

CADENCE DESIGN SYSTEMS INC

Form 10-Q

October 29, 2010

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-Q

(Mark One)

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended **October 2, 2010**
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 **0-15867**

CADENCE DESIGN SYSTEMS, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

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

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

95134
(Zip Code)

(408) 943-1234

Registrant's Telephone Number, including Area Code

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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

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 the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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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

On October 2, 2010, 267,211,463 shares of the registrant's common stock, \$0.01 par value, were outstanding.

**CADENCE DESIGN SYSTEMS, INC.
INDEX**

		Page
<u>PART I.</u>	<u>FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	<u>Financial Statements:</u>	
	<u>Condensed Consolidated Balance Sheets: October 2, 2010 and January 2, 2010</u>	1
	<u>Condensed Consolidated Statements of Operations: Three and Nine Months Ended October 2, 2010 and October 3, 2009</u>	2
	<u>Condensed Consolidated Statements of Cash Flows: Nine Months Ended October 2, 2010 and October 3, 2009</u>	3
	<u>Notes to Condensed Consolidated Financial Statements</u>	4
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	29
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	50
<u>Item 4.</u>	<u>Controls and Procedures</u>	53
<u>PART II.</u>	<u>OTHER INFORMATION</u>	
<u>Item 1.</u>	<u>Legal Proceedings</u>	54
<u>Item 1A.</u>	<u>Risk Factors</u>	55
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	72
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	72
<u>Item 4.</u>	<u>Reserved</u>	72
<u>Item 5.</u>	<u>Other Information</u>	72
<u>Item 6.</u>	<u>Exhibits</u>	73
	<u>Signatures</u>	74
	<u>EX-10.01</u>	
	<u>EX-10.02</u>	
	<u>EX-31.01</u>	
	<u>EX-31.02</u>	
	<u>EX-32.01</u>	
	<u>EX-32.02</u>	
	<u>EX-101 INSTANCE DOCUMENT</u>	
	<u>EX-101 SCHEMA DOCUMENT</u>	

[EX-101 CALCULATION LINKBASE DOCUMENT](#)

[EX-101 LABELS LINKBASE DOCUMENT](#)

[EX-101 PRESENTATION LINKBASE DOCUMENT](#)

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****CADENCE DESIGN SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)****(Unaudited)****ASSETS**

	October 2, 2010	January 2, 2010
Current Assets:		
Cash and cash equivalents	\$ 509,035	\$ 569,115
Short-term investments	2,641	2,184
Receivables, net of allowances of \$10,833 and \$14,020, respectively	202,237	200,628
Inventories	28,486	24,165
Prepaid expenses and other	79,910	54,655
Total current assets	822,309	850,747
Property, plant and equipment, net of accumulated depreciation of \$641,805 and \$637,107, respectively	290,103	311,502
Goodwill	158,893	----
Acquired intangibles, net of accumulated amortization of \$98,173 and \$124,507, respectively	185,866	28,841
Installment contract receivables, net of allowances of \$0 and \$9,724, respectively	28,231	58,448
Other assets	220,546	161,049
Total Assets	\$ 1,705,948	\$ 1,410,587

LIABILITIES AND STOCKHOLDERS EQUITY

Current Liabilities:		
Accounts payable and accrued liabilities	\$ 152,436	\$ 150,207
Current portion of deferred revenue	308,591	247,691
Total current liabilities	461,027	397,898
Long-Term Liabilities:		
Long-term portion of deferred revenue	96,439	92,298
Convertible notes	548,093	436,012
Other long-term liabilities	304,402	376,006
Total long-term liabilities	948,934	904,316
Contingencies (Notes 8 and 13)		
Stockholders' Equity:		
Common stock and capital in excess of par value	1,706,590	1,674,396
Treasury stock, at cost	(353,289)	(431,310)
Accumulated deficit	(1,100,111)	(1,177,983)

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Accumulated other comprehensive income	42,797	43,270
Total stockholders' equity	295,987	108,373
Total Liabilities and Stockholders' Equity	\$ 1,705,948	\$ 1,410,587

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

1

Table of Contents

CADENCE DESIGN SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
Revenue:				
Product	\$ 118,221	\$ 96,932	\$ 338,053	\$ 286,295
Services	23,945	26,669	75,123	83,684
Maintenance	95,768	92,521	273,760	262,374
Total revenue	237,934	216,122	686,936	632,353
Costs and Expenses:				
Cost of product	10,757	6,405	23,172	23,828
Cost of services	19,102	21,139	62,583	69,602
Cost of maintenance	9,960	11,105	31,839	35,423
Marketing and sales	76,065	68,282	222,340	214,603
Research and development	97,275	88,049	278,585	273,394
General and administrative	25,081	28,732	64,973	101,311
Amortization of acquired intangibles	4,459	2,726	9,701	8,694
Restructuring and other charges (credits)	(1,682)	(175)	(3,073)	17,833
Total costs and expenses	241,017	226,263	690,120	744,688
Loss from operations	(3,083)	(10,141)	(3,184)	(112,335)
Interest expense	(10,476)	(7,278)	(25,879)	(21,592)
Other income (expense), net	(2,907)	2,917	(33)	(5,765)
Loss before provision (benefit) for income taxes	(16,466)	(14,502)	(29,096)	(139,692)
Provision (benefit) for income taxes	(143,219)	(455)	(192,671)	11,969
Net income (loss)	\$ 126,753	\$ (14,047)	\$ 163,575	\$ (151,661)
Basic net income (loss) per share	\$ 0.49	\$ (0.05)	\$ 0.63	\$ (0.59)
Diluted net income (loss) per share	\$ 0.48	\$ (0.05)	\$ 0.62	\$ (0.59)
Weighted average common shares outstanding basic	258,606	259,193	261,122	256,792
Weighted average common shares outstanding diluted	263,302	259,193	265,383	256,792

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

CADENCE DESIGN SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended	
	October 2, 2010	October 3, 2009
Cash and Cash Equivalents at Beginning of Period	\$ 569,115	\$ 568,255
Cash Flows from Operating Activities:		
Net income (loss)	163,575	(151,661)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	64,795	71,334
Amortization of debt discount and fees	18,331	15,557
Loss on extinguishment of debt	5,321	----
Stock-based compensation	32,817	43,690
Loss from equity method investments	105	369
(Gain) loss on investments, net	(5,133)	4,307
Gain on sale of property, plant and equipment	(799)	----
Write-down of investment securities	1,500	5,207
Impairment of property, plant and equipment	491	6,603
Deferred income taxes	(70,617)	(6,520)
Proceeds from the sale of receivables, net	----	5,827
Provisions (recoveries) for losses (gains) on trade and installment contract receivables	(13,339)	18,668
Other non-cash items	2,259	(4,084)
Changes in operating assets and liabilities, net of effect of acquired businesses:		
Receivables	(44,422)	56,444
Installment contract receivables	97,818	122,302
Inventories	(16,005)	2,846
Prepaid expenses and other	(23,828)	(4,041)
Other assets	(32,223)	11,809
Accounts payable and accrued liabilities	3,308	(79,395)
Deferred revenue	45,229	(83,760)
Other long-term liabilities	(87,054)	(10,773)
Net cash provided by operating activities	142,129	24,729
Cash Flows from Investing Activities:		
Proceeds from the sale of available-for-sale securities	----	139
Proceeds from the sale of long-term investments	10,276	----
Proceeds from the sale of property, plant and equipment	900	----
Purchases of property, plant and equipment	(28,940)	(30,504)
Purchases of software licenses	(2,706)	(774)
Investment in venture capital partnerships and equity investments	(3,000)	(2,300)
Cash paid in business combinations and asset acquisitions, net of cash acquired	(256,117)	(14,126)
Net cash used for investing activities	(279,587)	(47,565)

Cash Flows from Financing Activities:		
Principal payments on receivable sale financing	(3,540)	(2,467)
Proceeds from issuance of 2015 Notes	350,000	----
Payment of Convertible Senior Notes	(187,150)	----
Payment of 2015 Notes issuance costs	(10,419)	----
Purchase of 2015 Notes Hedges	(76,635)	----
Proceeds from termination of Convertible Senior Notes Hedges	280	----
Proceeds from sale of 2015 Warrants	37,450	----
Tax effect related to employee stock transactions allocated to equity	(9,624)	----
Proceeds from issuance of common stock	13,269	27,862
Stock received for payment of employee taxes on vesting of restricted stock	(5,875)	(4,055)
Purchases of treasury stock	(39,997)	----
Net cash provided by financing activities	67,759	21,340
Effect of exchange rate changes on cash and cash equivalents	9,619	3,858
Increase (decrease) in cash and cash equivalents	(60,080)	2,362
Cash and Cash Equivalents at End of Period	\$ 509,035	\$ 570,617

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

CADENCE DESIGN SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1. BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q have been prepared by Cadence Design Systems, Inc., or Cadence, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission, or the SEC. Certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. However, Cadence believes that the disclosures contained in this Quarterly Report on Form 10-Q comply with the requirements of Section 13(a) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, for a Quarterly Report on Form 10-Q and are adequate to make the information presented not misleading. These Condensed Consolidated Financial Statements are meant to be, and should be, read in conjunction with the Consolidated Financial Statements and the Notes thereto included in Cadence's Annual Report on Form 10-K for the fiscal year ended January 2, 2010.

The unaudited Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q reflect all adjustments (which include only normal, recurring adjustments and those items discussed in these Notes) that are, in the opinion of management, necessary to state fairly the results, financial position and cash flows for the periods and dates presented. The results for such periods are not necessarily indicative of the results to be expected for the full fiscal year.

Preparation of the Condensed Consolidated Financial Statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Condensed Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cadence adopted new disclosure requirements related to the fair value of Cadence's financial instruments on the first day of fiscal 2010. This adoption did not have a material impact on Cadence's consolidated financial position, results of operations or cash flows. See Note 5 for these disclosures.

Cadence has evaluated subsequent events through the date of issuance of the unaudited Condensed Consolidated Financial Statements.

NOTE 2. CONVERTIBLE NOTES

2.625% Cash Convertible Senior Notes Due 2015

In June 2010, Cadence issued \$350.0 million principal amount of its 2.625% Cash Convertible Senior Notes Due 2015, or the 2015 Notes. The 2015 Notes have a stated interest rate of 2.625%, mature on June 1, 2015 and may be settled only in cash. The indenture for the 2015 Notes does not contain any financial covenants. Contractual interest payable on the 2015 Notes began accruing in June 2010 and is payable semi-annually each December 1st and June 1st. The initial purchasers' transaction fees and expenses totaling \$10.6 million were capitalized as deferred financing costs and will be amortized over the term of the 2015 Notes using the effective interest method. An aggregate of \$187.2 million of the net proceeds was used to purchase \$100.0 million principal amount of Cadence's 1.375% Convertible Senior Notes Due December 15, 2011, or the 2011 Notes, and \$100.0 million principal amount of its 1.500%

Table of Contents

Convertible Senior Notes Due December 15, 2013, or the 2013 Notes, and collectively with the 2011 Notes, the Convertible Senior Notes. Cadence also used \$40.0 million of the net proceeds to repurchase approximately 6.5 million shares of Cadence common stock.

Prior to March 1, 2015, holders may convert their 2015 Notes into cash upon the occurrence of one of the following events:

The price of Cadence's common stock reaches \$9.81 during certain periods of time specified in the 2015 Notes;

Specified corporate transactions occur; or

The trading price of the 2015 Notes falls below 98% of the product of (i) the last reported sale price of Cadence's common stock and (ii) the conversion rate on that date.

From March 1, 2015 and until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert their 2015 Notes into cash at any time, regardless of the foregoing circumstances. Cadence may not redeem the 2015 Notes prior to maturity.

The initial cash conversion rate for the 2015 Notes is 132.5205 shares of Cadence common stock per \$1,000 principal amount of 2015 Notes, equivalent to a cash conversion price of approximately \$7.55 per share of Cadence common stock, with the amount due on conversion payable in cash. Upon cash conversion, a holder will receive the sum of the daily settlement amounts, calculated on a proportionate basis for each day, during a specified observation period following the cash conversion date.

If a fundamental change occurs prior to maturity and Cadence's stock price is greater than \$6.16 per share at that time, the cash conversion rate will increase by an additional amount of up to 29.8171 shares of Cadence's common stock per \$1,000 principal amount of 2015 Notes, which amount would be paid entirely in cash to each holder that elects to convert its 2015 Notes at that time. A fundamental change is any transaction or event (whether by means of an exchange offer, liquidation, tender offer, consolidation, merger, combination, reclassification, recapitalization or otherwise) in which more than 50% of Cadence's common stock is exchanged for, converted into, acquired for or constitutes solely the right to receive, consideration. No fundamental change will have occurred if at least 90% of the consideration received consists of shares of common stock, or depositary receipts representing such shares, that are:

Listed on, or immediately after the transaction or event will be listed on, a United States national securities exchange; or

Approved, or immediately after the transaction or event will be approved, for quotation on a United States system of automated dissemination of quotations of securities prices similar to the NASDAQ National Market prior to its designation as a national securities exchange.

As of October 2, 2010, none of the conditions allowing the holders of the 2015 Notes to convert the 2015 Notes into cash had been met.

The cash conversion feature of the 2015 Notes, or the 2015 Notes Embedded Conversion Derivative, requires bifurcation from the 2015 Notes and the 2015 Notes Embedded Conversion Derivative is accounted for as a derivative liability, which is included in Other long-term liabilities in Cadence's Condensed Consolidated Balance Sheet. The fair value of the 2015 Notes Embedded Conversion Derivative at the time of issuance of the 2015 Notes was \$76.6 million, and was recorded as the original debt discount for purposes of accounting for the debt component of the 2015 Notes. This discount will be recognized as interest expense using the effective interest method over the term of the 2015 Notes. The estimated fair value of the 2015 Notes Embedded Conversion Derivative, as of October 2, 2010 was \$114.3 million.

Table of Contents

Concurrently with the issuance of the 2015 Notes, Cadence entered into hedge transactions, or the 2015 Notes Hedges, with various parties whereby Cadence has the option to receive the cash equivalent of approximately 46.4 million shares of Cadence's common stock at a price of approximately \$7.55 per share, subject to certain conversion rate adjustments in the 2015 Notes. These options expire on June 1, 2015 and must be settled in cash. The aggregate cost of the 2015 Notes Hedges was \$76.6 million. The 2015 Notes Hedges are accounted for as derivative assets, and are included in Other assets in Cadence's Condensed Consolidated Balance Sheet. The estimated fair value of the 2015 Notes Hedges, as of October 2, 2010, was \$114.3 million.

The 2015 Notes Embedded Conversion Derivative and the 2015 Notes Hedges are adjusted to fair value each reporting period and unrealized gains and losses are reflected in Cadence's Condensed Consolidated Statements of Operations. As the fair values of the 2015 Notes Embedded Conversion Derivative and the 2015 Notes Hedges are similar, there was no impact to Cadence's Condensed Consolidated Statements of Operations relating to these adjustments to fair value during the three months ended October 2, 2010.

In separate transactions, Cadence also sold warrants, or the 2015 Warrants, to various parties for the purchase of up to approximately 46.4 million shares of Cadence's common stock at a price of \$10.78 per share in a private placement pursuant to Section 4(2) of the Securities Act of 1933, as amended, or the Securities Act. The 2015 Warrants expire on various dates from September 2015 through December 2015 and must be settled in net shares. Cadence received \$37.5 million in cash proceeds from the sale of the 2015 Warrants, which has been recorded as an increase in Stockholders' equity. Changes in the fair value of the 2015 Warrants will not be recognized in Cadence's Condensed Consolidated Financial Statements as long as the instruments remain classified as equity. The 2015 Warrants are included in diluted earnings per share to the extent the impact is dilutive.

The principal amount, unamortized debt discount and net carrying amount of the liability component of the 2015 Notes as of October 2, 2010 was as follows:

	As of October 2, 2010 (In thousands)
Principal amount of 2015 Notes	\$ 350,000
Unamortized debt discount of 2015 Notes	(72,848)
Net liability of 2015 Notes	\$ 277,152

The effective interest rate, contractual interest expense and amortization of debt discount for the 2015 Notes for the three and nine months ended October 2, 2010 and October 3, 2009 were as follows:

	Three Months Ended		Nine Months Ended	
	October 2, 2010	October 3, 2009	October 2, 2010	October 3, 2009
	(In thousands, except percentages)			
Effective interest rate	8.1%	N/A	8.1%	N/A
Contractual interest expense	\$ 2,289	\$ ----	\$ 2,716	\$ ----
Amortization of debt discount	\$ 3,196	\$ ----	\$ 3,788	\$ ----
	6			

Table of Contents

As of October 2, 2010, the if-converted value of the 2015 Notes exceeded the principal amount of the 2015 Notes. The total fair value of the 2015 Notes was \$414.8 million.

1.375% Convertible Senior Notes Due December 15, 2011 and 1.500% Convertible Senior Notes Due December 15, 2013

In December 2006, Cadence issued \$250.0 million principal amount of its 2011 Notes and \$250.0 million principal amount of its 2013 Notes. The indentures for the Convertible Senior Notes do not contain any financial covenants. Contractual interest payable on the Convertible Senior Notes began accruing in December 2006 and is payable semi-annually each December 15th and June 15th. In June 2010, Cadence repurchased \$100.0 million principal amount of its 2011 Notes and \$100.0 million principal amount of its 2013 Notes, resulting in a remaining principal balance of \$150.0 million for the 2011 Notes and \$150.0 million for the 2013 Notes.

Holder may convert their Convertible Senior Notes prior to maturity upon the occurrence of one of the following events:

The price of Cadence's common stock reaches \$27.50 during certain periods of time specified in the Convertible Senior Notes;

Specified corporate transactions occur; or

The trading price of the Convertible Senior Notes falls below 98% of the product of (i) the last reported sale price of Cadence's common stock and (ii) the conversion rate on that date.

From November 2, 2011, in the case of the 2011 Notes, and November 1, 2013, in the case of the 2013 Notes, and until the close of business on the scheduled trading day immediately preceding the maturity date, holders may convert their Convertible Senior Notes at any time, regardless of the foregoing circumstances. Cadence may not redeem the Convertible Senior Notes prior to maturity.

The initial conversion rate for the Convertible Senior Notes is 47.2813 shares of Cadence common stock per \$1,000 principal amount of Convertible Senior Notes, equivalent to a conversion price of approximately \$21.15 per share of Cadence common stock. Upon conversion, a holder will receive the sum of the daily settlement amounts, calculated on a proportionate basis for each day, during a specified observation period following the conversion date. The daily settlement amount during each date of the observation period consists of:

Cash up to the principal amount of the note; and

Cadence's common stock to the extent that the conversion value exceeds the amount of cash paid upon conversion of the Convertible Senior Notes.

If a fundamental change occurs prior to maturity and Cadence's stock price is greater than \$18.00 per share at that time, the conversion rate will increase by an additional amount of up to \$8.27 per share, which amount would be paid entirely in cash to each holder that elects to convert its Convertible Senior Notes at that time. A fundamental change is any transaction or event (whether by means of an exchange offer, liquidation, tender offer, consolidation, merger, combination, reclassification, recapitalization or otherwise) in which more than 50% of Cadence's common stock is exchanged for, converted into, acquired for or constitutes solely the right to receive, consideration. No fundamental change will have occurred if at least 90% of the consideration received consists of shares of common stock, or depositary receipts representing such shares, that are:

Table of Contents

Listed on, or immediately after the transaction or event will be listed on, a United States national securities exchange; or

Approved, or immediately after the transaction or event will be approved, for quotation on a United States system of automated dissemination of quotations of securities prices similar to the NASDAQ National Market prior to its designation as a national securities exchange.

As of October 2, 2010, none of the conditions allowing the holders of the Convertible Senior Notes to convert had been met.

In connection with the issuance of the 2015 Notes, an aggregate of \$187.2 million of the net proceeds were used to purchase in the open market \$100.0 million principal amount of the 2011 Notes and \$100.0 million principal amount of the 2013 Notes. At settlement, the fair value of the liability component immediately prior to its extinguishment is measured first and the difference between the fair value of the aggregate consideration remitted to its holders and the fair value of the liability component immediately prior to its extinguishment is attributed to the reacquisition of the equity component. The components of the repurchase and related loss on early extinguishment of debt are as follows:

	2011 Notes	2013 Notes (In thousands)	Total
Principal amount repurchased	\$ 100,000	\$ 100,000	\$ 200,000
Amount allocated to:			
Extinguishment of liability component	\$ 95,865	\$ 85,751	\$ 181,616
Extinguishment of equity component	2,285	3,249	5,534
Total cash paid for repurchase	\$ 98,150	\$ 89,000	\$ 187,150
Principal amount repurchased	\$ 100,000	\$ 100,000	\$ 200,000
Unamortized debt discount	(6,958)	(15,036)	(21,994)
Extinguishment of liability component	(95,865)	(85,751)	(181,616)
Related debt issuance costs	(676)	(1,035)	(1,711)
Loss on early extinguishment of debt	\$ (3,499)	\$ (1,822)	\$ (5,321)

Concurrently with the issuance of the Convertible Senior Notes, Cadence entered into hedge transactions, or the Convertible Senior Notes Hedges, with various parties whereby Cadence had the option to purchase up to 23.6 million shares of Cadence's common stock at a price of \$21.15 per share, subject to adjustment. The aggregate cost of the Convertible Senior Notes Hedges was \$119.8 million and has been recorded as a reduction to Stockholders' equity. In connection with the purchase of a portion of the Convertible Senior Notes in June 2010, Cadence also sold a portion of the Convertible Senior Notes Hedges representing options to purchase approximately 9.5 million shares of Cadence's common stock and received proceeds of \$0.4 million. The estimated fair value of the remaining Convertible Senior Notes Hedges was \$1.2 million as of October 2, 2010. These options expire on December 15, 2011, in the case of the 2011 Notes, and December 15, 2013, in the case of the 2013 Notes, and must be settled in net shares.

Subsequent changes in the fair value of the Convertible Senior Notes Hedges will not be recognized in Cadence's Condensed Consolidated Financial Statements as long as the instruments remain classified as equity.

In separate transactions, Cadence also sold warrants, or the Convertible Senior Notes Warrants, to various parties for the purchase of up to 23.6 million shares of Cadence's common stock at a price of \$31.50 per share in a private placement pursuant to Section 4(2) of the Securities Act. Cadence received \$39.4 million in cash proceeds from the sale of the Convertible Senior Notes Warrants, which has been recorded as an increase in Stockholders' equity. In

connection with the purchase of a portion of the Convertible Senior Notes in June 2010, Cadence also purchased a portion of the

Table of Contents

Convertible Senior Notes Warrants, reducing the number of shares of Cadence common stock available for purchase by 9.5 million shares at a cost of \$0.1 million. The Convertible Senior Notes Warrants expire on various dates from February 2012 through April 2012 in the case of the 2011 Notes, and February 2014 through April 2014 in the case of the 2013 Notes, and must be settled in net shares. Changes in the fair value of the Convertible Senior Notes Warrants will not be recognized in Cadence's Condensed Consolidated Financial Statements as long as the instruments remain classified as equity. The remaining warrants are included in diluted earnings per share to the extent the impact is dilutive.