SYNOPSYS INC
Form 10-Q
February 24, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED JANUARY 31, 2015

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 0-19807

SYNOPSYS, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	56-1546236
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

690 EAST MIDDLEFIELD ROAD
MOUNTAIN VIEW, CA 94043
(Address of principal executive offices, including zip code)
(650) 584-5000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý 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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	ý	Accelerated Filer	¨
Non-accelerated filer	¨ (Do not check if smaller reporting company)	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 ý

As of February 20, 2015, there were 153,686,533 shares of the registrant's common stock outstanding.

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SYNOPSYS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE FISCAL QUARTER ENDED JANUARY 31, 2015
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
SYNOPSYS, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value amounts)

	January 31, 2015	October 31, 2014*
ASSETS		
Current assets:		
Cash and cash equivalents	$796,824	$985,762
Short-term investments	120,238	—
Total cash, cash equivalents and short-term investments	917,062	985,762
Accounts receivable, net	283,007	326,727
Deferred income taxes	95,800	111,449
Income taxes receivable and prepaid taxes	28,089	26,496
Prepaid and other current assets	92,315	54,301
Total current assets	1,416,273	1,504,735
Property and equipment, net	256,092	249,098
Goodwill	2,245,920	2,255,708
Intangible assets, net	332,385	365,030
Long-term prepaid taxes	4,501	17,645
Long-term deferred income taxes	227,715	208,156
Other long-term assets	179,463	175,127
Total assets	$4,662,349	$4,775,499
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$242,335	$397,113
Accrued income taxes	12,024	31,404
Deferred revenue	823,745	928,242
Short-term debt	265,000	30,000
Total current liabilities	1,343,104	1,386,759
Long-term accrued income taxes	42,154	50,952
Long-term deferred revenue	98,413	77,646
Long-term debt	37,500	45,000
Other long-term liabilities	204,157	158,972
Total liabilities	1,725,328	1,719,329
Stockholders’ equity:		
Preferred stock, $0.01 par value: 2,000 shares authorized; none outstanding	—	—
Common stock, $0.01 par value: 400,000 shares authorized; 153,457 and 155,965 shares outstanding, respectively	1,535	1,560
Capital in excess of par value	1,586,965	1,614,603
Retained earnings	1,608,758	1,551,592
Treasury stock, at cost: 3,807 and 1,299 shares, respectively	(162,992)	(49,496)
Accumulated other comprehensive income (loss)	(97,245)	(62,089)
Total stockholders’ equity	2,937,021	3,056,170
Total liabilities and stockholders’ equity	$4,662,349	$4,775,499

* Derived from audited financial statements.
See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended January 31,	
	2015	2014
Revenue:		
Time-based license	$431,026	$400,146
Upfront license	46,480	33,972
Maintenance and service	64,537	44,833
Total revenue	542,043	478,951
Cost of revenue:		
License	70,784	62,825
Maintenance and service	27,983	20,271
Amortization of intangible assets	25,866	22,753
Total cost of revenue	124,633	105,849
Gross margin	417,410	373,102
Operating expenses:		
Research and development	181,610	167,543
Sales and marketing	106,169	105,792
General and administrative	36,354	34,233
Amortization of intangible assets	6,442	5,378
Restructuring charges	15,336	—
Total operating expenses	345,911	312,946
Operating income	71,499	60,156
Other income (expense), net	5,116	11,028
Income before provision for income taxes	76,615	71,184
Provision (benefit) for income taxes	11,426	3,488
Net income	$65,189	$67,696
Net income per share:		
Basic	$0.42	$0.44
Diluted	$0.41	$0.43
Shares used in computing per share amounts:		
Basic	154,458	154,066
Diluted	157,206	156,756

See accompanying notes to unaudited condensed consolidated financial statements.

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SYNOPSYS, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)

	Three Months Ended January 31,	
	2015	2014
	(in thousands)	
Net income	$65,189	$67,696
Other comprehensive income (loss):		
Change in foreign currency translation adjustment	(23,453)	(13,849)
Changes in unrealized gains (losses) on available-for-sale securities, net of tax of $0 for periods presented	17	—
Cash flow hedges:		
Deferred gains (losses), net of tax of $4,845 and $1,329, respectively	(12,775)	(575)
Reclassification adjustment on deferred (gains) losses included in net income, net of tax of $(390) and $294, respectively	1,055	(3,306)
Other comprehensive income (loss), net of tax effects	(35,156)	(17,730)
Comprehensive income	$30,033	$49,966

See accompanying notes to unaudited condensed consolidated financial statements.

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

	Three Months Ended January 31,	
	2015	2014
Cash flow from operating activities:		
Net income	$65,189	$67,696
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization and depreciation	50,529	43,714
Stock compensation	20,581	18,118
Allowance for doubtful accounts	300	(400)
Deferred income taxes	(158)	5,891
(Gain) loss on sale of investments	(12)	(6,529)
Net changes in operating assets and liabilities, net of acquired assets and liabilities:		
Accounts receivable	40,857	7,910
Prepaid and other current assets	(42,860)	(13,635)
Other long-term assets	(7,597)	(6,695)
Accounts payable and other liabilities	(125,320)	(134,902)
Income taxes	(14,024)	(10,068)
Deferred revenue	(74,828)	(44,992)
Net cash used in operating activities	(87,343)	(73,892)
Cash flows from investing activities:		
Proceeds from sales of long-term investments	—	6,791
Proceeds from sales and maturities of short-term investments	8,012	—
Purchases of short-term investments	(128,427)	—
Purchases of property and equipment	(19,607)	(14,353)
Cash paid for intangible assets	—	(900)
Capitalization of software development costs	(909)	(902)
Net cash used in investing activities	(140,931)	(9,364)
Cash flows from financing activities:		
Proceeds from credit facility	250,000	—
Repayment of debt	(22,723)	(7,748)
Issuances of common stock	10,542	21,581
Purchase of equity forward contract	(36,000)	—
Purchases of treasury stock	(144,000)	(54,747)
Other	(14)	(111)
Net cash provided by (used in) financing activities	57,805	(41,025)
Effect of exchange rate changes on cash and cash equivalents	(18,469)	(5,107)
Net change in cash and cash equivalents	(188,938)	(129,388)
Cash and cash equivalents, beginning of year	985,762	1,022,441
Cash and cash equivalents, end of period	$796,824	$893,053

See accompanying notes to unaudited condensed consolidated financial statements.

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SYNOPSYS, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
Note 1. Description of Business
Synopsys, Inc. (Synopsys or the Company) is a global leader in providing software, intellectual property and services used to design integrated circuits and electronic systems. The Company supplies the electronic design automation (EDA) software that engineers use to design, create prototypes for and test integrated circuits, also known as chips. The Company also offers intellectual property (IP) products, which are pre-designed circuits that engineers use as components of larger chip designs rather than designing those circuits themselves. The Company provides software and hardware used to develop the electronic systems that incorporate chips and the software that runs on them. To complement these product offerings, the Company provides technical services to support these solutions and help its customers develop chips and electronic systems. The Company is also a leading provider of software tools that developers use to improve the quality, security and time-to-market of software code in a wide variety of industries, including electronics, financial services, energy, and industrials.
Note 2. Summary of Significant Accounting Policies
The Company has prepared the accompanying unaudited condensed consolidated financial statements pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its annual consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP). In management’s opinion, the Company has made all adjustments (consisting only of normal, recurring adjustments, except as otherwise indicated) necessary to fairly present its unaudited condensed consolidated balance sheets, results of operations, comprehensive income and cash flows. The Company’s interim period operating results do not necessarily indicate the results that may be expected for any other interim period or for the full fiscal year. These financial statements and accompanying notes should be read in conjunction with the consolidated financial statements and notes thereto in Synopsys’ Annual Report on Form 10-K for the fiscal year ended October 31, 2014 as filed with the SEC on December 15, 2014.
Use of Estimates. To prepare financial statements in conformity with GAAP, management must make estimates and assumptions that affect the amounts reported in the unaudited condensed consolidated financial statements and accompanying notes. Actual results could differ from these estimates and may result in material effects on the Company’s operating results and financial position.
Principles of Consolidation. The unaudited condensed consolidated financial statements include the accounts of the Company and all of its subsidiaries. All significant intercompany accounts and transactions have been eliminated.
Fiscal Year End. The Company’s fiscal year generally ends on the Saturday nearest to October 31 and consists of 52 weeks, with the exception that approximately every five years, the Company has a 53-week year. When a 53-week year occurs, the Company includes the additional week in the first quarter to realign fiscal quarters with calendar quarters. Fiscal 2015 and 2014 are both 52-week years. The first fiscal quarters of fiscal 2015 and 2014 ended on January 31, 2015 and February 1, 2014, respectively, and the prior year ended on November 1, 2014. For presentation purposes, the unaudited condensed consolidated financial statements and accompanying notes refer to the closest calendar month end.
Subsequent Events. The Company has evaluated subsequent events through the date that these unaudited condensed consolidated financial statements were issued.
Note 3. Goodwill and Intangible Assets
Goodwill as of January 31, 2015 and October 31, 2014 consisted of the following:

	(in thousands)
As of October 31, 2014	$2,255,708
Additions	—
Effect of foreign currency translation	(9,788)
As of January 31, 2015	$2,245,920

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Intangible assets as of January 31, 2015 consisted of the following:

	Gross Assets	Accumulated Amortization	Net Assets
	(in thousands)		
Core/developed technology	$490,929	$316,714	$174,215
Customer relationships	209,984	97,829	112,155
Contract rights intangible	145,616	116,389	29,227
Covenants not to compete	2,530	2,530	—
Trademarks and trade names	18,779	8,464	10,315
In-process research and development (IPR&D)(1)	2,400	—	2,400
Capitalized software development costs	22,738	18,665	4,073
Total	$892,976	$560,591	$332,385

Intangible assets as of October 31, 2014 consisted of the following:

	Gross Assets	Accumulated Amortization	Net Assets
	(in thousands)		
Core/developed technology	$490,242	$298,705	$191,537
Customer relationships	210,172	92,146	118,026
Contract rights intangible	146,364	109,067	37,297
Covenants not to compete	2,530	2,530	—
Trademarks and trade names	18,779	7,765	11,014
In-process research and development (IPR&D)(1)	3,086	—	3,086
Capitalized software development costs	21,829	17,759	4,070
Total	$893,002	$527,972	$365,030

(1) IPR&D is reclassified to core/developed technology upon completion or is written off upon abandonment.

Amortization expense related to intangible assets consisted of the following:

	Three Months Ended January 31,	
	2015	2014
	(in thousands)	
Core/developed technology	$18,009	$15,621
Customer relationships	5,748	5,053
Contract rights intangible	7,852	7,126
Covenants not to compete	—	17
Trademarks and trade names	699	314
Capitalized software development costs(1)	906	864
Total	$33,214	$28,995

(1) Amortization of capitalized software development costs is included in cost of license revenue in the unaudited condensed consolidated statements of operations.

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

Fiscal Year	(in thousands)
Remainder of fiscal 2015	$95,690
2016	92,056
2017	55,627
2018	40,298
2019	20,645
2020 and thereafter	25,669
IPR&D(1)	2,400
Total	$332,385

(1) IPR&D projects are estimated to be completed within one year as of January 31, 2015. Assets are amortized over their useful life upon completion of the project or are written off upon abandonment.

Note 4. Financial Assets and Liabilities

Cash equivalents and short-term investments. The Company classifies time deposits and other investments with maturities less than three months as cash equivalents. Debt securities and other investments with maturities longer than three months are classified as short-term investments. The Company's investments generally have a term of less than three years and are classified as available-for-sale carried at fair value, with unrealized gains and losses included in the unaudited condensed consolidated balance sheet as a component of accumulated other comprehensive income (loss), net of tax. Those unrealized gains or losses deemed other than temporary are reflected in other income (expense), net. The cost of securities sold is based on the specific identification method and realized gains and losses are included in other income (expense), net.

During the first fiscal quarter of 2015, the Company made investments in available-for-sale securities, as follows:

As of January 31, 2015	Cost	Gross Unrealized Gains	Gross Unrealized Losses Less Than 12 Months	Gross Unrealized Losses 12 Months or Longer	Estimated Fair Value(1)
	(in thousands)				
Cash equivalents:					
Certificates of deposit	$2,400	$—	$—	$—	$2,400
Money market funds	377,370	—	—	—	377,370
Commercial paper	8,697	—	—	—	8,697
Total:	388,467	—	—	—	388,467
Short-term investments:					
U.S. government agency securities	17,928	8	—	—	17,936
Municipal bonds	1,405	—	(2)	—	1,403
Certificates of deposit	3,400	—	—	—	3,400
Commercial paper	7,090	—	—	—	7,090
Corporate debt securities	67,160	26	(18)	—	67,168
Asset-backed securities	23,238	5	(2)	—	23,241
Total:	120,221	39	(22)	—	120,238

(1) See Note 5. Fair Value Measures for further discussion on fair values of cash equivalents and short-term investments.

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As of January 31, 2015 the stated maturities of the Company's short-term investments are:

	Amortized Cost	Fair Value
	(in thousands)	
Due in 1 year or less	$64,421	$64,414
Due in 1-5 years	55,800	55,824
Total	$120,221	$120,238

Non-marketable equity securities. The Company's strategic investment portfolio consists of non-marketable equity securities in privately-held companies. The securities accounted for under cost method investments are reported at cost net of impairment losses. Securities accounted for under equity method investments are recorded at cost plus the proportional share of the issuers' income or loss, which is recorded in the Company's other income (expense), net. The cost basis of securities sold is based on the specific identification method. Refer to Note 5. Fair Value Measures.

Derivatives. The Company recognizes derivative instruments as either assets or liabilities in the unaudited condensed consolidated financial statements at fair value and provides qualitative and quantitative disclosures about such derivatives. The Company operates internationally and is exposed to potentially adverse movements in foreign currency exchange rates. The Company enters into hedges in the form of foreign currency forward contracts to reduce its exposure to foreign currency rate changes on non-functional currency denominated forecasted transactions and balance sheet positions including: (1) certain assets and liabilities, (2) shipments forecasted to occur within approximately one month, (3) future billings and revenue on previously shipped orders, and (4) certain future intercompany invoices denominated in foreign currencies.

The duration of forward contracts ranges from approximately one month to 22 months, the majority of which are short-term. The Company does not use foreign currency forward contracts for speculative or trading purposes. The Company enters into foreign exchange forward contracts with high credit quality financial institutions that are rated 'A' or above and to date has not experienced nonperformance by counterparties. Further, the Company anticipates continued performance by all counterparties to such agreements.

The assets or liabilities associated with the forward contracts are recorded at fair value in other current assets or accrued liabilities in the unaudited condensed consolidated balance sheets. The accounting for gains and losses resulting from changes in fair value depends on the use of the foreign currency forward contract and whether it is designated and qualifies for hedge accounting.

Cash Flow Hedging Activities

Certain foreign exchange forward contracts are designated and qualify as cash flow hedges. These contracts have durations of approximately 22 months or less. Certain forward contracts are rolled over periodically to capture the full length of exposure to the Company's foreign currency risk, which can be up to three years. To receive hedge accounting treatment, all hedging relationships are formally documented at the inception of the hedge, and the hedges must be highly effective in offsetting changes to future cash flows on the hedged transactions. The effective portion of gains or losses resulting from changes in fair value of these hedges is initially reported, net of tax, as a component of other comprehensive income (OCI), in stockholders' equity and reclassified into revenue or operating expenses, as appropriate, at the time the hedged transactions affect earnings. The Company expects a majority of the hedge balance in OCI to be reclassified to the statements of operations within the next twelve months.

Hedging effectiveness is evaluated monthly using spot rates, with any gain or loss caused by hedging ineffectiveness recorded in other income (expense), net. The premium/discount component of the forward contracts is recorded to other income (expense), net, and is not included in evaluating hedging effectiveness.

Non-designated Hedging Activities

The Company's foreign exchange forward contracts that are used to hedge non-functional currency denominated balance sheet assets and liabilities are not designated as hedging instruments. Accordingly, any gains or losses from changes in the fair value of the forward contracts are recorded in other income (expense), net. The gains and losses on these forward contracts generally offset the gains and losses associated with the underlying assets and liabilities, which are also recorded in other income (expense), net. The duration of the forward contracts for hedging the Company's balance sheet exposure is approximately one month.

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The Company also has certain foreign exchange forward contracts for hedging certain international revenues and expenses that are not designated as hedging instruments. Accordingly, any gains or losses from changes in the fair value of the forward contracts are recorded in other income (expense), net. The gains and losses on these forward contracts generally offset the gains and losses associated with the foreign currency in operating income. The duration of these forward contracts is usually less than one year. The overall goal of the Company's hedging program is to minimize the impact of currency fluctuations on its net income over its fiscal year.

The effects of the changes in the fair values of non-designated forward contracts are summarized as follows:

	Three Months Ended January 31,	
	2015	2014
	(in thousands)	
Gain (loss) recorded in other income (expense), net	$(2,758)	$(943)

The notional amounts in the table below for derivative instruments provide one measure of the transaction volume outstanding:

	As of January 31, 2015	As of October 31, 2014
	(in thousands)	
Total gross notional amount	$732,766	$793,937
Net fair value	$(6,894)	$(2,455)

The notional amounts for derivative instruments do not represent the amount of the Company's exposure to market gain or loss. The Company's exposure to market gain or loss will vary over time as a function of currency exchange rates. The amounts ultimately realized upon settlement of these financial instruments, together with the gains and losses on the underlying exposures, will depend on actual market conditions during the remaining life of the instruments.

The following represents the unaudited condensed consolidated balance sheet location and amount of derivative instrument fair values segregated between designated and non-designated hedge instruments:

	Fair values of derivative instruments designated as hedging instruments	Fair values of derivative instruments not designated as hedging instruments
	(in thousands)	
As of January 31, 2015		
Other current assets	$16,781	$1,549
Accrued liabilities	$25,210	$14
As of October 31, 2014		
Other current assets	$9,299	$1
Accrued liabilities	$11,656	$99

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The following table represents the unaudited condensed consolidated statement of operations location and amount of gains and losses on derivative instrument fair values for designated hedge instruments, net of tax:

	Location of gain (loss) recognized in OCI on derivatives	Amount of gain (loss) recognized in OCI on derivatives (effective portion)	Location of gain (loss) reclassified from OCI	Amount of gain (loss) reclassified from OCI (effective portion)
	(in thousands)			
Three months ended January 31, 2015				
Foreign exchange contracts	Revenue	$ 2,966	Revenue	$ 2,381
Foreign exchange contracts	Operating expenses	(15,795)	Operating expenses	(3,436)
Total		$ (12,829)		$ (1,055)
Three months ended January 31, 2014				
Foreign exchange contracts	Revenue	$ 3,188	Revenue	$ 2,756
Foreign exchange contracts	Operating expenses	(3,782)	Operating expenses	550
Total		$ (594)		