breach of Indemnitee’s duty of loyalty to the Company or its stockholders, (b) is an act or omission not in good faith or which involves intentional misconduct or a knowing violation of the law, (c) involves an unlawful distribution to shareholders or (d) involves a transaction from which the Indemnitee derived an improper personal benefit.

(b) Notwithstanding any limitation in Sections 3, 4, 5 or 7(a), the Company shall indemnify, hold harmless and exonerate Indemnitee if Indemnitee is a party to or threatened to be made a party to any Proceeding (including a Proceeding by or in the right of the Company to procure a judgment in its favor) against all Expenses, judgments, fines, penalties and amounts paid in settlement (including all interest, assessments and other charges paid or payable in connection with or in respect of such Expenses, judgments, fines, penalties and amounts paid in settlement) actually and reasonably incurred by Indemnitee in connection with the Proceeding.

8. CONTRIBUTION IN THE EVENT OF JOINT LIABILITY.

(a) To the fullest extent permissible under applicable law, if the indemnification, hold harmless and/or exoneration rights provided for in this Agreement are unavailable to Indemnitee, in whole or in part, for any reason whatsoever, the Company, in lieu of indemnifying, holding harmless or exonerating Indemnitee, shall pay, in the first instance, the entire amount incurred by Indemnitee, whether for judgments, liabilities, fines, penalties, amounts paid or to be paid in settlement and/or for Expenses, in connection with any Proceeding without requiring Indemnitee to contribute to such payment, and the Company hereby waives and relinquishes any right of contribution it may have at any time against Indemnitee.

(b) The Company shall not enter into any settlement of any Proceeding in which the Company is jointly liable with Indemnitee (or would be if joined in such Proceeding) unless such settlement provides for a full and final release of all claims asserted against Indemnitee.

(c) The Company hereby agrees to fully indemnify, hold harmless and exonerate Indemnitee from any claims for contribution which may be brought by officers, directors or employees of the Company other than Indemnitee who may be jointly liable with Indemnitee.

9. EXCLUSIONS. Notwithstanding any provision in this Agreement, the Company shall not be obligated under this Agreement to make any indemnification, hold harmless or exoneration payment:

(a) in connection with any claim made against Indemnitee for which payment has actually been received by or on behalf of Indemnitee under any insurance policy or other indemnity provision, except with respect to any excess beyond the amount actually received under any insurance policy, contract, agreement, other indemnity provision or otherwise;

(b) in connection with any claim made against Indemnitee for an accounting of profits made from the purchase and sale (or sale and purchase) by Indemnitee of securities of the Company within the meaning of Section 16(b) of the Exchange Act or similar provisions of state statutory law or common law; or

(c) except as otherwise provided in Sections 14(e)-(f) hereof, prior to a Change in Control, in connection with any Proceeding (or any part of any Proceeding) initiated by Indemnitee, including any Proceeding (or any part of any Proceeding) initiated by Indemnitee against the Company or its directors, officers, employees or other indemnitees, unless (i) the Board
authorized the Proceeding (or any part of any Proceeding) prior to its initiation, (ii) such payment arises in connection with any
mandatory counterclaim or cross-claim that the Indemnitee asserts against the Company or its directors, officers, employees or other
indemnitees or any affirmative defense Indemnitee raises, or (iii) the Company provides the indemnification, hold harmless or
exoneration payment, in its sole discretion, pursuant to the powers vested in the Company under applicable law.

10. ADVANCES OF EXPENSES; DEFENSE OF CLAIM.

(a) Notwithstanding any provision of this Agreement to the contrary, and to the fullest extent permitted by applicable law, the
Company shall advance the Expenses incurred by Indemnitee (or reasonably expected by Indemnitee to be incurred by Indemnitee
within three months) in connection with any Proceeding within ten (10) days after the receipt by the Company of a statement or
statements requesting such advances from time to time, whether prior to or after final disposition of any Proceeding. Advances shall
be unsecured and interest free. Advances shall be made without regard to Indemnitee’s ability to repay the Expenses and without
regard to Indemnitee’s ultimate entitlement to be indemnified, held harmless or exonerated under the other provisions of this
Agreement. Advances shall include any and all reasonable Expenses incurred in pursuing a Proceeding to enforce this right of
advancement, including Expenses incurred preparing and forwarding statements to the Company to support the advances claimed.
The Indemnitee shall qualify for advances, to the fullest extent permitted by applicable law, solely upon the execution and delivery to
the Company of an undertaking providing that the Indemnitee undertakes to repay the advance to the extent that it is ultimately
determined that Indemnitee is not entitled to be indemnified by the Company under the provisions of this Agreement, the Articles, the
Bylaws of the Company, applicable law or otherwise. This Section 10(a) shall not apply to any claim made by Indemnitee for which
an indemnification, hold harmless or exoneration payment is excluded pursuant to Section 9.

(b) The Company will be entitled to participate in the Proceeding at its own expense.

(c) The Company shall not settle any action, claim or Proceeding (in whole or in part) which would impose any Expense, judgment, fine, penalty or limitation on the Indemnitee without the Indemnitee’s prior written consent.

11. PROCEDURE FOR NOTIFICATION AND APPLICATION FOR INDEMNIFICATION.

(a) Indemnitee agrees to notify promptly the Company in writing upon being served with any summons, citation, subpoena,
complaint, indictment, information or other document relating to any Proceeding or matter which may be subject to indemnificati
on, hold harmless or exoneration rights, or advancement of Expenses covered hereunder. The failure of Indemnitee to so notify the
Company shall not relieve the Company of any obligation which it may have to the Indemnitee under this Agreement, or otherwise.

(b) Indemnitee may deliver to the Company a written application to indemnify, hold harmless or exonerate Indemnitee in
accordance with this Agreement. Such application(s) may be delivered from time to time and at such time(s) as Indemnitee deems
appropriate in his sole discretion. Following such a written application for indemnification by Indemnitee, the Indemnitee’s
entitlement to indemnification shall be determined according to Section 12(a) of this Agreement.

12. PROCEDURE UPON APPLICATION FOR INDEMNIFICATION.

(a) A determination, if required by applicable law, with respect to Indemnitee’s entitlement to indemnification shall be made in
the specific case by one of the following methods, which shall be at the election of Indemnitee: (i) by a majority vote of the
Disinterested Directors, even though less than a quorum of the Board or (ii) by Independent Counsel in a written opinion to the Board,
a copy of which shall be delivered to Indemnitee. The Company promptly will advise Indemnitee in writing with respect to any
determination that Indemnitee is or is not entitled to indemnification, including, without limitation, a description of any reason or
basis for which indemnification has been denied. If it is so determined that Indemnitee is entitled to indemnification, payment to
Indemnitee shall be made within ten (10) days after such determination. Indemnitee shall reasonably cooperate with the Person or
Persons making such determination with respect to Indemnitee’s entitlement to indemnification, including, without limitation,
providing to such Person or Persons upon reasonable advance request any documentation or information which is not privileged or
otherwise protected from disclosure and which is reasonably available to Indemnitee and reasonably necessary to such determination.
Any costs or Expenses (including attorneys’ fees and disbursements) incurred by Indemnitee in so cooperating with the person,
persons or entity making such determination shall be borne by the Company (irrespective of the determination as to Indemnitee’s
entitlement to indemnification) and the Company hereby indemnifies and agrees to hold Indemnitee harmless therefrom.
(b) In the event the determination of entitlement to indemnification is to be made by Independent Counsel pursuant to Section 12 (a) hereof, the Independent Counsel shall be selected as provided in this Section 12(b). The Independent Counsel shall be selected by Indemnitee (unless Indemnitee shall request that such selection be made by the Board), and Indemnitee shall give written notice to the Company advising it of the identity of the Independent Counsel so selected and certifying that the Independent Counsel so selected meets the requirements of “Independent Counsel” as defined in Section 2 of this Agreement. If the Independent Counsel is selected by the Board, the Company shall give written notice to Indemnitee advising him of the identity of the Independent Counsel so selected and certifying that the Independent Counsel so selected meets the requirements of “Independent Counsel” as defined in Section 2 of this Agreement. In either event, Indemnitee or the Company, as the case may be, may, within ten (10) days after such written notice of selection shall have been received, deliver to the Company or to Indemnitee, as the case may be, a written objection to such selection; provided, however, that such objection may be asserted only on the ground that the Independent Counsel so selected does not meet the requirements of “Independent Counsel” as defined in Section 2 of this Agreement, and the objection shall set forth with particularity the factual basis of such assertion. Absent a proper and timely objection, the person so selected shall act as Independent Counsel. If such written objection is so made and substantiated, the Independent Counsel so selected may not serve as Independent Counsel unless and until such objection is withdrawn or a court of competent jurisdiction has determined that such objection is without merit. If, within twenty (20) days after submission by Indemnitee of a written request for indemnification pursuant to Section 11(a) hereof, no Independent Counsel shall have been selected and not objected to, either the Company or Indemnitee may petition the Oregon Court for resolution of any objection which shall have been made by the Company or Indemnitee to the other’s selection of Independent Counsel and/or for the appointment as Independent Counsel of a person selected by the Oregon Court, and the person with respect to whom all objections are so resolved or the person so appointed shall act as Independent Counsel under Section 12(a) hereof. Upon the due commencement of any judicial proceeding or arbitration pursuant to Section 14(a) of this Agreement, Independent Counsel shall be discharged and relieved of any further responsibility in such capacity (subject to the applicable standards of professional conduct then prevailing).

(c) The Company agrees to pay the reasonable fees and expenses of Independent Counsel and to fully indemnify and hold harmless such Independent Counsel against any and all Expenses, claims, liabilities and damages arising out of or relating to this Agreement or its engagement pursuant hereto.

(d) If the Company disputes a portion of the amounts for which indemnification is requested, the undisputed portion shall be paid and only the disputed portion withheld pending resolution of any such dispute.

13. PRESUMPTIONS AND EFFECT OF CERTAIN PROCEEDINGS.

(a) In making a determination with respect to entitlement to indemnification hereunder, the Person or Persons making such determination shall presume that Indemnitee is entitled to indemnification under this Agreement if Indemnitee has submitted a request for indemnification in accordance with Section 11(b) of this Agreement, and the Company shall have the burden of proof to overcome that presumption in connection with the making by any Person or Persons of any determination contrary to that presumption. Neither the failure of the Company (including by its directors or Independent Counsel) to have made a determination prior to the commencement of any action pursuant to this Agreement that indemnification is proper in the circumstances because Indemnitee has met the applicable standard of conduct, nor an actual determination by the Company (including by its directors or Independent Counsel) that Indemnitee has not met such applicable standard of conduct, shall be a defense to the action or create a presumption that Indemnitee has not met the applicable standard of conduct.

(b) If the Person or Persons empowered or selected under Section 12 of this Agreement to determine whether Indemnitee is entitled to indemnification shall not have made a determination within thirty (30) days after receipt by the Company of the request therefor, the requisite determination of entitlement to indemnification shall be deemed to have been made and Indemnitee shall be entitled to such indemnification, absent (i) a misstatement by Indemnitee of a material fact, or an omission of a material fact necessary to make Indemnitee’s statement not materially misleading, in connection with the request for indemnification, or (ii) a final judicial determination that any or all such indemnification is expressly prohibited under applicable law; provided, however, that such 30-day period may be extended for a reasonable time, not to exceed an additional fifteen (15) days, if the person, persons or entity making the determination with respect to entitlement to indemnification in good faith requires such additional time for the obtaining or evaluating of documentation and/or information relating thereto.

(c) The termination of any Proceeding or of any claim, issue or matter therein, by judgment, order, settlement or conviction, or upon a plea of nolo contendere or its equivalent, shall not (except as otherwise expressly provided in this Agreement) of itself adversely affect the right of Indemnitee to indemnification or create a presumption that Indemnitee did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the Company or, with respect to any criminal Proceeding, that Indemnitee had reasonable cause to believe that his conduct was unlawful.
(d) For purposes of any determination of good faith, Indemnitee shall be deemed to have acted in good faith if Indemnitee’s action is based on the records or books of account of the Enterprise, including financial statements, or on information supplied to Indemnitee by the directors or officers of the Enterprise in the course of their duties, or on the advice of legal counsel for the Enterprise, its Board, any committee of the Board or any director, or on information or records given or reports made to the Enterprise, its Board, any committee of the Board or any director, by an independent certified public accountant or by an appraiser or other expert selected by the Enterprise, its Board, any committee of the Board or any director. The provisions of this Section 13(d) shall not be deemed to be exclusive or to limit in any way the other circumstances in which the Indemnitee may be deemed or found to have met the applicable standard of conduct set forth in this Agreement.

(e) The knowledge and/or actions, or failure to act, of any other director, officer, trustee, partner, managing member, fiduciary, agent or employee of the Enterprise shall not be imputed to Indemnitee for purposes of determining the right to indemnification under this Agreement.

14. REMEDIES OF INDEMNITEE.

(a) In the event that (i) a determination is made pursuant to Section 12 of this Agreement that Indemnitee is not entitled to indemnification under this Agreement, (ii) advancement of Expenses, to the fullest extent permitted by applicable law, is not timely made pursuant to Section 10 of this Agreement, (iii) no determination of entitlement to indemnification shall have been made pursuant to Section 12(a) of this Agreement within thirty (30) days after receipt by the Company of the request for indemnification, (iv) payment of indemnification is not made pursuant to Section 5, 6, 7 or the last sentence of Section 12(a) of this Agreement within ten (10) days after receipt by the Company of a written request therefor, (v) a contribution payment is not made in a timely manner pursuant to Section 8 of this Agreement, (vi) payment of indemnification pursuant to Section 3 or 4 of this Agreement is not made within ten (10) days after a determination has been made that Indemnitee is entitled to indemnification, or (vii) payment to Indemnitee pursuant to any hold harmless or exoneration rights under this Agreement or otherwise is not made within ten (10) days after receipt by the Company of a written request therefor, Indemnitee shall be entitled to an adjudication by the Oregon Court to such indemnification, hold harmless, exoneration, contribution or advancement rights. Alternatively, Indemnitee, at his option, may seek an award in arbitration to be conducted by a single arbitrator pursuant to the Commercial Arbitration Rules of the American Arbitration Association. Except as set forth herein, the provisions of Oregon law (without regard to its conflict of laws rules) shall apply to any such arbitration. The Company shall not oppose Indemnitee’s right to seek any such adjudication or award in arbitration.

(b) Upon the occurrence or non-occurrence of any of the events set forth in Section 14(a) of this Agreement, any judicial proceeding or arbitration commenced pursuant to this Section 14 shall be conducted in all respects as a de novo trial, or arbitration, on the merits and Indemnitee shall not be prejudiced by reason of that adverse determination. In any judicial proceeding or arbitration commenced pursuant to this Section 14, Indemnitee shall be presumed to be entitled to be indemnified, held harmless, exonerated and to receive advances of Expenses under this Agreement and the Company shall have the burden of proving Indemnitee is not entitled to be indemnified, held harmless, exonered and to receive advances of Expenses, as the case may be, and the Company may not refer to or introduce into evidence any determination pursuant to Section 12(a) of this Agreement adverse to Indemnitee for any purpose. If Indemnitee commences a judicial proceeding or arbitration pursuant to this Section 14, Indemnitee shall not be required to reimburse the Company for any advances pursuant to Section 10 until a final determination is made with respect to Indemnitee’s entitlement to indemnification (as to which all rights of appeal have been exhausted or lapsed).

(c) If a determination shall have been made pursuant to Section 12(a) of this Agreement that Indemnitee is entitled to payment, the Company shall be bound by such determination in any judicial proceeding or arbitration commenced pursuant to this Section 14, absent (i) a misstatement by Indemnitee of a material fact, or an omission of a material fact necessary to make Indemnitee’s statement not materially misleading, in connection with the request for indemnification, or (ii) a prohibition of such indemnification under applicable law.

(d) The Company shall be precluded from asserting in any judicial proceeding or arbitration commenced pursuant to this Section 14 that the procedures and presumptions of this Agreement are not valid, binding and enforceable and shall stipulate in any such court or before any such arbitrator that the Company is bound by all the provisions of this Agreement.
(c) The Company shall indemnify and hold harmless Indemnitee to the fullest extent permitted by law against all Expenses and, if requested by Indemnitee, shall (within ten (10) days after the Company’s receipt of such written request) pay to Indemnitee, to the fullest extent permitted by applicable law, all such Expenses which are incurred by Indemnitee in connection with any judicial proceeding or arbitration brought by Indemnitee (i) in connection with, to enforce his rights under, or to recover damages for breach of, this Agreement or any other indemnification, hold harmless, exoneration, advancement or contribution agreement or provision of the Articles or Bylaws of the Company now or hereafter in effect; or (ii) for recovery or advances under any insurance policy maintained by any person for the benefit of Indemnitee, regardless of the outcome and whether Indemnitee ultimately is determined to be entitled to such indemnification, hold harmless or exonerator right, advancement, contribution or insurance recovery, as the case may be (unless such judicial proceeding or arbitration was not brought by Indemnitee in good faith).

(f) Interest shall be paid by the Company to Indemnitee at the legal rate under Oregon law for amounts which the Company indemnifies, holds harmless or exonerates, or is obliged to indemnify, hold harmless or exonerate for the period commencing with the date on which Indemnitee pays such amounts for which he requested indemnification, to be held harmless, exoneration, contribution, reimbursement or advancement of any Expenses and ending with the date on which such payment is made to or on behalf of Indemnitee by the Company.

15. ESTABLISHMENT OF TRUST. In the event of a Potential Change in Control, the Company shall, upon written request by Indemnitee, create a “Trust” for the benefit of Indemnitee and from time to time upon written request of Indemnitee shall fund such Trust in an amount sufficient to satisfy any and all Expenses reasonably anticipated at the time of each such request to be incurred in connection with investigating, preparing for, participating in or defending any Proceedings, and any and all judgments, fines, penalties and amounts paid in settlement (including all interest, assessments and other charges paid or payable in connection with or in respect of such judgments, fines penalties and amounts paid in settlement) in connection with any and all Proceedings from time to time actually paid or claimed, reasonably anticipated or proposed to be paid. The trustee of the Trust (the “Trustee”) shall be a bank or trust company or other individual or entity chosen by the Indemnitee and reasonably acceptable to the Company. Nothing in this Section 15 shall relieve the Company of any of its obligations under this Agreement. The amount or amounts to be deposited in the Trust pursuant to the foregoing funding obligation shall be determined by mutual agreement of the Indemnitee and the Company or, if the Company and the Indemnitee are unable to reach such an agreement, by Independent Counsel selected in accordance with Section 12(b) of this Agreement. The terms of the Trust shall provide that, except upon the consent of both the Indemnitee and the Company, (a) the Trust shall not be revoked or the principal thereof invaded, without the written consent of the Indemnitee; and (b) upon a Change in Control: (i) the Trustee shall make advances of Expenses, to the fullest extent permitted by applicable law, within two (2) business days of a request by the Indemnitee and upon the execution and delivery to the Company of an undertaking providing that the Indemnitee undertakes to repay the advance to the extent that it is ultimately determined that Indemnitee is not entitled to be indemnified, held harmless or exonerated by the Company; (ii) the Trust shall continue to be funded by the Company in accordance with the funding obligations set forth above; (iii) the Trustee shall promptly pay to the Indemnitee all amounts for which the Indemnitee shall be entitled to indemnification, or to be held harmless or exonerated pursuant to this Agreement or otherwise; and (iv) all unexpended funds in such Trust shall revert to the Company upon mutual agreement by the Indemnitee and the Company or, if the Indemnitee and the Company are unable to reach such an agreement, by Independent Counsel selected in accordance with Section 12(b) of this Agreement, that the Indemnitee has been fully indemnified, held harmless and exonerated under the terms of this Agreement. The Trust shall be governed by Oregon law (without regard to its conflicts of laws rules) and the Trustee shall consent to the exclusive jurisdiction of the Oregon Court in accordance with Section 23 of this Agreement.

16. SECURITY. Notwithstanding anything herein to the contrary, to the extent requested by the Indemnitee and approved by the Board, the Company may at any time and from time to time provide security to the Indemnitee for the Company’s obligations hereunder through an irrevocable bank line of credit, funded trust or other collateral. Any such security, once provided to the Indemnitee, may not be revoked or released without the prior written consent of the Indemnitee.

17. NON-EXCLUSIVITY; SURVIVAL OF RIGHTS; INSURANCE; SUBROGATION.

(a) The rights of Indemnitee as provided by this Agreement (i) shall not be deemed exclusive of any other rights to which Indemnitee may at any time be entitled under applicable law, the Articles or Bylaws of the Company, any agreement, a vote of stockholders or a resolution of directors, or otherwise and (ii) shall be enforced and this Agreement shall be interpreted independently of and without reference to or limitation or constraint (whether procedural, substantive or otherwise) by any other such rights to which Indemnitee may at any time be entitled. No amendment, alteration or repeal of this Agreement or of any provision hereof shall limit or restrict any right of Indemnitee under this Agreement in respect of any action taken or omitted by such Indemnitee in his Corporate Status prior to such amendment, alteration or repeal. To the extent that a change in applicable law, whether by statute or judicial decision, permits greater indemnification, hold harmless
or exoneration rights or advancement of Expenses than would be afforded currently under the Articles or Bylaws of the Company or this Agreement, it is the intent of the parties hereto that Indemnitee shall enjoy by this Agreement the greater benefits so afforded by such change. To the extent that a change in Oregon law, whether by statute or judicial decision, narrows or limits indemnification or advancement of Expenses that are afforded currently under the Articles, the Company’s Bylaws or this Agreement, it is the intent of the parties hereto that such change, except to the extent required by applicable law, shall have no effect on this Agreement or the parties’ rights and obligations hereunder. No right or remedy herein conferred is intended to be exclusive of any other right or remedy, and every other right and remedy shall be cumulative and in addition to every other right and remedy given hereunder or now or hereafter existing at law or in equity or otherwise. The assertion or employment of any right or remedy hereunder, or otherwise, shall not prevent the concurrent assertion or employment of any other right or remedy.

(b) The Act, the Articles and the Company’s Bylaws permit the Company to purchase and maintain insurance or furnish similar protection or make other arrangements including, but not limited to, providing a trust fund, letter of credit, or surety bond (“Indemnification Arrangements”) on behalf of Indemnitee against any liability asserted against him or incurred by or on behalf of him or in such capacity as a director, officer, employee or agent of the Company, or arising out of his status as such, whether or not the Company would have the power to indemnify him against such liability under the provisions of this Agreement or under the Act, as it may then be in effect. The purchase, establishment, and maintenance of any such Indemnification Arrangement shall not in any way limit or affect the rights and obligations of the Company or of the Indemnitee under this Agreement except as expressly provided herein, and the execution and delivery of this Agreement by the Company and the Indemnitee shall not in any way limit or affect the rights and obligations of the Company or the other party or parties thereto under any such Indemnification Arrangement.

(c) The Company shall maintain directors’ and officers’ insurance programs providing coverage to Indemnitee for Expenses during the time period Indemnitee serves the Company in a Corporate Status, and for a period of no less than six (6) years following the conclusion of such service. If, at the time the Company receives notice from any source of a Proceeding as to which Indemnitee is a party or a participant (as a witness or otherwise), the Company has director and officer liability insurance in effect, the Company shall give prompt notice of such Proceeding to the insurers in accordance with the procedures set forth in the respective policies. The Company shall thereafter take all necessary or desirable action to cause such insurers to pay, on behalf of the Indemnitee, all amounts payable as a result of such Proceeding in accordance with the terms of such policies.

(d) In the event of any payment under this Agreement, the Company shall be subrogated to the extent of such payment to all of the rights of recovery of Indemnitee, who shall execute all papers required and take all action necessary to secure such rights, including execution of such documents as are necessary to enable the Company to bring suit to enforce such rights.

(e) The Company’s obligation to indemnify, hold harmless, exonerate or advance Expenses hereunder to Indemnitee who is or was serving at the request of the Company as a director, officer, trustee, partner, managing member, fiduciary, employee or agent of any other Enterprise shall be reduced by any amount Indemnitee has actually received as indemnification, hold harmless or exonation payments or advancement of expenses from such Enterprise. Notwithstanding any other provision of this Agreement to the contrary, (i) Indemnitee shall have no obligation to reduce, offset, allocate, pursue or apportion any indemnification, hold harmless, exonation, advancement, contribution or insurance coverage among multiple parties possessing such duties to Indemnitee prior to the Company’s satisfaction and performance of all its obligations under this Agreement, and (ii) the Company shall perform fully its obligations under this Agreement without regard to whether Indemnitee holds, may pursue or has pursued any indemnification, advancement, hold harmless, exonation, contribution or insurance coverage rights against any person or entity other than the Company.

18. DURATION OF AGREEMENT. All agreements and obligations of the Company contained herein shall continue during the period Indemnitee serves as a director or officer of the Company or as a director, officer, trustee, partner, managing member, fiduciary, employee or agent of any other corporation, partnership, joint venture, trust, employee benefit plan or other Enterprise which Indemnitee serves at the request of the Company and shall continue thereafter so long as Indemnitee may be subject to any possible Proceeding (including any rights of appeal thereto and any Proceeding commenced by Indemnitee pursuant to Section 14 of this Agreement) by reason of his Corporate Status, whether or not he is acting in any such capacity at the time any liability or expense is incurred for which indemnification can be provided under this Agreement.

19. SEVERABILITY. If any provision or provisions of this Agreement shall be held to be invalid, illegal or unenforceable for any reason whatsoever: (a) the validity, legality and enforceability of the remaining provisions of this Agreement (including, without limitation, each portion of any Section, paragraph or sentence of this Agreement containing any such
provision held to be invalid, illegal or unenforceable, that is not itself invalid, illegal or unenforceable) shall not in any way be
affected or impaired thereby and shall remain enforceable to the fullest extent permitted by law; (b) such provision or provisions shall
be deemed reformed to the extent necessary to conform to applicable law and to give the maximum effect to the intent of the parties
hereto; and (c) to the fullest extent possible, the provisions of this Agreement (including, without limitation, each portion of any
Section, paragraph or sentence of this Agreement containing any such provision held to be invalid, illegal or unenforceable, that is not
itself invalid, illegal or unenforceable) shall be construed so as to give effect to the intent manifested thereby.

20. ENFORCEMENT AND BINDING EFFECT

(a) The Company expressly confirms and agrees that it has entered into this Agreement and assumed the obligations imposed on
it hereby in order to encourage Indemnitee to serve and/or continue to serve as a director, officer or key employee of the Company,
and the Company acknowledges that Indemnitee is relying upon this Agreement in serving as a director, officer or key employee of
the Company.

(b) Without limiting any of the rights of Indemnitee under the Articles or Bylaws of the Company as they may be amended from
time to time, and except as provided in Section 17(a), this Agreement constitutes the entire agreement between the parties hereto with
respect to the subject matter hereof and supersedes all prior agreements and understandings, oral, written and implied, between the
parties hereto with respect to the subject matter hereof.

(c) The rights to be indemnified and to receive contribution and advancement of Expenses provided by or granted Indemnitee
pursuant to this Agreement shall apply to Indemnitee’s service as an officer, director, employee or agent of the Company prior to the
date of this Agreement, as well as service on or after the date of this Agreement.

(d) The indemnification, hold harmless, exoneration and advancement of expenses rights provided by or granted pursuant to this
Agreement shall be binding upon and be enforceable by the parties hereto and their respective successors and assigns (including any
direct or indirect successor by purchase, merger, consolidation or otherwise to all or substantially all of the business or assets of the
Company), shall continue as to an Indemnitee who has ceased to be a director, officer, employee or agent of the Company or of any
other Enterprise, and shall inure to the benefit of Indemnitee and his or her spouse, assigns, estate, heirs, devisees, executors and
administrators and other legal representatives.

(e) The Company shall require and cause any successor (whether direct or indirect by purchase, merger, consolidation or
otherwise) to all, substantially all or a substantial part, of the business and/or assets of the Company, by written agreement in form
and substance satisfactory to the Indemnitee, expressly to assume and agree to perform this Agreement in the same manner and to the
same extent that the Company would be required to perform if no such succession had taken place.

(f) The Company and Indemnitee agree herein that a monetary remedy for breach of this Agreement, at some later date, may be
inadequate, impracticable and difficult of proof, and further agree that such breach may cause Indemnitee irreparable harm.
Accordingly, the parties hereto agree that Indemnitee may enforce this Agreement by seeking, among other things, injunctive relief
and/or specific performance hereof, without any necessity of showing actual damage or irreparable harm and that by seeking
injunctive relief and/or specific performance, Indemnitee shall not be precluded from seeking or obtaining any other relief to which he
may be entitled. The Company and Indemnitee further agree that Indemnitee shall be entitled to such specific performance and
injunctive relief, including temporary restraining orders, preliminary injunctions and permanent injunctions, without the necessity of
posting bonds or other undertaking in connection therewith. The Company acknowledges that in the absence of a waiver, a bond or
undertaking may be required of Indemnitee by the Court, and the Company hereby waives any such requirement of such a bond or
undertaking.

21. MODIFICATION AND WAIVER

No supplement, modification or amendment of this Agreement shall be binding unless
executed in writing by the parties hereto. No waiver of any of the provisions of this Agreement shall be deemed or shall constitute a
waiver of any other provisions of this Agreement nor shall any waiver constitute a continuing waiver.

22. NOTICES

All notices, requests, demands and other communications under this Agreement shall be in writing and shall be
deemed to have been duly given (i) if delivered by hand and receipted for by the party to whom said notice or other communication
shall have been directed, or (ii) mailed by certified or registered mail with postage prepaid, on the third (3rd) business day after the
date on which it is so mailed:

(a) If to Indemnitee, at the address indicated on the signature page of this Agreement, or such other address as Indemnitee shall
provide in writing to the Company.
(b) If to the Company, to:

    Mentor Graphics Corporation  
c/o Dean M. Freed, Vice President and General Counsel  
8005 S.W. Boeckman Road  
Wilsonville, OR 97070-7777

or to any other address as may have been furnished to Indemnitee in writing by the Company.

23. APPLICABLE LAW AND CONSENT TO JURISDICTION. This Agreement and the legal relations among the parties shall be governed by, and construed and enforced in accordance with, the laws of the State of Oregon, without regard to its conflict of laws rules. Except with respect to any arbitration commenced by Indemnitee pursuant to Section 14(a) of this Agreement, the Company and Indemnitee hereby irrevocably and unconditionally: (a) agree that any action or proceeding arising out of or in connection with this Agreement shall be brought only in the Oregon Court and not in any other state or federal court in the United States of America or any court in any other country; (b) consent to submit to the exclusive jurisdiction of the Oregon Court for purposes of any action or proceeding arising out of or in connection with this Agreement; (c) appoint irrevocably, to the extent such party is not a resident of the State of Oregon, Latham & Watkins, 140 Scott Drive, Menlo Park, CA 94025 as such party’s agent for acceptance of legal process in connection with any such action or proceeding against such party with the same legal force and validity as if served upon such party personally within the State of Oregon; (d) waive any objection to the laying of venue of any such action or proceeding in the Oregon Court; and (e) waive, and agree not to plead or to make, any claim that any such action or proceeding brought in the Oregon Court has been brought in an improper or inconvenient forum, or is subject (in whole or in part) to a jury trial.

24. IDENTICAL COUNTERPARTS. This Agreement may be executed in one or more counterparts, each of which shall for all purposes be deemed to be an original but all of which together shall constitute one and the same Agreement. Only one such counterpart signed by the party against whom enforceability is sought needs to be produced to evidence the existence of this Agreement.

25. MISCELLANEOUS. Use of the masculine pronoun shall be deemed to include usage of the feminine pronoun where appropriate. The headings of the paragraphs of this Agreement are inserted for convenience only and shall not be deemed to constitute part of this Agreement or to affect the construction thereof.

26. PERIOD OF LIMITATIONS. No legal action shall be brought and no cause of action shall be asserted by or in the right of the Company against Indemnitee, Indemnitee’s spouse, heirs, executors or personal or legal representatives after the expiration of two years from the date of accrual of such cause of action, and any claim or cause of action of the Company shall be extinguished and deemed released unless asserted by the timely filing of a legal action within such two-year period; provided, however, that if any shorter period of limitations is otherwise applicable to any such cause of action such shorter period shall govern.

27. ADDITIONAL ACTS. If for the validation of any of the provisions in this Agreement any act, resolution, approval or other procedure is required, the Company undertakes to cause such act, resolution, approval or other procedure to be affected or adopted in a manner that will enable the Company to fulfill its obligations under this Agreement.

[Remainder of page intentionally left blank; signatures appear on following page]
IN WITNESS WHEREOF, the parties hereto have caused this Indemnity Agreement to be signed as of the day and year first above written.

<table>
<thead>
<tr>
<th>MENTOR GRAPHICS CORPORATION</th>
<th>INDEMNITEE</th>
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<tbody>
<tr>
<td>Name:</td>
<td>Name:</td>
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<td>Title:</td>
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Severance Agreement

August 10, 2008

Dear ________,

On ____________, you entered into a letter agreement with Mentor Graphics Corporation (the “Corporation”) regarding compensation and benefits arrangements in connection with a Change in Control (as defined herein), and you and the Corporation amended and restated such letter agreement on ____________ (as amended, the “Prior Agreement”). You and the Corporation now desire to make certain changes to the Agreement in order to modify the benefits provided thereunder as well as to reflect recent changes affecting the taxation of deferred compensation arrangements under Section 409A of the Internal Revenue Code of 1986, as amended (the “Code”). Accordingly, you and the Corporation have agreed to amend and restate the Prior Agreement as set forth below (the “Agreement”) as of August 10, 2008 (the “Effective Date”).

The Board of Directors (the “Board”) of the Corporation has determined that it is in the best interests of the Corporation and its shareholders to assure that the Corporation will continue to have your dedication and services notwithstanding the possibility, threat or occurrence of a Change in Control. The Board believes it is imperative to diminish the distraction that you would face by virtue of the personal uncertainties created by a pending or threatened Change in Control and to encourage your full attention and dedication to the Corporation currently and in the event of any threatened or pending Change in Control. Further, the Board desires to provide you with compensation and benefits arrangements upon a Change in Control which ensure that your compensation and benefits expectations will be satisfied and which are competitive with those of other corporations. Therefore, in order to accomplish these objectives, the Board has caused the Corporation to enter into this Agreement.

1. Term of Agreement. The terms of this Agreement shall become effective upon the execution hereof by the Corporation and shall continue, unless terminated by written agreement between you and the Corporation, until the later to occur of (a) twenty-four (24) months following the Effective Date, or (b) the date occurring twelve (12) months after the date on which a Change in Control occurs (the date of such Change in Control, the “Change in Control Date”) provided such Change in Control occurs within the twenty-four month period following the Effective Date. No benefits shall be payable hereunder unless there has been a Change in Control.

2. Change in Control. A Change in Control shall be deemed to occur upon the earliest to occur after the date of this Agreement of any of the following events:

2.1 Acquisition of Stock by Third Party. The acquisition by any Person of Beneficial Ownership of 40% or more of either the then-outstanding shares of common stock of the Corporation or the Outstanding Voting Securities; provided, however, that, for purposes of this Section 2.1, the following acquisitions shall not constitute a Change in Control: (a) any acquisition directly from the Corporation, (b) any acquisition by the Corporation, or (c) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Corporation or any Subsidiary of the Corporation;

2.2 Change in Board of Directors. Individuals who, as of the Effective Date, constitute the Board, and any new director whose election by the Board or nomination for election by the Corporation’s shareholders was approved by a vote of at least two thirds of the directors then still in office who were directors on the Effective Date or whose election or nomination for election was previously so approved (collectively, the “Continuing Directors”), cease for any reason to constitute at least a majority of the members of the Board;

2.3 Corporate Transactions. The effective date of a reorganization, merger or consolidation of the Corporation (a “Business Combination”), in each case, unless immediately following such Business Combination: (a) all or substantially all of the Persons who were Beneficial Owners of Outstanding Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 51% of the combined voting power of the then outstanding securities entitled to vote generally in the election of directors of the corporation resulting from such Business
Combination (including, without limitation, a corporation which as a result of such transaction either owns the Corporation or all or substantially all of the Corporation’s assets either directly or through one or more Subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination, of the Outstanding Voting Securities; (b) no Person (excluding any corporation resulting from such Business Combination) is the Beneficial Owner, directly or indirectly, of 40% or more of the combined voting power of the then outstanding securities entitled to vote generally in the election of directors of such corporation except to the extent that such ownership existed prior to such Business Combination; and (c) at least a majority of the board of directors of the corporation resulting from such Business Combination were Continuing Directors at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination;

2.4 **Liquidation.** The approval by the shareholders of the Corporation of a complete liquidation of the Corporation or an agreement or series of agreements for the sale or disposition by the Corporation of all or substantially all of the Corporation’s assets, other than factoring the Corporation’s current receivables or escrows due (or, if such approval is not required, the decision by the Board to proceed with such a liquidation, sale or disposition in one transaction or a series of related transactions); or

2.5 **Other Events.** There occurs any other event of a nature that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A (or a response to any similar or successor item on any similar or successor schedule or form) promulgated under the Exchange Act (as defined below), whether or not the Corporation is then subject to such reporting requirement.

2.6 **Certain Definitions.** For purposes of this Section 2, the following terms shall have the following meanings:

“Beneficial Owner” and “Beneficial Ownership” shall have the meanings set forth in Rule 13d-3 promulgated under the Exchange Act.


“Outstanding Voting Securities” shall mean the combined voting power of the then-outstanding voting securities of the Corporation entitled to vote generally in the election of directors.

“Person” shall have the meaning as set forth in Sections 13(d) and 14(d) of the Exchange Act; provided, however, that Person shall exclude (i) the Corporation, (ii) any Subsidiary of the Corporation, (iii) any employment benefit plan of the Corporation or Subsidiary of the Corporation or of any corporation owned, directly or indirectly, by the shareholders of the Corporation in substantially the same proportions as their ownership of stock of the Corporation, and (iv) any trustee or other fiduciary holding securities under an employee benefit plan of the Corporation or Subsidiary of the Corporation or of a corporation owned, directly or indirectly, by the shareholders of the Corporation in substantially the same proportions as their ownership of stock of the Corporation.

“Subsidiary” shall mean, with respect to any Person, any business organization or legal entity of which a majority of the voting power of the voting equity securities or equity interest is owned, directly or indirectly, by that Person.

3. **Termination Related to a Change in Control.**

3.1 **General.** You shall be entitled to the benefits provided in Section 4 upon

(a) the termination of your employment if your employment is terminated after the Change in Control Date or

(b) with respect to the benefits described in Section 4.2 (other than the amounts described in Section 4.2(a)), the Change in Control Date if your employment is terminated after the date on which the shareholders of the Corporation approve a transaction, the consummation of which would result in the occurrence of a Change in Control (the “Approval Date”), provided that, to the extent that such benefits constitute a deferral of compensation which is subject to Section 409A of the Code, the Change in Control constitutes a change in the ownership or effective control of the Corporation or a change in the ownership of a substantial portion of the assets of the Corporation, as described in Treasury Regulation Section 1.409A-3(i)(5).

Notwithstanding the foregoing, to the extent that the benefits provided in Section 4 constitute a deferral of compensation which is subject to Section 409A of the Code, you shall be entitled to such benefits only if the termination of your employment constitutes a “separation from service” within the meaning of Treasury Regulation Section 1.409A-1(h) (a “Separation from Service”).
3.2 Definition of Disability. If, as a result of your incapacity due to physical or mental illness, you shall have been absent from the full-time performance of your duties with the Corporation for six (6) consecutive months, and within thirty (30) days after written notice of termination is given you shall not have returned to the full-time performance of your duties, your employment may be terminated for “Disability.”

3.3 Definition of Cause. Termination by the Corporation of your employment for “Cause” shall mean termination (a) upon your willful and continued failure to perform substantially your duties with the Corporation (other than any such failure resulting from your incapacity due to physical or mental illness or any such actual or anticipated failure after your issuance of a Notice of Termination (as defined in Section 3.5) for Good Reason), after a written demand for substantial performance is delivered to you by the Board which demand specifically identifies the manner in which the Board believes that you have not substantially performed your duties, (b) upon your willful and continued failure to follow and comply substantially with the specific and lawful directives of the Board, as reasonably determined by the Board (other than any such failure resulting from your incapacity due to physical or mental illness or any such actual or anticipated failure after your issuance of a Notice of Termination for Good Reason), after a written demand for substantial performance is delivered to you by the Board, which demand specifically identifies the manner in which the Board believes that you have not substantially followed or complied with the directives of the Board, (c) upon your willful commission of an act of fraud or dishonesty resulting in material economic or financial injury to the Corporation, or (d) upon your willful engagement in illegal conduct which is materially and demonstrably injurious to the Corporation. For purposes of this Section 3.3, no act, or failure to act, on your part shall be deemed “willful” unless done, or omitted to be done, by you not in good faith. Notwithstanding the foregoing, you shall not be deemed terminated for Cause pursuant to Sections 3.3(a), (b), (c) or (d) hereof unless and until there shall have been delivered to you a copy of a resolution duly adopted by the affirmative vote of not less than three-quarters of the entire membership of the Board at a meeting of the Board (after reasonable notice to you, an opportunity for you, together with your counsel, to be heard before the Board and a reasonable opportunity to cure), finding that in the Board’s good faith opinion you were guilty of conduct set forth above in Section 3.3(a), (b), (c) or (d) and specifying the particulars thereof in reasonable detail. In the event of a Change in Control under Section 2.3 pursuant to which the Corporation is not the surviving entity, then on and after the Change in Control Date all determinations and actions required to be taken by the Board under this Section 3.3 shall be made or taken by the board of directors of the surviving entity, or if the surviving entity is a subsidiary, then by the board of directors of the ultimate parent corporation of the surviving entity.

3.4 Good Reason. You shall be entitled to terminate your employment for Good Reason. For purposes of this Agreement, “Good Reason” shall mean, without your express written consent, the occurrence after the Approval Date of any of the following circumstances unless, in the case of Sections 3.4(a), (f), (g), or (h), such circumstances are fully corrected (provided such circumstances are capable of correction) prior to the Date of Termination (as defined in Section 3.6) specified in the Notice of Termination given in respect thereof:

(a) the assignment to you of any duties inconsistent with the position in the Corporation that you held immediately prior to the Approval Date, if applicable, or the Change in Control Date, a significant adverse alteration in the nature or status of your responsibilities or the conditions of your employment from those in effect immediately prior to the Approval Date, if applicable, or the Change in Control Date, or any other action by the Corporation that results in a material diminution in your position, authority, title, duties or responsibilities;

(b) the Corporation’s reduction of your annual base salary as in effect on the Approval Date, if applicable, or the Change in Control Date or as the same may be increased from time to time;

(c) the relocation of the Corporation’s offices at which you are principally employed immediately prior to the Approval Date, if applicable, or the Change in Control Date (your “Principal Location”) to a location more than twenty-five (25) miles from such location or the Corporation’s requiring you, without your written consent, to be based anywhere other than your Principal Location, except for required travel on the Corporation’s business to an extent substantially consistent with your present business travel obligations;

(d) the Corporation’s failure to pay to you any portion of your current compensation or to pay to you any portion of an installment of deferred compensation under any deferred compensation program of the Corporation within seven (7) days of the date such compensation is due;

(e) the Corporation’s failure to continue in effect any material compensation or benefit plan or practice in which you are eligible to participate in on the Approval Date, if applicable, or the Change in Control Date (other than any equity based plan), unless an equitable arrangement (embodied in an ongoing substitute or alternative plan)
has been made with respect to such plan, or the Corporation’s failure to continue your participation therein (or in such substitute or alternative plan) on a basis not materially less favorable, both in terms of the amount of benefits provided and the level of your participation relative to other participants, as existed at the time of the Approval Date, if applicable, or the Change in Control Date;

(f) the Corporation’s failure to continue to provide you with benefits substantially similar in the aggregate to those enjoyed by you under any of the Corporation’s life insurance, medical, health and accident, disability, pension, retirement, or other benefit plans or practices in which you and your eligible family members were eligible to participate in on the Approval Date, if applicable, or the Change in Control Date (other than any equity based plans), the taking of any action by the Corporation which would directly or indirectly materially reduce any of such benefits, or the failure by the Corporation to provide you with the number of paid vacation days to which you are entitled on the basis of years of service with the Corporation in accordance with the Corporation’s normal vacation policy in effect on the Approval Date, if applicable, or the Change in Control Date;

(g) the Corporation’s failure to obtain a satisfactory agreement from any successor to assume and agree to perform this Agreement, as contemplated in Section 6 hereof; or

(h) any purported termination of your employment that is not effected pursuant to a Notice of Termination satisfying the requirements of Section 3.6 hereof (and, if applicable, the requirements of Section 3.3 hereof), which purported termination shall not be effective for purposes of this Agreement.

Your right to terminate your employment pursuant to this Section 3.4 shall not be affected by your incapacity due to physical or mental illness. Your continued employment shall not constitute consent to, or a waiver of rights with respect to, any circumstance constituting Good Reason hereunder.

3.5 Notice of Termination. Any purported termination of your employment by the Corporation or by you (other than termination due to death which shall terminate your employment automatically) shall be communicated by written Notice of Termination to the other party hereto in accordance with Section 7. “Notice of Termination” shall mean a notice that shall indicate the specific termination provision in this Agreement relied upon and shall set forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of your employment under the provision so indicated.

3.6 Date of Termination, Etc. “Date of Termination” shall mean (a) if your employment is terminated due to your death, the date of your death; (b) if your employment is terminated for Disability, thirty (30) days after Notice of Termination is given (provided that you shall not have returned to the full-time performance of your duties during such thirty (30) day period), and (c) if your employment is terminated pursuant to Section 3.3 or Section 3.4 or for any other reason (other than death or Disability), the date specified in the Notice of Termination (which in the case of a termination for Cause or Good Reason shall be the date thirty (30) days after the date on which Notice of Termination is given). Notwithstanding anything to the contrary contained in this Section 3.6, if within fifteen (15) days after any Notice of Termination is given, the party receiving such Notice of Termination notifies the other party that a dispute exists concerning the termination, then the Date of Termination shall be the date on which the dispute is finally determined, either by mutual written agreement of the parties, or otherwise; provided, however, that (i) the Date of Termination shall be extended by a notice of dispute only if such notice is given in good faith and the party giving such notice pursues the resolution of such dispute with reasonable diligence; and (ii) in the event of your death pending a dispute, and the resolution of such dispute is ultimately in your favor, then the Date of Termination shall be the date specified in the Notice of Termination.

4. Compensation Upon Termination. The benefits to which you are entitled upon termination of your employment, subject to Section 3 and the other terms and conditions of this Agreement, are:

4.1 Cause or Voluntary Termination. If your employment shall be terminated by the Corporation for Cause or voluntarily terminated by you other than for Good Reason, the Corporation shall pay you your full base salary through the Date of Termination at the rate in effect at the time Notice of Termination is given, plus all other amounts to which you are entitled under any compensation plan or practice of the Corporation, and the Corporation shall have no further obligations to you under this Agreement.

4.2 Good Reason; Termination By Corporation Without Cause; Death or Disability. If your employment by the Corporation shall be terminated by you for Good Reason, by the Corporation other than for Cause, or due to your Disability or death, then you shall be entitled to the benefits provided below:

(a) the Corporation shall pay to you your full base salary, when due, through the Date of Termination at the rate in effect at the time Notice of Termination is given, at the time specified in Section 4.3, plus (i) that portion of your full targeted annual bonus prorated through the Date of Termination, (ii) all accrued but unused vacation time through the Date of Termination and (iii) all other amounts to which you are entitled under any compensation plan or practice of the Corporation at the time such payments are due;
(b) in lieu of any further salary payments to you for periods subsequent to the Date of Termination, the Corporation shall pay as severance pay to you, at the time specified in Section 4.3, a lump sum payment equal to the sum of the following:

(1) three (3) times your annual base salary as in effect at the time the Notice of Termination is given or immediately prior to the Change in Control Date (or the Approval Date if the Date of Termination is prior to the Change in Control Date), whichever is greater; and

(2) three (3) times your full targeted annual bonus as in effect at the time the Notice of Termination is given or immediately prior to the Change in Control Date (or the Approval Date if the Date of Termination is prior to the Change in Control Date), whichever is greater; and

(c) for a period of two (2) years following the Date of Termination, the Corporation shall, at its sole expense as incurred, provide you with outplacement services, the scope and provider of which shall be consistent with your status at the Corporation on the Date of Termination;

(d) for a thirty-six (36) month period after the Date of Termination, the Corporation shall continue to provide you and your eligible family members, based on the cost sharing arrangement between you and the Corporation at the time the Notice of Termination is given, with medical and dental health benefits and life and disability benefits at least equal to those which would have been provided to you and them if your employment had not been terminated or, if more favorable to you, as in effect generally at any time thereafter; provided, however, that if you become re-employed with another employer and are eligible to receive such benefits under another employer’s plans, the Corporation’s obligations under this Section 4.2(d) shall be reduced to the extent comparable benefits are actually received by you during the thirty-six (36) month period following your termination, and any such benefits actually received by you shall be reported to the Corporation. In the event you are ineligible under the terms of such benefit plans or programs to continue to be so covered, the Corporation shall provide you with substantially equivalent coverage through other sources. At the termination of the medical and dental benefits coverage under the second preceding sentence, you, your spouse and your dependents shall be entitled to continuation coverage pursuant to section 4980B of the Code, sections 601-608 of the Employee Retirement Income Security Act of 1974, as amended, and under any other applicable law, to the extent required by such laws, as if you had terminated employment with the Corporation on the date such benefits coverage terminates;

(e) the Corporation shall furnish you for six (6) years following the Date of Termination (without reference to whether the term of this Agreement continues in effect) with directors’ and officers’ liability insurance insuring you against insurable events which occur or have occurred while you were a director or officer of the Corporation, such insurance to have policy limits aggregating not less than the amount in effect immediately prior to the Change in Control or the Approval Date (whichever is more favorable to you), and otherwise to be in substantially the same form and to contain substantially the same terms, conditions and exceptions as the liability issuance policies provided for officers and directors of the Corporation in force from time to time, provided, however, that (i) such terms, conditions and exceptions shall not be, in the aggregate, materially less favorable to you than those in effect on the date hereof and (ii) if the aggregate annual premiums for such insurance at any time during such period exceed two hundred percent (200%) of the per annum rate of premium currently paid by the Corporation for such insurance, then the Corporation shall provide the maximum coverage that will then be available at an annual premium equal to two hundred percent (200%) of such rate;

(f) you shall be fully vested in your accrued benefits under all qualified or nonqualified pension, profit sharing, deferred compensation or supplemental plans maintained by the Corporation for your benefit, and the Corporation shall provide you with additional fully vested benefits under all defined benefit and cash balance plans in an amount equal to the benefits which you would have accrued had you continued your employment with the Corporation until the second anniversary of your Date of Termination; provided, however, that to the extent that the acceleration of vesting or enhanced accrual of such benefits would violate any applicable law or require the Corporation to accelerate the vesting of the accrued benefits of all participants in such plan or plans or to provide additional benefit accruals to such participants, the Corporation shall pay you a lump-sum payment at the time specified in Section 4.3 in an amount equal to the value of such benefits;

(g) in the event you relocate during the period of twenty-four (24) months following the Date of Termination, your costs (grossed up for taxes) of such relocation shall be provided by the Corporation as if the Corporation had (i) hired you as of the date of this Agreement and provided you with its “Tier 4” relocation package (as described in the policy attached hereto as Exhibit A) or (ii) hired you on the Date of Termination, whichever is greater; and
(h) all unvested stock options held by you on the Date of Termination shall immediately vest and become exercisable in full and all stock options held by you on the Date of Termination shall remain exercisable until the earlier of (i) the date occurring one year after the Date of Termination, or (ii) the date on which the right to exercise the option would have expired had you continued to be employed by the Corporation for the full term of such option, notwithstanding any vesting schedule or other provisions to the contrary in the agreements or plans evidencing such options (the “Option Arrangements”). You acknowledge and agree that in exchange for the benefits provided pursuant to this Agreement, you will not receive any acceleration of vesting of any stock options solely as a result of an acquisition of the Corporation (including a Change in Control, i.e. “single trigger acceleration”) pursuant any Option Arrangement, except if such acceleration results from the failure of the acquirer to assume or substitute for the stock option.

4.3 Timing of Payments under Sections 4.1 and 4.2. The payments provided for in (a) Section 4.1 and (b) Sections 4.2 (a), (b) and (f) shall be made on the fifth day following the Date of Termination (or, if the Date of Termination occurs after the Approval Date but before the Change in Control Date, the fifth day following the Change in Control Date); provided, however, that if the amounts of such payments cannot be finally determined on or before such day, the Corporation shall pay to you on such day an estimate, as determined in good faith by the Corporation, of the minimum amount of such payments and shall pay the remainder of such payments (together with interest at the rate provided in section 1274(d) of the Code, compounded quarterly) from the Date of Termination as soon as the amount thereof can be determined but in no event later than the thirtieth day after the Date of Termination or the Change in Control Date, as applicable. In the event that the amount of the estimated payments exceeds the amount subsequently determined to have been due, such excess shall constitute a loan by the Corporation to you, payable on the fifth day after demand by the Corporation (together with interest at the rate provided in section 1274(d) of the Code, compounded quarterly) from the date such payment was made by the Corporation.

4.4 No Mitigation. You shall not be required to mitigate the amount of any payment provided for in this Section 4 by seeking other employment or otherwise nor, except as provided in Section 4.2(d), shall the amount of any payment or benefit provided for in this Section 4 be reduced by any compensation earned by you as the result of employment by another employer or self-employment, by retirement benefits, by offset against any amount claimed to be owed by you to the Corporation, or otherwise.

4.5 Code Section 409A. Notwithstanding any provision to the contrary in the Agreement, if you are deemed by the Corporation at the time of your Separation from Service to be a “specified employee” for purposes of Section 409A(a)(2)(B)(i) of the Code, to the extent delayed commencement of any portion of the termination benefits to which you are entitled under this Agreement is required in order to avoid a prohibited distribution under Section 409A(a)(2)(B)(i) of the Code, such portion of your termination benefits shall not be provided to you prior to the earlier of (a) the expiration of the six-month period measured from the date of your Separation from Service with the Corporation or (b) the date of your death. Upon first business day following the expiration of the applicable Code Section 409A(a)(2)(B)(i) deferral period, all payments deferred pursuant to this Section 4.5 shall be paid in a lump sum to you, and any remaining payments due under the Agreement shall be paid as otherwise provided herein. For purposes of Section 409A of the Code (including, without limitation, for purposes of Treasury Regulation Section 1.409A-2(b)(2)(iii)), your right to receive the payments payable pursuant to this Agreement shall be treated as a right to receive a series of separate payments and, accordingly, each payment shall at all times be considered separate and distinct. To the extent that any reimbursements payable pursuant to this Agreement are subject to the provisions of Section 409A of the Code, any such reimbursements shall be paid to you no later than December 31 of the year following the year in which the cost was incurred, the amount of expenses reimbursed in one year shall not affect the amount eligible for reimbursement in any subsequent year, and your right to reimbursement under the Agreement will not be subject to liquidation or exchange for another benefit.

5. Taxes; Gross-Up Payment. You shall bear all expense of, and be solely responsible for, all federal, state, local or foreign taxes due with respect to any payment received hereunder; provided, however, that if any payment or benefit received or to be received by you in connection with a Change in Control or the termination of your employment (whether payable pursuant to the terms of this Agreement or any other plan, arrangements or agreement with the Corporation or an affiliate (collectively, the “Payments”) would be subject to the excise tax imposed by Section 4999 of the Code (the “Excise Tax”), you shall be entitled to receive an additional payment from the Corporation (the “Gross-Up Payment”) in an amount such that, after your payment of all taxes (and any interest or penalties imposed with respect to such taxes), including, without limitation, any income taxes (and any interest and penalties imposed with respect thereto) and Excise Tax imposed upon the Gross-Up Payment, you retain an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments. With respect to each Payment that is subject to the Excise Tax, the related Gross-Up Payment shall be paid to you on, or as soon as practicable following, the payment date (and in any event, such Gross-Up Payment shall be paid to you by the end of the calendar year next following the calendar year in which you remit the related Excise Tax). The foregoing determination will be made by the Corporation’s independent certified public accountants serving immediately prior to the Change in Control (the “Accountants”). In the event that the Accountants are also serving as accountant or auditor for the
individual, group or entity effecting the Change in Control you may appoint another nationally recognized public accounting firm to make the determination required hereunder (which firm shall then be referred to as the Accountants hereunder). All fees and expenses of the Accountants shall be borne by the Corporation. You will direct the Accountants to submit their determination and detailed supporting calculations to both you and the Corporation within fifteen (15) days of receipt from you or the Corporation that you have received or will receive a Payment or such earlier time as requested by the Corporation. You and the Corporation will each provide the Accountants access to and copies of any books, records, and documents in the possession of you or the Corporation, as the case may be, reasonably requested by the Accountants, and otherwise cooperate with the Accountants in connection with the preparation and issuance of the determinations and calculations contemplated by this Section 5.

6. Successors; Binding Agreement.

6.1 Successor to Assume Agreement. The Corporation shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Corporation to expressly assume and agree to perform this Agreement. Failure of the Corporation to obtain such assumption and agreement prior to the Change in Control Date shall be a breach of this Agreement and shall entitle you to terminate your employment and receive compensation from the Corporation in the same amount and on the same terms to which you would be entitled hereunder if you terminate your employment for Good Reason following the Approval Date or, if inapplicable, the Change in Control Date, except that for purposes of implementing the foregoing, the Change in Control Date shall be deemed the Date of Termination. Unless expressly provided otherwise, “Corporation” as used herein shall mean the Corporation as defined in this Agreement and any successor to its business and/or assets as aforesaid.

6.2 Binding Agreement. This Agreement shall inure to the benefit of and be enforceable by you and your personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. If you should die while any amount would still be payable to you hereunder had you continued to live, all such amounts, unless otherwise provided herein, shall be paid in accordance with the terms of this Agreement to your devisee, legatee or other designee or, if there is no such designee, to your estate.

7. Notice. All notices, requests, demands and other communications which are required or may be given under this Agreement shall be in writing and shall be deemed to have been duly given when received if personally delivered; when transmitted if transmitted by telecopy; the day after it is sent, if sent for next day delivery to a domestic address by recognized overnight delivery service (e.g., FedEx); and upon receipt, if sent by certified or registered mail, return receipt requested. All notices, requests, demands and other communications shall be addressed to the respective addresses set forth on the first page of this Agreement, provided that all notices to the Corporation shall be directed to the attention of the Board with a copy to the Secretary of the Corporation, or to such other address as either party may have furnished to the other in writing in accordance herewith, except that notice of change of address shall be effective only upon receipt.

8. Miscellaneous. No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing and signed by you and such officer as may be specifically designated by the Board. No waiver by either party hereto at any time of any breach by the other party hereto of or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement. All references to sections of the Exchange Act or the Code shall be deemed also to refer to any successor provisions to such sections. Any payments provided for hereunder shall be paid net of any applicable withholding required under federal, state or local law. The obligations of the Corporation under Section 4 shall survive the expiration of the term of this Agreement. The section headings contained in this Agreement are for convenience only, and shall not affect the interpretation of this Agreement.

9. Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement, which shall remain in full force and effect.

10. Counterparts. This Agreement may be executed in several counterparts, each of which shall be deemed to be an original but all of which together shall constitute one and the same instrument.


11.1 Compensation During Dispute, Etc. Your compensation during any disagreement, dispute, controversy, claim, suit, action or proceeding (collectively, a “Dispute”), arising out of or relating to this Agreement or the interpretation of this Agreement shall be as follows: If there is a termination followed by a Dispute as to whether you are
entitled to the payments and other benefits provided under this Agreement, then, during the period of that Dispute the Corporation shall pay you fifty percent (50%) of the amount specified in Sections 4.2(a) and 4.2(b) hereof, and the Corporation shall provide you with the other benefits provided in Section 4.2 of this Agreement, if, but only if, you agree in writing that if the Dispute is resolved against you, you shall promptly refund to the Corporation all payments you receive under Sections 4.2(a) and 4.2(b) of this Agreement plus interest at the rate provided in Section 1274(d) of the Code, compounded quarterly. If the Dispute is resolved in your favor, promptly after resolution of the dispute the Corporation shall pay you the sum that was withheld during the period of the Dispute plus interest at the rate provided in Section 1274(d) of the Code, compounded quarterly.

11.2 Legal Fees. The Corporation shall pay to you all legal fees and expenses incurred by you in connection with any Dispute arising out of or relating to this Agreement or the interpretation or clarification thereof (including, without limitation, all such fees and expenses, if any, incurred in contesting or disputing any termination of your employment or in seeking to obtain or enforce any right or benefit provided by this Agreement, or in connection with any tax audit or proceeding to the extent attributable to the application of section 4999 of the Code to any payment or benefit provided hereunder).

11.3 Choice of Law; Arbitration. The internal laws of the State of Oregon, United States of America, applicable to contracts entered into and wholly to be performed in Oregon by Oregon residents, without reference to any principles concerning conflicts of law, shall govern the validity of this Agreement, the construction of its terms and the interpretation of the rights and duties of the parties hereunder; provided, however, that this Section 11.3 and the parties’ rights under this Section 11.3 shall be governed by and construed in accordance with the Federal Arbitration Act, 9 U.S.C. ss. 1 et. sec. Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by the following procedures: Either party may send the other written notice identifying the matter in dispute and involving the procedures of this Section 11.3. Within fourteen (14) days after such written notice is given, one or more principals of each party shall meet at a mutually agreeable location in Portland, Oregon, for the purpose of determining whether they can resolve the dispute themselves by written agreement, and, if not, whether they can agree upon a third-party impartial arbitrator (the “Arbitrator”) to whom to submit the matter in dispute for final and binding arbitration. If the parties fail to resolve the dispute by written agreement or agree on the Arbitrator within such twenty-one (21) day period, either party may make written application to the Judicial Arbitration and Mediation Services (“JAMS”), 600 University Street, Suite 1910, Seattle, Washington 98101, for the appointment of a single Arbitrator to resolve the dispute by arbitration and at the request of JAMS, the parties shall meet with JAMS at its offices or confer with JAMS by telephone within ten (10) calendar days of such request to discuss the dispute and the qualifications and experience which each party respectively believes the Arbitrator should have; provided, however, the selection of the Arbitrator shall be the exclusive decision of JAMS and shall be made within thirty (30) days of the written application to JAMS. Within thirty days of the selection of the Arbitrator, the parties shall meet in Portland, Oregon with such Arbitrator at a place and time designated by the Arbitrator after consultation with the parties and present their respective positions on the dispute. Each party shall have no longer than one day to present its position, the entire proceedings before the Arbitrator shall be on no more than three consecutive days, and the award shall be made in writing no more than 30 days following the end of the proceeding. Such award shall be a final and binding determination of the dispute and shall be fully enforceable as an arbitration award in any court having jurisdiction and venue over the parties. The Corporation shall pay the Arbitrator’s fees and expenses.

12. Effect on Other Agreements. In the event that you are a party to any employment agreement (“Employment Agreement”) with the Corporation, it is the intention that this Agreement provide benefits which are not otherwise provided by any Employment Agreement. Therefore, in the event that during the term of this Agreement you are entitled to payment under both this Agreement and any Employment Agreement, then you shall only receive the greater of the benefits provided under either this Agreement or such Employment Agreement, but not both. In the event you receive benefits under this Agreement, you waive all rights to receive any benefits under such Employment Agreement, and vice versa. For clarification purposes, the parties agree that any agreement evidencing a retention bonus payable pursuant to the Corporation’s Retention Bonus Plan shall not be treated as an Employment Agreement for purposes of this Section 12.

13. Entire Agreement. This Agreement sets forth the entire agreement of the parties hereto in respect of the subject matter contained herein and supersedes all other prior agreements, promises, covenants, arrangements, communications, representations or warranties, whether oral or written, by any officer, employee or representative of any party hereto; and any prior agreement of the parties hereto in respect of the subject matter contained herein, including, without limitation, any prior severance agreements, is hereby terminated and canceled; provided, however, that subject to Section 12 of this Agreement, any Employment Agreement shall remain in full force and effect and shall, pursuant to the terms and conditions thereof (and subject to Section 12 hereof), provide certain severance benefits to you upon certain terminations of employment. Subject to Section 12 of this Agreement, any of your rights hereunder shall be in addition to any rights you may otherwise have under benefit plans or agreements of the Corporation to which you are a party or in which you are a participant, including, but not limited to, any Corporation sponsored employee benefit plans and stock options plans. Subject to Section 12 of this Agreement, provisions of this Agreement shall not in any way abrogate your rights under such other plans and agreements.
If this letter sets forth our agreement on the subject matter hereof, kindly sign and return to the Corporation the enclosed copy of this letter. A duly authorized officer of the Corporation will sign this letter and a fully executed copy will be returned to you, constituting our agreement on this subject. Unless and until accepted in writing by the Corporation, this Agreement is deemed to be neither executed nor effective.

Sincerely,

MENTOR GRAPHICS CORPORATION

By: _________________________
Its: _________________________

Agreed and Accepted,
this ___ day of _____, 2008.
Severance Agreement

August 10, 2008

Dear [Name],

On [Date], you entered into a letter agreement (the “Prior Agreement”) with Mentor Graphics Corporation (the “Corporation”) regarding compensation and benefits arrangements in connection with a Change in Control (as defined herein). You and the Corporation now desire to make certain changes to the Agreement in order to modify the benefits provided thereunder as well as to reflect recent changes affecting the taxation of deferred compensation arrangements under Section 409A of the Internal Revenue Code of 1986, as amended (the “Code”). Accordingly, you and the Corporation have agreed to amend and restate the Prior Agreement as set forth below (the “Agreement”) as of August 10, 2008 (the “Effective Date”).

The Board of Directors (the “Board”) of the Corporation has determined that it is in the best interests of the Corporation and its shareholders to assure that the Corporation will continue to have your dedication and services notwithstanding the possibility, threat or occurrence of a Change in Control. The Board believes it is imperative to diminish the distraction that you would face by virtue of the personal uncertainties created by a pending or threatened Change in Control and to encourage your full attention and dedication to the Corporation currently and in the event of any threatened or pending Change in Control. Further, the Board desires to provide you with compensation and benefits arrangements upon a Change in Control which ensure that your compensation and benefits expectations will be satisfied and which are competitive with those of other corporations. Therefore, in order to accomplish these objectives, the Board has caused the Corporation to enter into this Agreement.

1. Term of Agreement. The terms of this Agreement shall become effective upon the execution hereof by the Corporation and shall continue, unless terminated by written agreement between you and the Corporation, until the later to occur of (a) twenty-four (24) months following the Effective Date, or (b) the date occurring twelve (12) months after the date on which a Change in Control occurs (the date of such Change in Control, the “Change in Control Date”) provided such Change in Control occurs within the twenty-four month period following the Effective Date. No benefits shall be payable hereunder unless there has been a Change in Control.

2. Change in Control. A Change in Control shall be deemed to occur upon the earliest to occur after the date of this Agreement of any of the following events:

2.1 Acquisition of Stock by Third Party. The acquisition by any Person of Beneficial Ownership of 40% or more of either the then-outstanding shares of common stock of the Corporation or the Outstanding Voting Securities; provided, however, that, for purposes of this Section 2.1, the following acquisitions shall not constitute a Change in Control: (a) any acquisition directly from the Corporation, (b) any acquisition by the Corporation, or (c) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Corporation or any Subsidiary of the Corporation;

2.2 Change in Board of Directors. Individuals who, as of the Effective Date, constitute the Board, and any new director whose election by the Board or nomination for election by the Corporation’s shareholders was approved by a vote of at least two thirds of the directors then still in office who were directors on the Effective Date or whose election or nomination for election was previously so approved (collectively, the “Continuing Directors”), cease for any reason to constitute at least a majority of the members of the Board;

2.3 Corporate Transactions. The effective date of a reorganization, merger or consolidation of the Corporation (a “Business Combination”), in each case, unless immediately following such Business Combination: (a) all or substantially all of the Persons who were Beneficial Owners of Outstanding Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 51% of the combined voting power of the then outstanding securities entitled to vote generally in the election of directors of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction either owns the Corporation or all or substantially all of the Corporation’s assets either directly or through one or more Subsidiaries) in substantially the
same proportions as their ownership, immediately prior to such Business Combination, of the Outstanding Voting Securities; (b) no Person (excluding any corporation resulting from such Business Combination) is the Beneficial Owner, directly or indirectly, of 40% or more of the combined voting power of the then outstanding securities entitled to vote generally in the election of directors of such corporation except to the extent that such ownership existed prior to such Business Combination; and (c) at least a majority of the board of directors of the corporation resulting from such Business Combination were Continuing Directors at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination;

2.4 Liquidation. The approval by the shareholders of the Corporation of a complete liquidation of the Corporation or an agreement or series of agreements for the sale or disposition by the Corporation of all or substantially all of the Corporation’s assets, other than factoring the Corporation’s current receivables or escrows due (or, if such approval is not required, the decision by the Board to proceed with such a liquidation, sale or disposition in one transaction or a series of related transactions); or

2.5 Other Events. There occurs any other event of a nature that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A (or a response to any similar or successor item on any similar or successor schedule or form) promulgated under the Exchange Act (as defined below), whether or not the Corporation is then subject to such reporting requirement.

2.6 Certain Definitions. For purposes of this Section 2, the following terms shall have the following meanings:

“Beneficial Owner” and “Beneficial Ownership” shall have the meanings set forth in Rule 13d-3 promulgated under the Exchange Act.


“Outstanding Voting Securities” shall mean the combined voting power of the then-outstanding voting securities of the Corporation entitled to vote generally in the election of directors.

“Person” shall have the meaning as set forth in Sections 13(d) and 14(d) of the Exchange Act; provided, however, that Person shall exclude (i) the Corporation, (ii) any Subsidiary of the Corporation, (iii) any employment benefit plan of the Corporation or Subsidiary of the Corporation or of any corporation owned, directly or indirectly, by the shareholders of the Corporation in substantially the same proportions as their ownership of stock of the Corporation, and (iv) any trustee or other fiduciary holding securities under an employee benefit plan of the Corporation or Subsidiary of the Corporation or of a corporation owned, directly or indirectly, by the shareholders of the Corporation in substantially the same proportions as their ownership of stock of the Corporation.

“Subsidiary” shall mean, with respect to any Person, any business organization or legal entity of which a majority of the voting power of the voting equity securities or equity interest is owned, directly or indirectly, by that Person.

3. Termination Related to a Change in Control.

3.1 General. You shall be entitled to the benefits provided in Section 4 upon

(a) the termination of your employment if your employment is terminated after the Change in Control Date or

(b) with respect to the benefits described in Section 4.2 (other than the amounts described in Section 4.2(a)), the Change in Control Date if your employment is terminated after the date on which the shareholders of the Corporation approve a transaction, the consummation of which would result in the occurrence of a Change in Control (the “Approval Date”), provided that, to the extent that such benefits constitute a deferral of compensation which is subject to Section 409A of the Code, the Change in Control constitutes a change in the ownership or effective control of the Corporation or a change in the ownership of a substantial portion of the assets of the Corporation, as described in Treasury Regulation Section 1.409A-3(i)(5).

Notwithstanding the foregoing, to the extent that the benefits provided in Section 4 constitute a deferral of compensation which is subject to Section 409A of the Code, you shall be entitled to such benefits only if the termination of your employment constitutes a “separation from service” within the meaning of Treasury Regulation Section 1.409A-1(h) (a “Separation from Service”).
3.2 Definition of Disability. If, as a result of your incapacity due to physical or mental illness, you shall have been absent from the full-time performance of your duties with the Corporation for six (6) consecutive months, and within thirty (30) days after written notice of termination is given you shall not have returned to the full-time performance of your duties, your employment may be terminated for “Disability.”

3.3 Definition of Cause. Termination by the Corporation of your employment for “Cause” shall mean termination (a) upon your willful and continued failure to perform substantially your duties with the Corporation (other than any such failure resulting from your incapacity due to physical or mental illness or any such actual or anticipated failure after your issuance of a Notice of Termination (as defined in Section 3.5) for Good Reason, after a written demand for substantial performance is delivered to you by the Board which demand specifically identifies the manner in which the Board believes that you have not substantially performed your duties, (b) upon your willful and continued failure to follow and comply substantially with the specific and lawful directives of the Board, as reasonably determined by the Board (other than any such failure resulting from your incapacity due to physical or mental illness or any such actual or anticipated failure after your issuance of a Notice of Termination for Good Reason), after a written demand for substantial performance is delivered to you by the Board, which demand specifically identifies the manner in which the Board believes that you have not substantially followed or complied with the directives of the Board, (c) upon your willful commission of an act of fraud or dishonesty resulting in material economic or financial injury to the Corporation, or (d) upon your willful engagement in illegal conduct which is materially and demonstrably injurious to the Corporation. For purposes of this Section 3.3, no act, or failure to act, on your part shall be deemed “willful” unless done, or omitted to be done, by you not in good faith. Notwithstanding the foregoing, you shall not be deemed terminated for Cause pursuant to Sections 3.3(a), (b), (c) or (d) hereof unless and until there shall have been delivered to you a copy of a resolution duly adopted by the affirmative vote of not less than three-quarters of the entire membership of the Board at a meeting of the Board (after reasonable notice to you, an opportunity for you, together with your counsel, to be heard before the Board and a reasonable opportunity to cure), finding that in the Board’s good faith opinion you were guilty of conduct set forth above in Section 3.3(a), (b), (c) or (d) and specifying the particulars thereof in reasonable detail. In the event of a Change in Control under Section 2.3 pursuant to which the Corporation is not the surviving entity, then on and after the Change in Control Date all determinations and actions required to be taken by the Board under this Section 3.3 shall be made or taken by the board of directors of the surviving entity, or if the surviving entity is a subsidiary, then by the board of directors of the ultimate parent corporation of the surviving entity.

3.4 Good Reason. You shall be entitled to terminate your employment for Good Reason. For purposes of this Agreement, “Good Reason” shall mean, without your express written consent, the occurrence after the Approval Date of any of the following circumstances unless, in the case of Sections 3.4(a), (f), (g), or (h), such circumstances are fully corrected (provided such circumstances are capable of correction) prior to the Date of Termination (as defined in Section 3.6) specified in the Notice of Termination given in respect thereof:

(a) the assignment to you of any duties inconsistent with the position in the Corporation that you held immediately prior to the Approval Date, if applicable, or the Change in Control Date, a significant adverse alteration in the nature or status of your responsibilities or the conditions of your employment from those in effect immediately prior to the Approval Date, if applicable, or the Change in Control Date, or any other action by the Corporation that results in a material diminution in your position, authority, title, duties or responsibilities;

(b) the Corporation’s reduction of your annual base salary as in effect on the Approval Date, if applicable, or the Change in Control Date or as the same may be increased from time to time;

(c) the relocation of the Corporation’s offices at which you are principally employed immediately prior to the Approval Date, if applicable, or the Change in Control Date (your “Principal Location”) to a location more than twenty-five (25) miles from such location or the Corporation’s requiring you, without your written consent, to be based anywhere other than your Principal Location, except for required travel on the Corporation’s business to an extent substantially consistent with your present business travel obligations;

(d) the Corporation’s failure to pay to you any portion of your current compensation or to pay to you any portion of an installment of deferred compensation under any deferred compensation program of the Corporation within seven (7) days of the date such compensation is due;

(e) the Corporation’s failure to continue in effect any material compensation or benefit plan or practice in which you are eligible to participate in on the Approval Date, if applicable, or the Change in Control Date (other than any equity based plan), unless an equitable arrangement (embodied in an on going substitute or alternative plan) has been made with respect to such plan, or the Corporation’s failure to continue your participation therein (or in such substitute or alternative plan) on a basis not materially less favorable, both in terms of the amount of benefits provided and the level of your participation relative to other participants, as existed at the time of the Approval Date, if applicable, or the Change in Control Date;
(f) the Corporation’s failure to continue to provide you with benefits substantially similar in the aggregate to those enjoyed by you under any of the Corporation’s life insurance, medical, health and accident, disability, pension, retirement, or other benefit plans or practices in which you and your eligible family members were eligible to participate in on the Approval Date, if applicable, or the Change in Control Date (other than any equity based plans), the taking of any action by the Corporation which would directly or indirectly materially reduce any of such benefits, or the failure by the Corporation to provide you with the number of paid vacation days to which you are entitled on the basis of years of service with the Corporation in accordance with the Corporation’s normal vacation policy in effect on the Approval Date, if applicable, or the Change in Control Date;

(g) the Corporation’s failure to obtain a satisfactory agreement from any successor to assume and agree to perform this Agreement, as contemplated in Section 6 hereof; or

(h) any purported termination of your employment that is not effected pursuant to a Notice of Termination satisfying the requirements of Section 3.6 hereof (and, if applicable, the requirements of Section 3.3 hereof), which purported termination shall not be effective for purposes of this Agreement.

Your right to terminate your employment pursuant to this Section 3.4 shall not be affected by your incapacity due to physical or mental illness. Your continued employment shall not constitute consent to, or a waiver of rights with respect to, any circumstance constituting Good Reason hereunder.

3.5 Notice of Termination. Any purported termination of your employment by the Corporation or by you (other than termination due to death which shall terminate your employment automatically) shall be communicated by written Notice of Termination to the other party hereto in accordance with Section 7. “Notice of Termination” shall mean a notice that shall indicate the specific termination provision in this Agreement relied upon and shall set forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of your employment under the provision so indicated.

3.6 Date of Termination, Etc. “Date of Termination” shall mean (a) if your employment is terminated due to your death, the date of your death; (b) if your employment is terminated for Disability, thirty (30) days after Notice of Termination is given (provided that you shall not have returned to the full-time performance of your duties during such thirty (30) day period), and (c) if your employment is terminated pursuant to Section 3.3 or Section 3.4 or for any other reason (other than death or Disability), the date specified in the Notice of Termination (which in the case of a termination for Cause or Good Reason shall be the date thirty (30) days after the date on which Notice of Termination is given). Notwithstanding anything to the contrary contained in this Section 3.6, if within fifteen (15) days after any Notice of Termination is given, the party receiving such Notice of Termination notifies the other party that a dispute exists concerning the termination, then the Date of Termination shall be the date on which the dispute is finally determined, either by mutual written agreement of the parties, or otherwise; provided, however, that (i) the Date of Termination shall be extended by a notice of dispute only if such notice is given in good faith and the party giving such notice pursues the resolution of such dispute with reasonable diligence; and (ii) in the event of your death pending a dispute, and the resolution of such dispute is ultimately in your favor, then the Date of Termination shall be the date specified in the Notice of Termination.

4. Compensation Upon Termination. The benefits to which you are entitled upon termination of your employment, subject to Section 3 and the other terms and conditions of this Agreement, are:

4.1 Cause or Voluntary Termination. If your employment shall be terminated by the Corporation for Cause or voluntarily terminated by you other than for Good Reason, the Corporation shall pay you your full base salary through the Date of Termination at the rate in effect at the time Notice of Termination is given, plus all other amounts to which you are entitled under any compensation plan or practice of the Corporation, and the Corporation shall have no further obligations to you under this Agreement.

4.2 Good Reason; Termination By Corporation Without Cause; Death or Disability. If your employment by the Corporation shall be terminated by you for Good Reason, by the Corporation other than for Cause, or due to your Disability or death, then you shall be entitled to the benefits provided below:

(a) the Corporation shall pay to you your full base salary, when due, through the Date of Termination at the rate in effect at the time Notice of Termination is given, at the time specified in Section 4.3, plus (i) that portion of your full targeted annual bonus prorated through the Date of Termination, (ii) all accrued but unused vacation time through the Date of Termination and (iii) all other amounts to which you are entitled under any compensation plan or practice of the Corporation at the time such payments are due;
(b) in lieu of any further salary payments to you for periods subsequent to the Date of Termination, the Corporation shall pay as severance pay to you, at the time specified in Section 4.3, a lump sum payment equal to the sum of the following:

(1) one and one half (1.5) times your annual base salary as in effect at the time the Notice of Termination is given or immediately prior to the Change in Control Date (or the Approval Date if the Date of Termination is prior to the Change in Control Date), whichever is greater; and

(2) one and one half (1.5) times your full targeted annual bonus as in effect at the time the Notice of Termination is given or immediately prior to the Change in Control Date (or the Approval Date if the Date of Termination is prior to the Change in Control Date), whichever is greater; and

(c) for a period of two (2) years following the Date of Termination, the Corporation shall, at its sole expense as incurred, provide you with outplacement services, the scope and provider of which shall be consistent with your status at the Corporation on the Date of Termination;

(d) for an eighteen (18) month period (or thirty (30) month period if you have attained age fifty-five on the Date of Termination) after the Date of Termination, the Corporation shall continue to provide you and your eligible family members, based on the cost sharing arrangement between you and the Corporation at the time the Notice of Termination is given, with medical and dental health benefits and life and disability benefits at least equal to those which would have been provided to you and them if your employment had not been terminated or, if more favorable to you, as in effect generally at any time thereafter; provided, however, that if you become re-employed with another employer and are eligible to receive such benefits under another employer’s plans, the Corporation’s obligations under this Section 4.2(d) shall be reduced to the extent comparable benefits are actually received by you during the eighteen (or, if applicable, thirty) month period following your termination, and any such benefits actually received by you shall be reported to the Corporation. In the event you are ineligible under the terms of such benefit plans or programs to continue to be so covered, the Corporation shall provide you with substantially equivalent coverage through other sources. At the termination of the medical and dental benefits coverage under the second preceding sentence, you, your spouse and your dependents shall be entitled to continuation coverage pursuant to section 4980B of the Code, sections 601-608 of the Employee Retirement Income Security Act of 1974, as amended, and under any other applicable law, to the extent required by such laws, as if you had terminated employment with the Corporation on the date such benefits coverage terminates;

(e) the Corporation shall furnish you for six (6) years following the Date of Termination (without reference to whether the term of this Agreement continues in effect) with directors’ and officers’ liability insurance insuring you against insurable events which occur or have occurred while you were a director or officer of the Corporation, such insurance to have policy limits aggregating not less than the amount in effect immediately prior to the Change in Control or the Approval Date (whichever is more favorable to you), and otherwise to be in substantially the same form and to contain substantially the same terms, conditions and exceptions as the liability issuance policies provided for officers and directors of the Corporation in force from time to time, provided, however, that (i) such terms, conditions and exceptions shall not be, in the aggregate, materially less favorable to you than those in effect on the date hereof and (ii) if the aggregate annual premiums for such insurance at any time during such period exceed two hundred percent (200%) of the per annum rate of premium currently paid by the Corporation for such insurance, the Corporation shall provide the maximum coverage that will then be available at an annual premium equal to two hundred percent (200%) of such rate;

(f) you shall be fully vested in your accrued benefits under all qualified or nonqualified pension, profit sharing, deferred compensation or supplemental plans maintained by the Corporation for your benefit, and the Corporation shall provide you with additional fully vested benefits under all defined benefit and cash balance plans in an amount equal to the benefits which you would have accrued had you continued your employment with the Corporation until the second anniversary of your Date of Termination; provided, however, that to the extent that the acceleration of vesting or enhanced accrual of such benefits would violate any applicable law or require the Corporation to accelerate the vesting of the accrued benefits of all participants in such plan or plans or to provide additional benefit accruals to such participants, the Corporation shall pay you a lump-sum payment at the time specified in Section 4.3 in an amount equal to the value of such benefits;

(g) in the event you relocate during the period of twelve (12) months following the Date of Termination, your costs (grossed up for taxes) of such relocation shall be provided by the Corporation as if the Corporation had (i) hired you as of the date of this Agreement and provided you with its “Tier 4” relocation package (as described in the policy attached hereto as Exhibit A) or (ii) hired you on the Date of Termination, whichever is greater; and

(h) all unvested stock options held by you on the Date of Termination shall immediately vest and become exercisable in full and all stock options held by you on the Date of Termination shall remain exercisable until the
earlier of (i) the date occurring one year after the Date of Termination, or (ii) the date on which the right to exercise the option would have expired had you continued to be employed by the Corporation for the full term of such option, notwithstanding any vesting schedule or other provisions to the contrary in the agreements or plans evidencing such options (the “Option Arrangements”). You acknowledge and agree that in exchange for the benefits provided pursuant to this Agreement, you will not receive any acceleration of vesting of any stock options solely as a result of an acquisition of the Corporation (including a Change in Control, i.e. “single trigger acceleration) pursuant any Option Arrangement, except if such acceleration results from the failure of the acquirer to assume or substitute for the stock option.

4.3 Timing of Payments under Sections 4.1 and 4.2. The payments provided for in (a) Section 4.1 and (b) Sections 4.2 (a), (b) and (f) shall be made on the fifth day following the Date of Termination (or, if the Date of Termination occurs after the Approval Date but before the Change in Control Date, the fifth day following the Change in Control Date); provided, however, that if the amounts of such payments cannot be finally determined on or before such day, the Corporation shall pay to you on such day an estimate, as determined in good faith by the Corporation, of the minimum amount of such payments and shall pay the remainder of such payments (together with interest at the rate provided in section 1274(d) of the Code, compounded quarterly) from the Date of Termination as soon as the amount thereof can be determined but in no event later than the thirtieth day after the Date of Termination or the Change in Control Date, as applicable. In the event that the amount of the estimated payments exceeds the amount subsequently determined to have been due, such excess shall constitute a loan by the Corporation to you, payable on the fifth day after demand by the Corporation (together with interest at the rate provided in section 1274(d) of the Code, compounded quarterly) from the date such payment was made by the Corporation.

4.4 No Mitigation. You shall not be required to mitigate the amount of any payment provided for in this Section 4 by seeking other employment or otherwise nor, except as provided in Section 4.4(d), shall the amount of any payment or benefit provided for in this Section 4 be reduced by any compensation earned by you as the result of employment by another employer or self-employment, by retirement benefits, by offset against any amount claimed to be owed by you to the Corporation, or otherwise.

4.5 Code Section 409A. Notwithstanding any provision to the contrary in the Agreement, if you are deemed by the Corporation at the time of your Separation from Service to be a “specified employee” for purposes of Section 409A(a)(2)(B)(i) of the Code, to the extent delayed commencement of any portion of the termination benefits to which you are entitled under this Agreement is required in order to avoid a prohibited distribution under Section 409A(a)(2)(B)(i) of the Code, such portion of your termination benefits shall not be provided to you prior to the earlier of (a) the expiration of the six-month period measured from the date of your Separation from Service with the Corporation or (b) the date of your death. Upon first business day following the expiration of the applicable Code Section 409A(a)(2)(B)(i) deferral period, all payments deferred pursuant to this Section 4.5 shall be paid in a lump sum to you, and any remaining payments due under the Agreement shall be paid as otherwise provided herein. For purposes of Section 409A of the Code (including, without limitation, for purposes of Treasury Regulation Section 1.409A-2(b)(2)(iii)), your right to receive the payments payable pursuant to this Agreement shall be treated as a right to receive a series of separate payments and, accordingly, each payment shall at all times be considered separate and distinct. To the extent that any reimbursements payable pursuant to this Agreement are subject to the provisions of Section 409A of the Code, any such reimbursements shall be paid to you no later than December 31 of the year following the year in which the cost was incurred, the amount of expenses reimbursed in one year shall not affect the amount eligible for reimbursement in any subsequent year, and your right to reimbursement under the Agreement will not be subject to liquidation or exchange for another benefit.

5. Taxes; Gross-Up Payment. You shall bear all expense of, and be solely responsible for, all federal, state, local or foreign taxes due with respect to any payment received hereunder; provided, however, that if any payment or benefit received or to be received by you in connection with a Change in Control or the termination of your employment (whether payable pursuant to the terms of this Agreement or any other plan, arrangements or agreement with the Corporation or an affiliate (collectively, the “Payments”) would be subject to the excise tax imposed by Section 4999 of the Code (the “Excise Tax”), you shall be entitled to receive an additional payment from the Corporation (the “Gross-Up Payment”) in an amount such that, after your payment of all taxes (and any interest or penalties imposed with respect to such taxes), including, without limitation, any income taxes (and any interest and penalties imposed with respect thereto) and Excise Tax imposed upon the Gross-Up Payment, you retain an amount of the Gross-Up Payment equal to the Excise Tax imposed upon the Payments. With respect to each Payment that is subject to the Excise Tax, the related Gross-Up Payment shall be paid to you on, or as soon as practicable following, the payment date (and in any event, such Gross-Up Payment shall be paid to you by the end of the calendar year next following the calendar year in which you remit the related Excise Tax). The foregoing determination will be made by the Corporation’s independent certified public accountants serving immediately prior to the Change in Control (the “Accountants”). In the event that the Accountants are also serving as accountant or auditor for the individual, group or entity effecting the Change in Control you may appoint another nationally recognized public accounting firm to make the determination required hereunder (which firm shall then be referred to as the Accountants hereunder). All
fees and expenses of the Accountants shall be borne by the Corporation. You will direct the Accountants to submit their determination and detailed supporting calculations to both you and the Corporation within fifteen (15) days of receipt from you or the Corporation that you have received or will receive a Payment or such earlier time as requested by the Corporation. You and the Corporation will each provide the Accountants access to and copies of any books, records, and documents in the possession of you or the Corporation, as the case may be, reasonably requested by the Accountants, and otherwise cooperate with the Accountants in connection with the preparation and issuance of the determinations and calculations contemplated by this Section 5.

6. Successors; Binding Agreement.

6.1 Successor to Assume Agreement. The Corporation shall require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of the Corporation to expressly assume and agree to perform this Agreement. Failure of the Corporation to obtain such assumption and agreement prior to the Change in Control Date shall be a breach of this Agreement and shall entitle you to terminate your employment and receive compensation from the Corporation in the same amount and on the same terms to which you would be entitled hereunder if you terminate your employment for Good Reason following the Approval Date or, if inapplicable, the Change in Control Date, except that for purposes of implementing the foregoing, the Change in Control Date shall be deemed the Date of Termination. Unless expressly provided otherwise, “Corporation” as used herein shall mean the Corporation as defined in this Agreement and any successor to its business and/or assets as aforesaid.

6.2 Binding Agreement. This Agreement shall inure to the benefit of and be enforceable by you and your personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees. If you should die while any amount would still be payable to you hereunder had you continued to live, all such amounts, unless otherwise provided herein, shall be paid in accordance with the terms of this Agreement to your devisee, legatee or other designee or, if there is no such designee, to your estate.

7. Notice. All notices, requests, demands and other communications which are required or may be given under this Agreement shall be in writing and shall be deemed to have been duly given when received if personally delivered; when transmitted if transmitted by telecopy; the day after it is sent, if sent for next day delivery to a domestic address by recognized overnight delivery service (e.g., FedEx); and upon receipt, if sent by certified or registered mail, return receipt requested. All notices, requests, demands and other communications shall be addressed to the respective addresses set forth on the first page of this Agreement, provided that all notices to the Corporation shall be directed to the attention of the Board with a copy to the Secretary of the Corporation, or to such other address as either party may have furnished to the other in writing in accordance herewith, except that notice of change of address shall be effective only upon receipt.

8. Miscellaneous. No provision of this Agreement may be modified, waived or discharged unless such waiver, modification or discharge is agreed to in writing and signed by you and such officer as may be specifically designated by the Board. No waiver by either party hereto at any time of any breach by the other party hereto of or compliance with, any condition or provision of this Agreement to be performed by such other party shall be deemed a waiver of similar or dissimilar provisions or conditions at the same or at any prior or subsequent time. No agreements or representations, oral or otherwise, express or implied, with respect to the subject matter hereof have been made by either party which are not expressly set forth in this Agreement. All references to sections of the Exchange Act or the Code shall be deemed also to refer to any successor provisions to such sections. Any payments provided for hereunder shall be paid net of any applicable withholding required under federal, state or local law. The obligations of the Corporation under Section 4 shall survive the expiration of the term of this Agreement. The section headings contained in this Agreement are for convenience only, and shall not affect the interpretation of this Agreement.

9. Severability. The invalidity or unenforceability of any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement, which shall remain in full force and effect.

10. Counterparts. This Agreement may be executed in several counterparts, each of which shall be deemed to be an original but all of which together shall constitute one and the same instrument.


11.1 Compensation During Dispute, Etc. Your compensation during any disagreement, dispute, controversy, claim, suit, action or proceeding (collectively, a "Dispute"), arising out of or relating to this Agreement or the interpretation of this Agreement shall be as follows: If there is a termination followed by a Dispute as to whether you are entitled to the payments and other benefits provided under this Agreement, then, during the period of that Dispute the Corporation shall pay you fifty percent (50%) of the amount specified in Sections 4.2(a) and 4.2(b) hereof, and the
Corporation shall provide you with the other benefits provided in Section 4.2 of this Agreement, if, but only if, you agree in writing that if the Dispute is resolved against you, you shall promptly refund to the Corporation all payments you receive under Sections 4.2 (a) and 4.2(b) of this Agreement plus interest at the rate provided in Section 1274(d) of the Code, compounded quarterly. If the Dispute is resolved in your favor, promptly after resolution of the dispute the Corporation shall pay you the sum that was withheld during the period of the Dispute plus interest at the rate provided in Section 1274(d) of the Code, compounded quarterly.

11.2 Legal Fees. The Corporation shall pay to you all legal fees and expenses incurred by you in connection with any Dispute arising out of or relating to this Agreement or the interpretation or clarification thereof (including, without limitation, all such fees and expenses, if any, incurred in contesting or disputing any termination of your employment or in seeking to obtain or enforce any right or benefit provided by this Agreement, or in connection with any tax audit or proceeding to the extent attributable to the application of section 4999 of the Code to any payment or benefit provided hereunder).

11.3 Choice of Law; Arbitration. The internal laws of the State of Oregon, United States of America, applicable to contracts entered into and wholly to be performed in Oregon by Oregon residents, without reference to any principles concerning conflicts of law, shall govern the validity of this Agreement, the construction of its terms and the interpretation of the rights and duties of the parties hereunder; provided, however, that this Section 11.3 and the parties’ rights under this Section 11.3 shall be governed by and construed in accordance with the Federal Arbitration Act, 9 U.S.C. ss. 1 et. sec. Any controversy or claim arising out of or relating to this Agreement, or the breach thereof, shall be settled by the following procedures: Either party may send the other written notice identifying the matter in dispute and involving the procedures of this Section 11.3. Within fourteen (14) days after such written notice is given, one or more principals of each party shall meet at a mutually agreeable location in Portland, Oregon, for the purpose of determining whether they can resolve the dispute themselves by written agreement, and, if not, whether they can agree upon a third-party impartial arbitrator (the “Arbitrator”) to whom to submit the matter in dispute for final and binding arbitration. If the parties fail to resolve the dispute by written agreement or agree on the Arbitrator within such twenty-one (21) day period, either party may make written application to the Judicial Arbitration and Mediation Services (“JAMS”), 600 University Street, Suite 1910, Seattle, Washington 98101, for the appointment of a single Arbitrator to resolve the dispute by arbitration and at the request of JAMS, the parties shall meet with JAMS at its offices or confer with JAMS by telephone within ten (10) calendar days of such request to discuss the dispute and the qualifications and experience which each party respectively believes the Arbitrator should have; provided, however, the selection of the Arbitrator shall be the exclusive decision of JAMS and shall be made within thirty (30) days of the written application to JAMS. Within thirty days of the selection of the Arbitrator, the parties shall meet in Portland, Oregon with such Arbitrator at a place and time designated by the Arbitrator after consultation with the parties and present their respective positions on the dispute. Each party shall have no longer than one day to present its position, the entire proceedings before the Arbitrator shall be on no more than three consecutive days, and the award shall be made in writing no more than 30 days following the end of the proceeding. Such award shall be a final and binding determination of the dispute and shall be fully enforceable as an arbitration award in any court having jurisdiction and venue over the parties. The Corporation shall pay the Arbitrator’s fees and expenses.

12. Effect on Other Agreements. In the event that you are a party to any employment agreement (“Employment Agreement”) with the Corporation, it is the intention that this Agreement provide benefits which are not otherwise provided by any Employment Agreement. Therefore, in the event that during the term of this Agreement you are entitled to payment under both this Agreement and any Employment Agreement, then you shall only receive the greater of the benefits provided under either this Agreement or such Employment Agreement, but not both. In the event you receive benefits under this Agreement, you waive all rights to receive any benefits under such Employment Agreement, and vice versa. For clarification purposes, the parties agree that any agreement evidencing a retention bonus payable pursuant to the Corporation’s Retention Bonus Plan shall not be treated as an Employment Agreement for purposes of this Section 12.

13. Entire Agreement. This Agreement sets forth the entire agreement of the parties hereto in respect of the subject matter contained herein and supersedes all other prior agreements, promises, covenants, arrangements, communications, representations or warranties, whether oral or written, by any officer, employee or representative of any party hereto; and any prior agreement of the parties hereto in respect of the subject matter contained herein, including, without limitation, any prior severance agreements, is hereby terminated and canceled; provided, however, that subject to Section 12 of this Agreement, any Employment Agreement shall remain in full force and effect and shall, pursuant to the terms and conditions thereof (and subject to Section 12 hereof), provide certain severance benefits to you upon certain terminations of employment. Subject to Section 12 of this Agreement, any of your rights hereunder shall be in addition to any rights you may otherwise have under benefit plans or agreements of the Corporation to which you are a party or in which you are a participant, including, but not limited to, any Corporation sponsored employee benefit plans and stock options plans. Subject to Section 12 of this Agreement, provisions of this Agreement shall not in any way abrogate your rights under such other plans and agreements.
If this letter sets forth our agreement on the subject matter hereof, kindly sign and return to the Corporation the enclosed copy of this letter. A duly authorized officer of the Corporation will sign this letter and a fully executed copy will be returned to you, constituting our agreement on this subject. Unless and until accepted in writing by the Corporation, this Agreement is deemed to be neither executed nor effective.

Sincerely,

MENTOR GRAPHICS CORPORATION

By: ________________________________
Its: ________________________________

Agreed and Accepted,
this __ day of _____, 2008.
MENTOR GRAPHICS CORPORATION

RETENTION BONUS PLAN

1. Establishment and Purpose. The Plan is hereby established effective as of September 1, 2008 (the “Effective Date”). The purpose of the Plan is to reinforce and encourage the continued attention and dedication of certain key employees by providing the opportunity for such employees to receive retention bonus payments under the circumstances set forth herein and to provide an incentive for such individuals to remain in the employ of the Company (and its Subsidiaries) or its successor in order to provide transition assistance for a period of time in the event of an acquisition of the Company.

2. Definitions. The following terms as used herein shall have the meanings set forth in this Section 2.

2.1 “Administrator” shall mean (a) the Board or such committee thereof as shall be designated by the Board to administer the Plan, or (b) the Independent Committee (as defined in Section 3.1), to the extent provided in Section 3.1.

2.2 “Base Salary” shall mean (a) for Participants in the sales organization of the Company or a Subsidiary with pay based on product sales, the total targeted compensation payable to such a Participant by the Company or such Subsidiary assuming full quota attainment, before deductions or voluntary deferrals authorized by the Participant or required by law to be withheld from such compensation, and (b) for all other Participants, the annual base rate of compensation payable to a Participant by the Company or a Subsidiary, before deductions or voluntary deferrals authorized by the Participant or required by law to be withheld from such compensation. For purposes of determining the amount of a Participant’s Retention Bonus, Base Salary shall mean the higher of Participant’s Base Salary immediately prior to the date of payment of such Retention Bonus, or Participant’s Base Salary in effect at any time after the Effective Date.

2.3 “Beneficial Owner” and “Beneficial Ownership” shall have the meanings set forth in Rule 13d-3 promulgated under the Exchange Act.

2.4 “Board” shall mean the Board of Directors of the Company, as constituted from time to time.

2.5 “Cause” shall mean, the occurrence by a Participant of any one or more of the following events:

(a) the conviction of, or entry of a plea of “guilty” or “no contest” to, a felony or a crime involving moral turpitude or;

(b) an unauthorized use or disclosure of confidential information or trade secrets of the Company (or a Subsidiary) or any successor or parent or subsidiary thereof;

(c) other intentional misconduct, fraud, embezzlement or act of dishonesty that has a material adverse impact on the Company (and its Affiliates) or any successor or parent or subsidiary thereof; or

(d) an intentional and continued refusal or failure to act in accordance with any lawful and proper direction or order of the Board or the appropriate individual to whom Participant reports.

2.6 “Change in Control” shall mean the first to occur of any of the following:

(a) The acquisition by any Person of Beneficial Ownership of 40% or more of either the then-outstanding shares of common stock of the Company or the combined voting power of the then-outstanding voting securities of the Company entitled to vote generally in the election of directors (the “Outstanding Voting Securities”); provided, however, that, for purposes of this Section 2.6, the following acquisitions shall not constitute a Change in Control: (i) any acquisition directly from the Company, (ii) any acquisition by the Company, or (iii) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any of its Subsidiaries;
(b) Individuals who, as of the Effective Date, constitute the Board, and any new director whose election by the Board or nomination for election by the Company’s shareholders was approved by a vote of at least two thirds of the directors then still in office who were directors on the Effective Date or whose election or nomination for election was previously so approved (collectively, the “Continuing Directors”), cease for any reason to constitute at least a majority of the members of the Board;

(c) The effective date of a reorganization, merger or consolidation of the Company (a “Business Combination”), in each case, unless immediately following such Business Combination: (a) all or substantially all of the Persons who were Beneficial Owners of Outstanding Voting Securities immediately prior to such Business Combination beneficially own, directly or indirectly, more than 51% of the combined voting power of the then outstanding securities entitled to vote generally in the election of directors of the corporation resulting from such Business Combination (including, without limitation, a corporation which as a result of such transaction either owns the Company or all or substantially all of the Company’s assets either directly or through one or more Subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Business Combination, of the Outstanding Voting Securities; (b) no Person (excluding any corporation resulting from such Business Combination) is the Beneficial Owner, directly or indirectly, of 40% or more of the combined voting power of the then outstanding securities entitled to vote generally in the election of directors of such corporation except to the extent that such ownership existed prior to such Business Combination; and (c) at least a majority of the board of directors of the corporation resulting from such Business Combination were Continuing Directors at the time of the execution of the initial agreement, or of the action of the Board, providing for such Business Combination;

(d) The approval by the shareholders of the Company of a complete liquidation of the Company or an agreement or series of agreements for the sale or disposition by the Company of all or substantially all of the Company’s assets, other than factoring the Company’s current receivables or escrows due (or, if such approval is not required, the decision by the Board to proceed with such a liquidation, sale or disposition in one transaction or a series of related transactions); or

(e) There occurs any other event of a nature that would be required to be reported in response to Item 6(e) of Schedule 14A of Regulation 14A (or a response to any similar or successor item on any similar or successor schedule or form) promulgated under the Exchange Act, whether or not the Company is then subject to such reporting requirement.

2.7 “Code” shall mean the Internal Revenue Code of 1986, as amended.

2.8 “Company” shall mean Mentor Graphics Corporation, an Oregon corporation.

2.9 “Covered Termination” shall mean (a) a termination of Participant’s employment due to Participant’s death or Disability, or (b) following a Change in Control, either a termination of Participant’s employment by the Company (or any Subsidiary) for any reason other than Cause or the termination of Participant’s employment by Participant for Good Reason (which must occur within 180 days following the existence of the condition giving rise to Good Reason). Notwithstanding anything herein to the contrary, to the extent that the benefits provided hereunder constitute a deferral of compensation which is subject to Section 409A of the Code, the termination of Participant’s employment shall not constitute a Covered Termination unless such termination constitutes a Separation from Service.

2.10 “Disability” shall mean a Participant’s absence from full-time performance of Participant’s duties with the Company or a Subsidiary for six (6) consecutive months as a result of the incapacity of Participant due to physical or mental illness.

2.11 “Employee” shall mean an individual who is an employee of the Company (or any Subsidiary) within the meaning of Section 3401(c) of the Code.


2.13 “Executive” shall mean a Participant who is (a) an officer of the Company for purposes of Section 16 of the Exchange Act, or (b) a division officer or general manager.
2.14 “Good Reason” shall mean the occurrence of any one or more of the following events without a Participant’s written consent, unless the Company (or Subsidiary) fully corrects the circumstances constituting Good Reason within thirty (30) days after its receipt of a written notice from Participant specifying the event giving rise to Good Reason, such written notice to be received within ninety (90) days of the first occurrence of such event:

(a) a diminution in the nature or status of Participant’s position, authority, title, duties or responsibilities;

(b) with respect to a Participant who is in the sales organization of the Company or a Subsidiary and whose pay is directly determined in part by bookings and shipment of product or services, a material increase in Participant’s sales quota or material changes in Participant’s account responsibilities or sales territory;

(c) a reduction in Participant’s Base Salary;

(d) a reduction in Participant’s target bonus;

(e) a relocation of Participant’s place of employment by more than twenty-five (25) miles from Participant’s place of employment immediately prior to such relocation;

(f) a failure of the Company to expressly require, in writing, any successor to the Company to assume the Plan; or

(g) a material breach by the Company (or a Subsidiary) or its successor, of any material obligation owed to Participant under the Plan or any other written compensation agreement with Participant.

2.15 “Participant” shall mean an Employee who has been selected by the Administrator to receive a Retention Bonus pursuant to the Plan.

2.16 “Person” shall have the meaning as set forth in Sections 13(d) and 14(d) of the Exchange Act; provided, however, that Person shall exclude (a) the Company, (b) any Subsidiary of the Company, (c) any employment benefit plan of the Company or Subsidiary of the Company or of any corporation owned, directly or indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of stock of the Company, and (d) any trustee or other fiduciary holding securities under an employee benefit plan of the Company or Subsidiary of the Company or of a corporation owned, directly or indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of stock of the Company.

2.17 “Plan” shall mean this Mentor Graphics Corporation Retention Bonus Plan.

2.18 “Retention Bonus” shall mean a retention bonus payable to a Participant pursuant to the terms of this Plan.

2.19 “Separation from Service” shall mean a “separation from service” within the meaning of Section 409A of the Code and the Department of Treasury regulations and other guidance promulgated thereunder, including Treasury Regulation Section 1.409A-1(h).

2.20 “Subsidiary” shall mean, with respect to any Person, any business organization or legal entity of which a majority of the voting power of the voting equity securities or equity interest is owned, directly or indirectly, by that Person.

3. Administration.

3.1 General. The Plan shall be administered by the Board, or a committee thereof as designated by the Board. However, in the event of an impending Change in Control, the Administrator may (a) appoint a person (or persons) independent of the third party effectuating the Change in Control to be the Administrator effective upon the occurrence of such Change in Control (the “Independent Committee”) and (b) provide that each member of such Independent Committee shall be entitled to reasonable compensation for his or her service on the Independent Committee;
such Independent Committee shall not be involuntarily removed following such Change in Control and any rate of reasonable compensation established prior to the Change in Control shall not be involuntarily reduced by the Company following such Change in Control.

3.2 Authority of the Administrator. Subject to the provisions of the Plan, the Administrator shall have full authority and discretion to take any actions it deems necessary or advisable for the administration of the Plan. Subject to the provisions of the Plan, the Administrator has authority to determine, in its sole discretion, to whom, and the time at which, Retention Bonuses may be paid as well as the determination of the Retention Bonus amounts. Subject to the provisions of the Plan, the Administrator has authority to prescribe, amend and rescind rules and regulations relating to the Plan and to make all other determinations necessary or advisable for Plan administration. All decisions, interpretations and other actions of the Administrator shall be final, conclusive and binding on all parties who have an interest in the Plan, provided that in the event of a dispute between a Participant and the Company involving any determination by the Administrator following a Change in Control of whether “Cause”, “Disability” or “Good Reason” exists, such determination shall be conclusive only if an Independent Committee was appointed and acting as the Administrator when such determination was made.

3.3 Administrator Liability. All expenses and liabilities which members of the Administrator incur in connection with the administration of this Plan shall be borne by the Company or its successor. No members of the Administrator shall be personally liable for any action, determination or interpretation made in good faith with respect to this Plan or any Retention Bonus paid hereunder, and all members of the Administrator shall be fully indemnified and held harmless by the Company or its successor in respect of any such action, determination or interpretation.

4. Eligibility. Only Employees shall be eligible to participate in the Plan. Subject to the provisions of this Plan, the Administrator shall select the Participants in its sole discretion.

5. Terms and Conditions of the Retention Bonuses.

5.1 Retention Bonus Amounts. The amount of each Retention Bonus for a Participant who is an Executive shall be equal to such Participant’s Base Salary. The amount of the Retention Bonus for other Participants shall be determined by the Administrator, in its sole discretion. Unless otherwise determined by the Administrator, the amount of each Participant’s Retention Bonus shall be expressed as a percentage of Participant’s Base Salary. The Administrator shall notify each Participant of the amount of his or her Retention Bonus at any time after determining such Retention Bonus amount, and such amount may not subsequently be reduced without Participant’s written consent. Such notice shall be in a form specified by the Administrator and may contain such provisions as the Administrator deems appropriate (the “Retention Bonus Agreement”); the Administrator may, in its discretion, require a Participant to acknowledge the terms of such notice in order to be eligible to receive a Retention Bonus pursuant to the Plan.

5.2 Vesting. A Participant shall become vested in his or her Retention Bonus if (a) Participant remains an Employee from the Effective Date through February 14, 2010, or (b) Participant’s employment is terminated prior to February 14, 2010 as a result of a Covered Termination, provided that in either case, Participant has complied with the terms and conditions set forth in his or her Retention Bonus Agreement. In no event shall a Participant be entitled to receive a Retention Bonus payment that does not become vested in accordance with this Section 5.2.

5.3 Form of Payment; Timing. A Participant’s vested Retention Bonus shall be paid in a cash lump sum on the next regularly scheduled payroll day after the date on which the Retention Bonus becomes vested (but in no event later than 30 days after the date on which such Retention Bonus becomes vested).

6. Effect on Other Arrangements. A Participant’s rights hereunder shall be in addition to any rights Participant may otherwise have under all benefit plans or agreements of the Company or its Subsidiaries to which Participant is a party or in which Participant is a participant, including, but not limited to, any employee benefit plans, bonus plans and equity incentive plans. The provisions of the Plan shall not in any way abrogate the Participant’s rights under such other plans and agreements. Notwithstanding the foregoing, with respect to a Participant who (a) is not an Executive, (b) receives payment of a Retention Bonus pursuant to the Plan, and (c) terminates employment within six (6) months following a Change in Control, such Participant shall not be entitled to receive any other severance payment pursuant to another plan, guideline, practice or agreement with the Company or a Subsidiary (except as required under applicable law or such Participant’s written employment agreement).
7. Withholding Taxes. All amounts payable hereunder shall be subject to withholding of any applicable federal, state, local, and foreign income, employment and excise taxes as are required to be withheld pursuant to any applicable law or regulation.

8. Assignment or Transfer of Rights and Obligations. The Company shall require any corporation, entity, individual or other person who is the successor (whether direct or indirect by purchase, merger, consolidation, reorganization or otherwise) to all or substantially all the business and/or assets of the Company to expressly assume and agree to perform, by a written agreement in form and in substance satisfactory to the Company, all of the obligations of the Company under this Plan. As used in this Plan, the term “Company” shall mean the Company as hereinafter defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Plan by operation of law, written agreement or otherwise. No Participant’s rights hereunder shall be assigned, attached, garnished, optioned, transferred or made subject to any creditor’s process, whether voluntarily, involuntarily or by operation of law, except as approved by the Administrator.

9. No Employment Rights. No provision of the Plan shall be construed to give any person any right to become, to be treated as, or to remain an Employee. The Company and its Subsidiaries reserve the right to terminate any Participant’s employment at any time and for any reason or for no reason, with or without cause and with or without advance notice.

10. No Equity Interest. Neither the Plan nor any Retention Bonus payable hereunder creates or conveys any equity or ownership interest in the Company nor any rights commonly associated with such interests, including, without limitation, the right to vote on any matters put before the shareholders of the Company.

11. Duration and Amendments.

11.1 Term of the Plan. This Plan shall be effective as of the Effective Date, and shall terminate upon the payment of all Retention Bonuses benefits payable hereunder.

11.2 Right to Amend or Terminate the Plan. Except as otherwise provided herein, the Plan may be amended or terminated at any time or from time to time by the Board; provided, however, that no such amendment or termination shall impair the then-existing rights of a Participant with regard to the Plan without such Participant’s written consent.

12. Choice of Law. All questions concerning the construction, validation and interpretation of the Plan will be governed by the law of the State of Oregon without regard to its conflict of laws provision.

13. Funding. No provision of the Plan shall require the Company, for purpose of satisfying any obligations under the Plan, to purchase assets or place any assets in a trust or other entity to which contributions are made or otherwise to segregate any assets, nor shall the Company maintain separate bank accounts, books, records or other evidence of the existence of a segregated or separately maintained or administered fund for such purposes. Participants shall have no rights under the Plan other than as unsecured general creditors of the Company or its successor.

14. Code Section 409A. Notwithstanding anything herein to the contrary, if a Participant is deemed by the Company at the time of his or her Separation from Service to be a “specified employee” for purposes of Section 409A(a)(2)(B)(i) of the Code, to the extent delayed commencement of any portion of the benefits to which Participant is entitled hereunder is required in order to avoid a prohibited distribution under Section 409A(a)(2)(B)(i) of the Code, such portion of Participant’s benefits shall not be provided to Participant prior to the earlier of (a) the expiration of the six-month period measured from the date of the Participant’s Separation from Service with the Company or a Subsidiary or (b) the date of Participant’s death. Upon the first business day following the expiration of the applicable Code Section 409A(a)(2)(B)(i) period, all payments deferred pursuant to this Section 14 shall be paid in a lump sum to Participant (or Participant’s estate or beneficiaries), and any remaining payments due under the Agreement shall be paid as otherwise provided herein. In addition, notwithstanding anything herein to the contrary, within the time period permitted by the applicable Treasury Regulations or other Internal Revenue Service or Treasury Department authority, if any compensation or benefits provided by this Plan may result in accelerated taxation or tax penalties under Section 409A of the Code, the Company shall modify the Plan in the least restrictive manner necessary in order to exclude such compensation from the definition of “deferred compensation” within the meaning of Section 409A of the Code or in order to comply with the provisions of Section 409A of the Code, other applicable provision(s) of the Code and/or any rules, regulations or other regulatory guidance issued under such statutory provisions and without any diminution in the value of the payments to any Participant.
15. **Attorney Fees.** The Company agrees to reimburse each Participant, to the full extent permitted by law, for all legal fees and expenses that the Participant may reasonably incur as a result of any contest by the Company, the Participant or others of the validity or enforceability of, or liability under, any provision of this Plan or any guarantee of performance thereof (including as a result of any contest by the Participant about the amount of any payment pursuant to this Plan) (each, a “Contest”); provided, that the Company shall not be obligated to reimburse a Participant for such legal fees and expenses unless the Participant prevails on at least one material claim (regardless of by whom brought) and that the Participant shall have submitted an invoice for such fees and expenses not later than 30 days after the final resolution of such Contest, and the Company shall make such payment within 30 days after the date on which the invoice is so submitted. To the extent necessary to comply with Section 409A of the Code, (a) in no event shall the payments by the Company under this Section 15 be made later than the end of the calendar year next following the calendar year in which such fees and expenses were incurred, (b) the amount of such legal fees and expenses that the Company is obligated to pay in any given calendar year shall not affect the legal fees and expenses that the Company is obligated to pay in any other calendar year and (c) the Participant’s right to have the Company pay such legal fees and expenses may not be liquidated or exchanged for any other benefit.

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I hereby certify that the foregoing Plan was duly adopted by the Board on the Effective Date set forth above.

**MENTOR GRAPHICS CORPORATION**

By: /s/ Dean M. Freed

Title: Vice President, Legal Counsel
September 4, 2008

Mentor Graphics Corporation
Portland, Oregon

Ladies and Gentlemen:

We have been furnished with a copy of the quarterly report on Form 10-Q of Mentor Graphics Corporation and subsidiaries (the Company) for the quarterly period ended July 31, 2008, and have read the Company’s statements contained in Note 4 to the condensed consolidated financial statements included therein. As stated in Note 4, the Company changed its method of accounting for French research credits from a reduction of income tax expense to a reduction in research and development costs. The Company states the new accounting treatment is preferable based on its assessment that the French research credits are solely based on the Company’s research and development spending within France and can be recovered irrespective of whether the Company pays income tax in France. In accordance with your request, we have reviewed and discussed with Company officials the circumstances and business judgment and planning upon which the decision to make this change in the method of accounting was based.

We have not audited any financial statements of the Company as of any date or for any period subsequent to January 31, 2008, nor have we audited the information set forth in the aforementioned Note 4 to the condensed consolidated financial statements; accordingly, we do not express an opinion concerning the factual information contained therein.

With regard to the aforementioned accounting change, authoritative criteria have not been established for evaluating the preferability of one acceptable method of accounting over another acceptable method. However, for purposes of the Company’s compliance with the requirements of the Securities and Exchange Commission, we are furnishing this letter.

Based on our review and discussion, with reliance on management’s business judgment and planning, we concur that the newly adopted method of accounting is preferable in the Company’s circumstances.

Very truly yours,

/S/ KPMG LLP
CERTIFICATIONS

I, Walden C. Rhines, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Mentor Graphics Corporation, the registrant;

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

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

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Dated: September 4, 2008

/s/ WALDEN C. RHINES
Walden C. Rhines
Chief Executive Officer
CERTIFICATIONS

I, Maria M. Pope, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Mentor Graphics Corporation, the registrant;

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

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

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):
   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Dated: September 4, 2008

/s/ MARIA M. POPE
Maria M. Pope
Chief Financial Officer

Pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Mentor Graphics Corporation (the “Company”) hereby certifies to such officer’s knowledge that:

(i) the Quarterly Report on Form 10-Q of the Company for the quarter ended July 31, 2008 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: September 4, 2008

/s/ WALDEN C. RHINES
Walden C. Rhines
Chief Executive Officer

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing. A signed original of this written statement required by Section 906 has been provided to Mentor Graphics Corporation and will be retained by Mentor Graphics Corporation and furnished to the Securities and Exchange Commission or its staff upon request.


Pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of Mentor Graphics Corporation (the “Company”) hereby certifies to such officer’s knowledge that:

(i) the Quarterly Report on Form 10-Q of the Company for the quarter ended July 31, 2008 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: September 4, 2008

/s/ MARIA M. POPE
Maria M. Pope
Chief Financial Officer

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. § 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of the Company, whether made before or after the date hereof, regardless of any general incorporation language in such filing. A signed original of this written statement required by Section 906 has been provided to Mentor Graphics Corporation and will be retained by Mentor Graphics Corporation and furnished to the Securities and Exchange Commission or its staff upon request.