ANNUAL REPORT

2014

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Dear Fellow Shareholders,

Fiscal 2014 was another year of strong performance for Mentor Graphics:

- Record revenue of $1.156 billion, up 6% from fiscal 2013
- Record non-GAAP earnings per share of $1.62, up 13% from the prior year
- Record GAAP earnings per share of $1.29, up 10% from the prior year
- Record non-GAAP and GAAP operating margins of 20.8% and 15.8%

Solid Strategy and Execution Drive Results

The results of fiscal 2014 are rooted in a strategy built upon technology and product excellence, a focus on leadership in the categories we choose to serve, and an eye on the future driving research and development – all this augmented by targeted acquisitions and the rigorous management of expenses. Our strategy has enabled the expansion of Mentor's GAAP operating margin from 5.7 percent of revenues in fiscal 2011 to 15.8 percent of revenues in fiscal 2014. It has also enabled Mentor to exceed the 20 percent fiscal 2014 non-GAAP operating margin goal set three years ago.

Mentor is comfortable being contrarian and traveling where others do not. This independent spirit has empowered Mentor to create "Best of Breed" products such as the Calibre®, Xpedition™, Tessent® and Veloce® products and not fall into the temptation of mimicking others. This spirit also encourages management, technologists, and marketing staff to ask how Mentor's technological DNA can be used to solve new design requirements for existing and new customers. Answers to this question are best embodied in our embedded software tools and solutions, our growing presence in computational fluid dynamics and multiple transportation offerings. The transportation market now accounts for over 15% of Mentor's revenues. Transportation customers are in the early adoption phase of electronic design automation, which has enabled Mentor's transportation revenue to grow at a rate more than double traditional EDA software and maintenance in the past five and ten years.

A Little More on 2014

Bookings were strong in fiscal 2014 and backlog grew by 48% to $161 million. The Design to Silicon product category led the way with an approximate 75% year-on-year bookings increase. This increase is the result of on-going investment by leading semiconductor companies for advanced chip design nodes and evidences the strong competitive position of our leading semiconductor tools. Scalable Verification, which includes the Veloce2 emulator, closely followed Design to Silicon with bookings up over 65%. Emulation had a very strong year with record bookings. Emulation is benefiting from an expanding base of semiconductor companies doing full-chip verification and an increasing number of software developers using the emulator for system-level software development and integration. Emulation demand is expected to remain strong as functional verification of larger chips will continue the trend of using a combination of emulation and traditional simulation. Integrated System Design license expirations were light for the year; as a result the category was up only modestly.

Attention to expenses remains a constant focus. Despite significant growth in emulation revenue and cost of goods sold over the past three years, we amply beat our fiscal 2014 target with a non-GAAP operating margin of 20.8%. Fiscal 2014 was another good year in which we balanced investment in product development, market development and our distribution channels while delivering record operating performance for the company.

Capital Allocation

Early in fiscal 2014 Mentor initiated an $0.18 per share annual cash dividend. This dividend has broadened the company's ownership to include income-oriented institutional investors. Recognizing the success of fiscal 2014, in February 2014 the Board of Directors increased the annual dividend 11% to $0.20. This cash dividend is part of an overall capital deployment strategy that includes strategic acquisitions and share repurchases.

We believe Mentor's position in the market has never been stronger. We are grateful to the employees whose talent has driven these results, to our customers for their confidence in our products and services, and to our fellow shareholders. We look forward to continued growth in shareholder value in fiscal 2015.

Gregory K. Hinckley
President

Walden C. Rhines
Chairman & CEO

FOR A RECONCILATION OF GAAP AND non-GAAP FIGURES PRESENTED IN THIS LETTER, SEE SUPPLEMENTAL FINANCIAL INFORMATION FOLLOWING THE FORM 10-K.

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

FOR THE FISCAL YEAR ENDED January 31, 2014

COMMISSION FILE NUMBER 1 – 34795

MENTOR GRAPHICS CORPORATION

(Exact name of registrant as specified in its charter)

Oregon	**93-0786033**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
8005 SW Boeckman Road	**97070-7777**
Wilsonville, Oregon (Address of principal executive offices)	(Zip Code)

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

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

Title of Each Class	Name of Each Exchange on which Registered
Common Stock, without par value	NASDAQ Global Select Market
Incentive Stock Purchase Rights	NASDAQ Global Select Market

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

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. 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 (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 twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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

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 ☒ Accelerated Filer ☐ Non-accelerated filer ☐ (Do not check if a 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 ☒

The aggregate market value of the voting stock held by non-affiliates of the registrant was approximately $2,313,193,631 on July 31, 2013 based upon the last price of the Common Stock on that date reported in The NASDAQ Global Select Market. On March 13, 2014, there were 115,360,422 shares of the Registrant's Common Stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Part of Form 10-K into which incorporated
Portions of the 2014 Proxy Statement	Part III

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Item 1. Business

This Form 10-K contains forward-looking statements that involve risks and uncertainties. Actual results may differ materially from the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those set forth under Part I, Item 1A. "Risk Factors."

GENERAL

Mentor Graphics Corporation is a technology leader in electronic design automation (EDA). We provide software and hardware design solutions that enable our customers to develop better electronic products faster and more cost effectively. We market our products and services worldwide, primarily to large companies in the communications, computer, consumer electronics, semiconductor, networking, multimedia, military and aerospace, and transportation industries.

The electronic components and systems that our customers create with our products include integrated circuits (ICs), printed circuit boards (PCBs), field programmable gate arrays (FPGAs), embedded software solutions, wire harness systems, and computers. Our products are used in the design and development of a diverse set of electronic products, including automotive electronics, computers and workstations, digital cameras, cellular telephones, medical devices, smart phones, industrial electronics, and manufacturing systems. As silicon manufacturing process geometries shrink, our customers are creating entire electronic systems on a single IC. These devices are called a system-on-chip (SoC). This trend becomes apparent to the everyday consumer as consumer electronics become smaller and more sophisticated. This trend also poses significant opportunities and challenges for the EDA industry.

We were incorporated in Oregon in 1981, and our common stock is traded on The NASDAQ Global Select Market under the symbol "MENT." Our corporate headquarters are located at 8005 S.W. Boeckman Road, Wilsonville, Oregon 97070-7777. The telephone number at that address is (503) 685-7000. Our website address is www.mentor.com. We have approximately 75 offices worldwide. Electronic copies of our reports filed with the Securities and Exchange Commission (SEC) are available through our website as soon as reasonably practicable after the reports are filed with the SEC. Our Director Code of Ethics, Standards of Business Conduct, Guidelines for Corporate Disclosure, Corporate Governance Guidelines, and our Audit, Compensation, and Nominating and Corporate Governance Committee Charters are also posted on our website.

PRODUCTS

We design our products to enable engineers to overcome increasingly complex electronic design challenges by improving the accuracy of complex designs and shrinking product time-to-market schedules. A hardware design process is typically as follows:

- Electrical engineers begin the design process by describing and specifying the architectural, behavioral, functional, and structural characteristics of an IC, PCB, or electronic system and components.
- Engineers then create the component designs according to stated specifications.
- Engineers verify the design to reveal defects and then modify the component's design until it is correct and meets the previously stated specifications.
- Engineers assemble components and test the components and the entire system.
- The system then goes to production. During the manufacturing process, engineers work to identify defective parts and improve yields. "Yields" refers to the percentage of functional ICs on a silicon wafer or functional PCBs compared to the total of those manufactured.

We segregate revenues into five categories of similar products and services. These categories include Scalable Verification, IC Design to Silicon, Integrated System Design, New and Emerging Products, and Services and Other. Each category includes both product and support revenues. Additional information is provided in Part II, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Scalable Verification

The Mentor Graphics® Scalable Verification™ tools allow engineers to verify that their complex IC designs function as intended. Functional errors are a leading cause of design revisions that slow down an electronic system's time-to-market and reduce its profitability.

The Questa® scalable verification platform includes support for hardware description languages, including System Verilog, simulation, and new methodologies including assertions, use of verification intellectual property (IP), test benches, and formal verification methods. The Questa platform is used for verification of systems and ICs including application-specific integrated circuits, SoCs, and FPGAs.

Along with digital simulation products, we offer analog/mixed-signal simulators. Complex electronic designs often require different types of circuits, such as analog and digital, to work together. An example is a CD or DVD player which uses a digital input and produces an analog output of sounds or images. Our analog/mixed signal simulation products include the Eldo®, ADVance MS, and ADiT™ tools.

We provide hardware emulation systems, such as our Veloce® product family, which allow users to create high-performance functional and logical equivalent models of actual electronic circuits to verify the function and timing of those circuits. Hardware emulation systems typically run complex electronic circuits 100 times to 1,000 times faster than software simulation tools. Emulation is also used when software operating systems are embedded within circuits and there is a need for hardware/ software verification and debugging. Our Veloce product allows customers to verify complex designs containing up to two billion logic gates.

IC Design to Silicon

Shrinking geometries and increasing design size in the nanometer era have enabled ever increasing functionality on a single IC. Today's most advanced ICs are being produced in a 20 nanometer (nm) process with ongoing test tape-outs occurring for 14 nm ICs and prototype work at 10 nm and below. Nanometer process geometries cause design challenges in the creation of ICs which are not present at larger geometries. As a result, nanometer process technologies, used to deliver the majority of today's ICs, are the product of careful design and precision manufacturing. The increasing complexity and smaller size of designs have changed how those responsible for the physical layout of an IC design deliver their design to the IC manufacturer or foundry. In older technologies, this handoff was a relatively simple layout database check when the design went to manufacturing. Now it is a multi-step process where the layout database is checked and modified so the design can be manufactured with cost-effective yields of ICs.

To address these challenges, we offer the Calibre® tool family, which is a standard for most of the world's largest integrated device manufacturers and foundries:

- The Calibre physical verification tool suite, Calibre DRC™ and Calibre LVS-H™, helps ensure that a particular IC layout accurately corresponds to the original schematic or circuit diagram of the design and conforms to stringent manufacturing rules at wafer fabricators where ICs are manufactured.
- The Calibre xRC™ and xACT products, transistor-level extraction and device modeling tools, compute the values of detailed circuit parameters including interconnect resistances, capacitances, and inductances to enable customers to more accurately simulate the performance of a design before it is manufactured.
- The Calibre Resolution Enhancement Technology (RET) tools allow wafer foundries to simulate the lithographic patterning system and apply modifications to the design layout patterns to overcome the resolution limits of the physical wafer patterning process. The Calibre family of optical proximity correction (OPC), RET, and mask data preparation tools enable higher yields in semiconductor manufacturing. The Calibre OPCverify™ tool is used to check and report the effectiveness of mask pattern corrections against wafer manufacturing specifications. The Calibre RET tools continue to be extended to provide computational patterning capabilities for process technology nodes from .13 micron to 7 nanometers.
- In the Design For Manufacturing (DFM) area, the Calibre LFD™ product can help customers produce higher yields at nanometer process geometries where variations in manufacturing can cause yield reductions. The Calibre CMPAnalyzer tool allows customers to model the expected planarity (i.e., thickness variation) of ICs and identify where modifications to the layout will improve a chip's flatness. This helps prevent manufacturing defects and reduces variations in performance from one chip to the next. The Calibre MPCpro™ product is a solution for systematic errors introduced by e-beam lithography and mask etching processes built on Calibre OPCpro™ technology for optical process correction. Our Calibre nmMPC™ product provides optimizations specifically developed for e-beam mask writers. New correction and modeling capabilities improve mask linearity and uniformity for advanced nodes, especially for smaller feature sizes.
- The Calibre PERC™ tool checks the electrical design of an IC. It is useful in verifying the completeness of electrostatic discharge protection circuitry which affects both manufacturing yield and long-term reliability of an IC.

We also offer the Olympus-SoC™ place and route product targeted at customers designing ICs at advanced nodes. The Olympus-SoC system comprehensively addresses the performance, capacity, time-to-market, power, and variability challenges encountered at the leading-edge process geometries. The Olympus-SoC place and route solution is a physical design implementation tool which performs design planning, placement, physical synthesis, clock tree synthesis, routing, power optimization, and manufacturability closure. The Olympus-SoC tool is architected to handle the complex multi-patterning and FinFET requirements at advanced process technologies. The Calibre InRoute™ design and verification platform enables designers to increase their productivity by invoking Calibre tools within the Olympus-SoC place and route environment.

In December 2013, we acquired the RealTime synthesis tool to bring register-transfer level (RTL) synthesis to our digital implementation flow. The RealTime solution helps SoC and application specific integrated circuit (ASIC) design teams to realize improved quality of results and faster turnaround time for complex SoCs, ASICs, and IP blocks. The RealTime tool's "placement first" synthesis methodology and integrated RTL floorplanning capability enable physical backend issues to be analyzed and addressed at RTL stages before hand-off to the back-end groups for physical design implementation.

Our Tessent® suite of integrated silicon test products are used to test a design's logic and memories after manufacturing to ensure that a manufactured IC is functioning correctly. Our suite of tools includes scan insertion, boundary scan, automatic test pattern generation, logic and memory built-in self-test, and our patented Tessent TestKompress® product for EDT™. A suite of test analysis products is also available that leverages test data and layout-aware diagnosis capabilities for silicon debug and yield analysis.

Integrated System Design

As ICs grow in complexity and function and PCB fabrication technology advances to include embedded components and high-density interconnect layers within the PCB, the design of PCBs is becoming increasingly complex. This complexity can be a source of design bottlenecks.

Our PCB-FPGA Systems Design software products support the PCB design process from schematic entry, where the electronic circuit is defined by engineers, through physical layout of the PCB, and provide digital output data for manufacturing, assembly, and test. Most types of designs, including analog, radio frequency, and high-speed digital and mixed signal, are supported by our PCB design tools. We have specific integrated software tool flows for process management, component library creation, simulation, and verification of the PCB design:

- The Xpedition™ Series product line is our principal PCB design family of products used by larger enterprise customers for PCB design flows from system design definition to manufacturing execution.
- Our HyperLynx® product line offers a complete suite of analysis and verification software that meets the needs of PCB

engineers at any point in the board design flow including tools for power integrity, thermal analysis, electromagnetic design/verification, analog simulation, and package modeling.
- We also offer the "ready to use" PADS® product line which provides a lower cost Windows-based PCB design and layout solution.
- Our I/O Designer™ product integrates FPGA input/output planning with our PCB design tools to help improve routing in large complex designs.
- The XtremePCB™ tool offers a method for simultaneous design where multiple designers can edit the same design at the same time and view each other's edits in real-time.
- Our XtremeAR product is a PCB routing product that improves the routing time of large designs. This product allows improved designs by running more simultaneous routing iterations during the design cycle.

Our AutoActive™ place and route technology is available on both UNIX and Windows platforms and is used to replace older generation routers in PCB design flows. The AutoActive technology, which is incorporated into the Expedition® product line, is intended to help improve design quality, shorten design cycles, and increase manufacturability.

Our Valor® Division offers a line of products for PCB, DFM, and manufacturing execution systems. Valor's solutions target three key segments in the PCB manufacturing market: design of the physical layout of the PCB, fabrication of the bare PCB, and assembly of PCB components.

Our Mechanical Analysis Division provides simulation software and consultancy services to reduce costs, eliminate design mistakes, and accelerate and optimize designs involving heat transfer and fluid flow before physical prototypes are built. Our FloEFD ™ product is a 3D computational fluid dynamics and heat transfer analysis tool that is embedded into Mechanical Computer-Aided Design systems to help design engineers conduct computational fluid dynamics analysis throughout the product's life cycle. Our FloTHERM® three-dimensional computational fluid dynamics software predicts airflow and heat transfer in and around electronic equipment, including effects of conduction, convection, and radiation to enable engineers to create virtual models of electronic equipment, perform thermal analysis, and test design modifications before any physical prototypes are built. This product line also includes one-dimensional computational fluid dynamics analysis. The Flowmaster® one-dimensional computational fluid dynamics analysis software is used by thermo-fluid system engineers to model and analyze the fluid mechanics and pipe flow in complex systems. In addition, the MicReD® T3Ster® advanced transient temperature measurement system enables thermal testing and characterization of electronics components, PCBs, and sub-systems.

New and Emerging Products

We provide specialized software tools for design, analysis, and documentation of the complex electrical systems found in automotive, aerospace, and other transportation platforms. The tools also support design, costing, and manufacturing process modeling of wire harnesses.

Our Embedded Systems Division provides runtime software, tools, and professional engineering services that enable our customers to build secure embedded systems utilizing heterogeneous multi-core and multi-OS platforms. We have focused initiatives in the automotive market segment where we provide LINUX and Android based infotainment solutions, as well as AUTOSAR networking solutions. In addition to the automotive market, our embedded software solutions are used in mobile, medical, aerospace, industrial, and consumer electronics markets, and deployed on over 3 billion devices.

PLATFORMS

Our software products are available on UNIX, Windows, and LINUX platforms in a broad range of price and performance levels. Customers purchase platforms from leading workstation and personal computer suppliers.

MARKETING AND CUSTOMERS

Our sales and marketing emphasizes large corporate account penetration in the communications, computer, consumer electronics, semiconductor, networking, multimedia, military and aerospace, and transportation industries. We license our products worldwide through our direct sales force, distributors, and sales representatives. Revenues outside of North America accounted for 56% of total revenues for fiscal 2014 and 2013 and 59% for fiscal 2012. We enter into foreign currency exchange contracts in an effort to mitigate the impact of foreign currency fluctuations. See "Geographic Revenues Information" in Part II, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the footnotes to our financial statements included in Part II, Item 8. "Financial Statements and Supplementary Data" for more information.

Over time, no material portion of our business is dependent on a single or a few customers. We do not believe that the competitive loss of one or more individual products at one or more of our customers would have a material adverse effect on our revenues. We have traditionally experienced some seasonal fluctuations of orders, with orders typically stronger in the fourth quarter of each year. Due to the complexity of our products, the selling cycle can be six months or longer. During the selling cycle our account managers, application engineers, and technical specialists make technical presentations and product demonstrations to the customer. At some point during the selling cycle, our products may also be loaned to customers for short-term on-site evaluation. We ship our software products to customers primarily electronically, and all software products are generally shipped within 180 days after receipt of an order and a substantial portion of quarterly shipments tend to be made in the last month of each quarter. We license our products and some third-party products pursuant to end-user license agreements.

BACKLOG

Our backlog of firm orders was approximately $161 million as of January 31, 2014 compared to $109 million as of January 31, 2013. This backlog includes software products requested for delivery within six months and emulation hardware systems, professional services, and training requested for delivery within one year. We do not track backlog for support services. The January 31, 2014 backlog of orders is expected to be delivered before the end of our fiscal year ending January 31, 2015.

MANUFACTURING OPERATIONS

Our software manufacturing operations primarily consist of reproduction of our technical software and documentation. Mentor Graphics (Ireland) Limited, our wholly owned subsidiary, manufactures, or contracts with third-parties to manufacture our products and distributes these products worldwide through our established sales channels. Our line of emulation products, which has a large hardware component, is manufactured principally in the United States (U.S.) on an outsourced basis. See the discussion in Note 17. "Segment Reporting" in Part II, Item 8. "Financial Statements and Supplementary Data" for further detail of the location of property, plant, and equipment.

PRODUCT DEVELOPMENT

Our research and development is focused on continued improvement of our existing products and the development of new products. During the year ended January 31, 2014, we expensed $349 million related to product research and development compared to $314 million for fiscal 2013 and $311 million for fiscal 2012. We also seek to expand existing product offerings and pursue new lines of business through acquisitions. During the year ended January 31, 2014, we amortized purchased technology of $4 million compared to $8 million for fiscal 2013 and $10 million for fiscal 2012. Our future success depends on our ability to develop or acquire competitive new products that satisfy customer requirements.

CUSTOMER SUPPORT AND CONSULTING SERVICES

We have a worldwide support organization to meet our customers' needs for technical support, training, and optimization services. Most of our customers enter into support contracts that deliver regular software updates with the latest improvements, technical assistance from experienced experts, access to a self-service support site, and participation in our interactive communities. Hardware support is available for emulation products. Mentor Graphics Education Services offers a range of learning solutions developed specifically for electronics designers and engineers.

Mentor Consulting, our professional services division, is comprised of a worldwide team of consulting professionals. The services provided to customers are concentrated around our products. In addition, Mentor Consulting provides methodology development and refinement services that help customers improve their product development processes.

COMPETITION

The markets for our products are characterized by price competition, rapid technological advances in application software, and new market entrants. The EDA industry tends to be labor intensive rather than capital intensive. This means that the number of actual and potential competitors is significant. While our two principal competitors are large companies with extensive capital and marketing resources, we also compete with small companies with little capital but innovative ideas. Our principal competitors are Cadence Design Systems, Inc. (Cadence) and Synopsys, Inc. (Synopsys).

We believe the main competitive factors affecting our business are breadth and quality of application software, product integration, ability to respond to technological change, quality of a company's sales force, price, size of the installed base, level of customer support, and professional services. We can give no assurance, however, that we will have financial resources, marketing, distribution and service capability, depth of key personnel, or technological knowledge to compete successfully in our markets.

EMPLOYEES

We employed approximately 5,220 people full time as of January 31, 2014. Our future success will depend in part on our ability to attract and retain employees. None of our U.S. employees are covered by collective bargaining agreements. Employees in some jurisdictions outside the U.S. are represented by local or national union organizations. We continue to have satisfactory employee relations.

PATENTS AND LICENSES

We regard our products as proprietary and protect our rights in our products and technology in a variety of ways. We currently hold over 1,000 patents on inventions embodied in our products or that are otherwise relevant to EDA technology. In addition, we have approximately 350 patent applications pending in the U.S. and abroad. While we believe the patent applications relate to patentable technology, we cannot predict whether any patent will issue on a pending application, nor can we assure that any patent can be successfully defended.

We also rely on contractual and technical safeguards to protect our proprietary rights in our products. We typically include restrictions on disclosure, use, and transferability in our license agreements with customers and other parties. In addition, we use our trademark, copyright, and trade secret rights to protect our interests in our products and technology.

Some of our products include software or other intellectual property licensed from other parties. We also license software from other parties for internal use. We may have to seek new licenses or renew these licenses in the future.

Item 1A. Risk Factors

The forward-looking statements contained under "Outlook for Fiscal 2015" in Part II, Item 7. "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 2015," 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 and international economies may harm our business.

Our revenue levels are generally dependent on the level of technology capital spending, which includes worldwide expenditures for electronic design automation software, hardware, and consulting services. Periods of economic uncertainty, such as the recent worldwide recession, weakness in the European Union following the debt crisis, and the continued weakness of the Japanese economy together with the consolidation and restructuring of numerous large Japanese electronics companies, can adversely affect our customers. In times of economic difficulty, customers may postpone decisions to license or purchase our products, reduce their spending, or be less able or willing to make payment obligations, any of which could adversely affect our business. In addition, significant customer payment defaults or bankruptcies could materially harm our business.

We are subject to the cyclical nature of the integrated circuit 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 increasing complexity of ICs and resulting increase in costs to design and manufacture ICs have in recent years led to fewer design starts, which could cause a reduced demand for our products. In addition, 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 demand for our products and services.

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

Our revenues, particularly new hardware and 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 canceled. 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. This may result in failure to agree to terms within the fiscal quarter and cause expected revenue to slip into a subsequent quarter.

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. If planned contract renewals are delayed or the average size of renewed contracts is smaller than we anticipate, we could fail to meet our and investors’ expectations, which could have a material adverse impact on our stock price.

Our revenues are also affected by the mix of transaction types entered into where we recognize revenues in different ways as required by accounting rules: as payments become due and payable, on a cash basis, ratably over the license term, or at the beginning of the license term. A shift in the license mix toward increased ratable, due and payable, and/or cash-based revenue recognition could result in increased deferral of 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 emulation hardware 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 margin and operating results could be materially adversely impacted.

We face intense price competition in the EDA industry.

Price 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 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 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 or hardware products with other more desirable products at low prices or no marginal cost for promotional purposes, as a long-term pricing strategy, or to engage in predatory pricing. These practices could significantly reduce demand for our products or limit prices we can charge.

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

We may experience difficulty in manufacturing our emulation hardware.

We currently use one manufacturer to assemble our hardware emulation products and purchase some components from a single supplier. We may be exposed to delays in production and delivery of our emulation products due to delays in receiving components or manufacturing constraints; components rejected that do not meet our standards; components with latent defects; low yields of ICs, subassemblies, or printed circuit boards; or other delays in the manufacturing process. For single source parts we purchase for our emulation products, there can be no assurance that, if a supplier cannot deliver, a second source can be found on a timely basis. Our reliance on sole suppliers may also result in reduced control over product pricing and quality.

We may have to replace emulation components under warranty.

Our emulation hardware products are complex and despite pre-shipment testing, some defects may only appear after the products are put into use under operating conditions, including longer-term, continuous use at high capacities. As a result, customers may experience failures requiring us to replace components under warranty, thus increasing our costs and reducing availability of components for other sales.

Foreign currency fluctuations may have an adverse impact on our operating results.

We typically generate about half of our revenues from customers outside the U.S. and we generate approximately one-third of our expenses outside the U.S. While most of our international sales are denominated in U.S. dollars, our international operating expenses are typically denominated in foreign currencies. Significant changes in currency exchange rates, particularly in the Japanese yen, the euro, and the British pound, could have an adverse impact on our operating results.

Our international operations involve risks that could increase our expenses, adversely affect our operating results, and require increased time and attention of our management.

Our international operations subject us to risks in addition to those we face in our domestic operations, 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; anti-corruption, anti-bribery, and other similar laws; loss or modification of exemptions for taxes and tariffs; limitations on repatriation of earnings; and difficulties with licensing and protecting our intellectual property rights. If we violate laws related to our business, we could be subject to penalties, fines, or other sanctions and could be prohibited or limited from doing business in one or more countries.

IC and printed circuit board technology evolves rapidly.

The complexity of ICs, PCBs, and electrical systems 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.

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 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 products or systems designed with, or manufactured using our software that may not operate as expected. Errors or defects could result in:

- Loss of current customers, loss of market share, and loss of, or delay in, revenue;
- Failure to attract new customers or achieve market acceptance;
- Diversion of development resources to resolve problems resulting from errors or defects;
- Disputes with customers relating to such errors or defects, which could result in litigation or other concessions; and
- Increased support or service costs.

In addition, we include limited amounts of 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 long sales cycle. 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. Sales of our products and services are sometimes discretionary and may be delayed if customers delay approval or commencement of projects due to budgetary constraints, internal acceptance review procedures, timing of budget cycles, or timing of competitive evaluation processes. Long sales cycles for our hardware products may subject us to risks over which we have limited control, including insufficient, excess, or obsolete inventory, variations in inventory valuation, and fluctuations in quarterly operating results.

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

The industry in which we compete is characterized by very strong leadership positions in specific categories of the EDA market. For example, one company may have a large percentage of sales in the physical verification category of the market while another may 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 an important niche, we could be materially adversely impacted.

Accounting rules governing revenue recognition are complex and may change.

The accounting rules governing 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. To the extent that we do not recognize as much revenue at the beginning of the license period as in the past, such a change in accounting rules could have a material adverse impact on our short-term results.

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 a result, 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, could harm our operating results.

We may have additional tax liabilities.

Significant judgments and estimates are required in determining the provision for income taxes and other tax liabilities worldwide. 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 that could result if our tax positions were challenged by the Internal Revenue Service (IRS) and other tax authorities. The tax authorities in the U.S. and other countries where we do business regularly examine our income and other 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.

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

The computation of income tax expense (benefit) 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 provisions under U.S. generally accepted accounting principles. Income tax expense (benefit) for interim quarters is based on a forecast of our global tax rate, including a separate determination for entities, if any, with losses for which no tax benefit is obtained. This forecast includes forward looking financial projections, including the expectations of profit and loss by jurisdiction, and contains numerous assumptions. Various items cannot be accurately forecast and future events may be treated as discrete to the period in which they occur. Our income tax rate can be materially impacted, for example, by the geographical mix of our profits and losses; changes in our business, such as internal restructuring and acquisitions; changes in tax laws and accounting guidance, and other regulatory, legislative or judicial developments; tax audit determinations; changes in our tax positions; changes in our intent and capacity to permanently reinvest foreign earnings; changes to our transfer pricing practices; tax deductions attributed to equity compensation; and changes in our valuation allowance for deferred tax assets. For these reasons, our overall 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 errors and all fraud or that our policies and procedures can prevent all violations of the law by our employees, contractors, or agents. 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 our control system will detect all errors and instances of fraud, if any or prevent our employees, contractors, or agents from breaching or circumventing our policies or violating laws and regulations. Failure of our control systems to prevent error and fraud or violations of the law could materially adversely impact us.

We are subject to changing corporate governance regulations that impact compliance costs and risks of noncompliance.

Rules and regulations set out by various governmental and self-regulatory organizations in the United States such as Securities and Exchange Commission, NASDAQ, the Financial Industry Regulatory Authority, and the Financial Accounting Standards Board, as well as in other worldwide locations where we operate, are continually evolving in scope and complexity which makes compliance increasingly difficult and uncertain. The increase in costs to develop awareness and comply with such evolving rules and regulations as well as any risk of noncompliance could 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. These efforts may not result in a successful product offering because of changes in market conditions or our failure to successfully develop products based on that research and development activity. 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.

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 analyze all potential transactions before committing to them, we cannot assure that any completed transaction 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 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 liabilities or 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 effectively manage our business for long-term growth.

Our competitors may acquire technology or other companies that impact our business.

Our competitors may acquire technology or companies offering competing or complementary product offerings which could adversely impact our ability to compete in the marketplace. They may be able to deliver better or broader product offerings, offer better pricing, or otherwise make it more desirable for our customers to buy more of the tools in their design flow from the competitor after the acquisition. In addition, our competitors may purchase companies or technology that we had an interest in acquiring, which could limit our expansion into certain market segments.

Customers may acquire or merge with other customers or their business.

Like many industries, the semiconductor and electronics industries are subject to mergers, acquisitions, and divestitures and our customers or parts of their business may acquire or be acquired by other customers. Such synergies could result in fewer customers in the industries or the loss of some customers to competitors, or reduced customer spending on software and services due to redundancies or stronger customer negotiating power, which could have an adverse effect on our business and future revenues.

Customer payment defaults could adversely affect our timing of revenue recognition.

We use fixed-term license agreements as standard business practices with customers we believe are creditworthy. 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 IC foundries and 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, 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 under U.S. generally accepted accounting principles, revenue would be required to be recognized as the payments become due and payable over the license term. This change could have a material adverse impact on our near-term results.

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 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, continue to obtain patents at a rapid rate. We cannot predict if any of these patents will cover any of our products. In addition, 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. In addition, despite our measures to limit piracy, other parties may attempt to illegally copy or use our products, which could result in lost revenue.

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.

Intellectual property infringement actions may harm our business.

Patent holders are making increasing efforts to monetize their patent portfolios. Intellectual property infringement claims against us directly, or where we contractually must defend our customers, could result in costly litigation and consume significant time of employees and management. In addition, IP litigation could harm our business, either due to damage awards, payment of legal fees, an obligation to refund license fees to a customer or forgo receipt of future customer payments, the need to license technology on what might be unfavorable business terms, injunctions that could stop or delay future shipments, or the need to redesign our technology. For example, we are currently engaged in patent infringement litigation in Japan, California, and Oregon involving Emulation and Verification Engineering S.A., EVE-USA, Inc., and Synopsys. Further information regarding these lawsuits is contained in Part I, Item 3. “Legal Proceedings”.

Our use of open source software could negatively impact our ability to sell our products and may subject us to unanticipated obligations.

The products, services or technologies we acquire, license, provide or develop may incorporate or use open source software. We monitor and restrict our use of open source software in an effort to avoid unintended consequences, such as reciprocal license grants, patent retaliation clauses, and the requirement to license our products at no cost. Nevertheless, we may be subject to unanticipated obligations regarding our products which incorporate open source software.

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. Our failure to hire and retain such personnel could impair our ability to develop new products and manage our business effectively.

We have global sales and research and development offices in parts of the world that are not as politically stable as the United States.

We have global sales and research and development offices, some of which are in parts of the world that are not as politically stable as the United States. In particular, approximately 10% of our workforce, and a larger percentage of our engineers, are located in our offices in Israel, Egypt, and Pakistan may be subject to disruption or closure from time to time. As a result, we may face a greater risk of business interruption as a result of potential unrest, terrorist acts, or military conflicts than businesses located domestically. This could have a material and adverse effect on product delivery and our research and development operations.

Our business is subject to the risk of natural disasters.

We have sales and research and development offices worldwide which may be adversely affected by weather, earthquakes, or other natural disasters. If a natural disaster occurs at or near any of our offices, our operations may be interrupted, which could adversely impact our business and results of operations. In addition, if a natural disaster impacts a significant number of our customers, our business and results of operations could be adversely impacted.

If our information technology security measures are breached, our information systems may be perceived as being insecure, which could harm our business and reputation.

Our products and services involve the storage and transmission of proprietary information owned by us and our customers. We have sales and research and development offices throughout the world. Our operations are dependent upon the connectivity of our operations worldwide. Despite our security measures, our information technology and infrastructure may be vulnerable to cyber-attacks or breached due to employee errors or other disruptions that could result in unauthorized disclosure of sensitive information and could significantly interfere with our business operations. Breaches of our security measures could expose us to a risk of loss or misuse of this information, adverse publicity, violations of privacy laws, and litigation. Because techniques used to obtain unauthorized access or to sabotage information systems change frequently and generally are not recognized until launched against a target, we may be unable to anticipate these techniques or to implement adequate preventive measures. In addition, with the use of “cloud” services in our business, despite our attempts to validate the security of such services, proprietary information may be misappropriated by third parties. If there is an actual or perceived breach of our security, or the security of one of our vendors, the market perception of the effectiveness of our security measures could be harmed and we could suffer damage to our reputation or our business, or lose existing customers and lose our ability to obtain new customers.

Our shareholder rights plan may have anti-takeover effects.

In June 2013, we extended the term of our shareholder rights plan for 24 months, 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 provisions of 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.

Our revolving credit facility has financial and non-financial covenants, and default of any covenant could materially adversely impact us.

Our bank revolving credit facility imposes operating restrictions on us in the form of financial and non-financial covenants. Financial covenants include adjusted quick ratio, tangible net worth, leverage ratio, senior leverage ratio, and minimum cash and accounts receivable ratio. If we were to fail to comply with the financial covenants and did not obtain a waiver from our lenders, we would be in default under the revolving credit facility and our lenders could terminate the facility and demand immediate repayment of all outstanding loans under the revolving credit facility. The declaration of an event of default could have a material adverse effect on our financial condition. We could also find it difficult to obtain other bank lines or credit facilities on comparable terms.

We have a substantial level of indebtedness.

As of January 31, 2014, we had $263 million of outstanding indebtedness, which includes principal of $253 million of 4.00% Convertible Subordinated Debentures due 2031 (4.00% Debentures) and $10 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; and
- Place us at a possible competitive disadvantage relative to less leveraged competitors and competitors that have greater access to capital resources.

We may also be unable to borrow funds as a result of an inability of financial institutions to lend due to restrictive lending policies and/or institutional liquidity concerns.

Our 4.00% Debentures are convertible under certain circumstances at a conversion price as of January 31, 2014 of $20.35 per share (as adjusted for the effect of cash dividends and other applicable items). These circumstances include the market price of our common stock exceeding 120% of the conversion price, or $24.42 per share as of January 31, 2014, for at least 20 of the last 30 trading days of the previous fiscal quarter. If our 4.00% Debentures become convertible and any of the holders elect to convert their debentures, we would be required to pay cash for at least the principal amount of any converted debentures and cash or shares for the excess of the value of the converted shares over the principal amount. If holders of a significant amount of our 4.00% Debentures elect to convert, we could have difficulty paying the amount due upon conversion, which would have material adverse impact on our liquidity and financial condition.

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 “Risk Factors” 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 or by our competitors 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. 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.

Our business could be negatively affected as a result of actions of activist shareholders.

Responding to actions by activist shareholders can be costly and time-consuming, disrupting our operations, and diverting the attention of management and our employees. The perceived uncertainties as to our future direction may result in the loss of potential business opportunities, and may make it more difficult to attract and retain qualified personnel and business partners.

Ability to pay dividends.

We currently declare and pay quarterly cash dividends on our common stock. Any future payment of cash dividends will depend upon our financial condition, earnings, available cash, cash flow, and other factors our board of directors deems relevant. Our board may decrease or discontinue payment of dividends at any time, which could cause the market price of our stock to decline.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We own six buildings on 43 acres of land in Wilsonville, Oregon, occupying approximately 379,000 square feet in those buildings as our corporate headquarters. We also own an additional 69 acres of undeveloped land adjacent to our headquarters. Most administrative functions and a significant amount of our domestic research and development operations are located at the Wilsonville site. We own three buildings totaling approximately 196,000 square feet in Fremont, California which house research and development, sales, and administrative staff. We own two buildings totaling approximately 48,000 square feet in Shannon, Ireland which house information technology and administrative staff.

We lease additional space in Longmont, Colorado; Redmond, Washington; Huntsville and Mobile, Alabama; and Marlboro and Waltham, Massachusetts where some of our domestic research and development takes place; and in various locations throughout the United States and in other countries, primarily for sales and customer service operations. Additional research and development is done in locations outside the United States including locations in Armenia, Egypt, France, Germany, Hungary, India, Israel, Pakistan, Poland, Russia, Taiwan, and the United Kingdom. We believe that we will be able to renew or replace our existing leases as they expire and that our current facilities will be adequate through at least the year ending January 31, 2015.

Item 3. Legal Proceedings

From time to time we are involved in various disputes and litigation matters that arise in 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 our 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. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, we base accruals 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.

In some instances we are unable to reasonably estimate any potential loss or range of loss. The nature and progression of litigation can make it difficult to predict the impact a particular lawsuit will have. There are many reasons that we cannot make these assessments, including, among others, one or more of the following: the early stages of a proceeding; damages sought that are unspecific, unsupportable, unexplained or uncertain; discovery not having been started or incomplete; the complexity of the facts that are in dispute; the difficulty of assessing novel claims; the parties not having engaged in any meaningful settlement discussions; the possibility that other parties may share in any ultimate liability; and/or the often slow pace of litigation.

In December 2012, Synopsys filed a lawsuit claiming patent infringement against us in federal district court in the North District of California, alleging that our Veloce family of products infringes on four Synopsys United States Patents. On May 2, 2013, Synopsys also filed a claim against us in federal district court in Oregon, similarly alleging that our Veloce family of products infringes on two additional Synopsys United States Patents. These cases seek compensatory damages and a permanent injunction against the licensing of several of our software and hardware products relating to our emulation and field programmable gate arrays synthesis products. We believe these actions were filed in response to patent lawsuits we filed in 2010 and 2012 against Emulation and Verification Engineering S.A. and EVE-USA, Inc. (together EVE), which Synopsys acquired in October 2012. Our lawsuits, which allege that EVE's Zebu emulation products infringe several of our patents, were filed against EVE in federal district court in Oregon. We also filed a patent lawsuit against EVE in Tokyo district court. Our litigation in Oregon and Japan seeks compensatory damages and an injunction against the sale of EVE emulation products. We do not have sufficient information upon which to determine that a loss in connection with this matter is probable, reasonably possible, or estimable, and thus no liability has been established nor has a range of loss been disclosed.

Item 4. Mine Safety Disclosures

Not applicable.

EXECUTIVE OFFICERS OF THE REGISTRANT

The following are the executive officers of Mentor Graphics Corporation:

Name	Position	Age
Walden C. Rhines	Chairman of the Board and Chief Executive Officer	67
Gregory K. Hinckley	President, Chief Financial Officer, and Director	67
L. Don Maulsby	Senior Vice President, World Trade	62
Brian Derrick	Vice President, Corporate Marketing	50
Richard P. Trebing	Corporate Controller and Chief Accounting Officer	58
Dean Freed	Vice President, General Counsel, and Secretary	55
Mike Vishny	Vice President, Chief Human Resources Officer	49

The executive officers are elected by our Board of Directors annually. Officers hold their positions until they resign, are terminated, or their successors are elected. There are no arrangements or understandings between the officers or any other person pursuant to which officers were elected. There are no family relationships among any of our executive officers or directors.

Dr. Rhines has served as our Chairman of the Board and Chief Executive Officer since 2000. Dr. Rhines served as our Director, President, and Chief Executive Officer from 1993 to 2000. Dr. Rhines is currently a director of Triquint Semiconductor, Inc., a semiconductor manufacturer, and served as director of Cirrus Logic, Inc., also a semiconductor manufacturer, from 1995 to 2009.

Mr. Hinckley has served as our President, Chief Operating Officer, and Director since 2000. Mr. Hinckley has served as our Chief Financial Officer since 2008. He has primary responsibility for the operations of our corporate centers, sales, and research and development divisions. Mr. Hinckley is a director of Super Micro Computer, Inc., a server board, chassis, and server systems supplier and SI Bone, Inc., a privately held medical device company. Until 2013, Mr. Hinckley was a director of Intermec, Inc., a provider of integrated systems solutions.

Mr. Maulsby has served as our Senior Vice President, World Trade since 1999.

Mr. Derrick has served as our Vice President, Corporate Marketing since 2002. From 2000 to 2001, he was Vice President and General Manager of our Physical Verification Division. Since 2008, Mr. Derrick has served as a director of Calypto Design Systems, Inc., a sequential analysis technology company.

Mr. Trebing has been our Corporate Controller and Chief Accounting Officer since December 2011. He previously served as our Director of Finance for Operations since 1999.

Mr. Freed has served as our Vice President, General Counsel, and Secretary since 1995.

Mr. Vishny has served as our Vice President, Chief Human Resources since 2011. He was the Senior Vice President, Human Resources at Conexant Systems, Inc. from 2002 to 2011.

Item 5. Market for the Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Our common stock trades on The NASDAQ Global Select Market under the symbol "MENT." The following table sets forth for the periods indicated the high and low sales prices for our common stock, as reported by The NASDAQ Global Select Market, and the dividends paid per share:

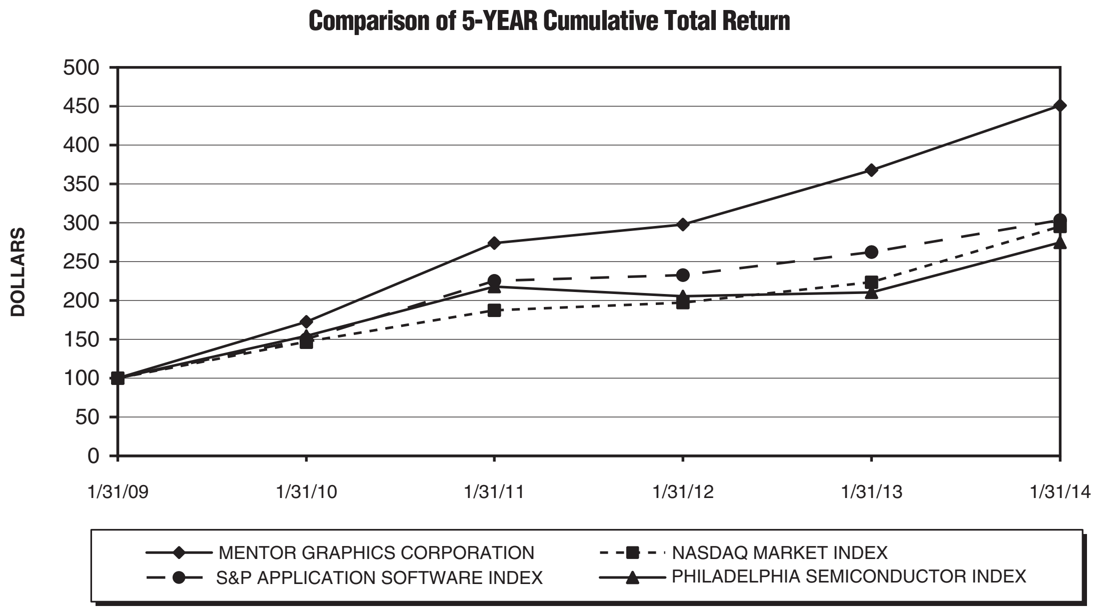
Quarter ended	April 30	July 31	October 31	January 31
Fiscal 2014				
High Price	$18.40	$20.78	$23.77	$24.31
Low Price	$13.21	$17.75	$20.57	$20.51
Dividends Paid	$0.045	$0.045	$0.045	$0.045

Quarter ended	April 30	July 31	October 31	January 31
Fiscal 2013				
High Price	$15.76	$15.75	$17.37	$17.50
Low Price	$13.70	$12.85	$14.84	$13.32
Dividends Paid	$ –	$ –	$ –	$ –

As of March 13, 2014, we had 444 stockholders of record.

We commenced the payment of quarterly dividends in the first quarter of fiscal 2014. Our revolving credit facility includes a limit on the amount we can pay for dividends and repurchases of our stock. For more information regarding our credit facility, see Note 5. "Short-Term Borrowings" in Part II, Item 8. "Financial Statements and Supplementary Data."

The following graph compares the cumulative 5-year total stockholder return on our common stock relative to the cumulative total return of the S&P Application Software Index, the NASDAQ Market Index and the Philadelphia Semiconductor Index.



Note: The stock price shown on the above graph is not necessarily indicative of future performance.

	Period Ending					
Company/Market/Peer Group	**1/31/2009**	**1/31/2010**	**1/31/2011**	**1/31/2012**	**1/31/2013**	**1/31/2014**
Mentor Graphics Corporation	$100.00	$172.10	$273.39	$297.64	$367.60	$450.79
NASDAQ Market Index	$100.00	$146.91	$186.66	$196.55	$222.91	$295.15
S&P Application Software Index	$100.00	$150.14	$225.04	$232.29	$261.73	$303.26
Philadelphia Semiconductor Index	$100.00	$154.38	$217.77	$204.78	$210.39	$274.70

The table below sets forth information regarding our repurchases of our common stock during the three months ended January 31, 2014:

Period	**Total number of shares purchased**	**Average price paid per share**	**Total number of shares purchased as part of publicly announced programs**	**Maximum dollar value of shares that may yet be purchased under the programs**
November 1 - November 30, 2013	–	$ –	–	$90,000,021
December 1 - December 31, 2013	–	–	–	$90,000,021
January 1 - January 31, 2014	–	–	–	$90,000,021
Total	–	$ –	–	

On April 18, 2011, we announced a share repurchase program approved by our Board of Directors which authorized the repurchase of up to $150.0 million of our common stock over a three year period. On February 27, 2012, our Board of Directors authorized an additional $50.0 million shares of our common stock to be repurchased under this program, and clarified that the $25.0 million of shares repurchased in April 2011, using proceeds from our issuance of 4.00% Debentures are considered to have been part of this program. On August 21, 2013, our Board of Directors authorized an additional $63.9 million of our common stock to be repurchased under this program.

Item 6. Selected Consolidated Financial Data

In thousands, except percentages and per share data

Year ended January 31,	2014	2013	2012	2011	2010
Statement of Operations Data					
Total revenues	$1,156,373	$1,088,727	$1,014,638	$ 914,753	$ 802,727
Operating income (loss)	$ 183,040	$ 161,633	$ 112,192	$ 52,539	$ (1,167)
Net income (loss) attributable to Mentor Graphics shareholders	$ 155,258	$ 138,736	$ 83,872	$ 28,584	$ (21,889)
Gross profit percent	84%	83%	83%	83%	83%
Operating income (loss) as a percent of revenues	16%	15%	11%	6%	– %
Per Share Data					
Net income (loss) per share attributable to Mentor Graphics shareholders (1):					
Basic	$ 1.33	$ 1.20	$ 0.76	$ 0.27	$ (0.23)
Diluted	$ 1.29	$ 1.17	$ 0.74	$ 0.26	$ (0.23)
Weighted average number of shares outstanding:					
Basic	113,671	110,998	110,138	107,743	96,474
Diluted	116,702	114,017	112,915	109,861	96,474
Dividends paid	$ 0.18	$ –	$ –	$ –	$ –

As of January 31,	2014	2013	2012	2011	2010
Balance Sheet Data					
Cash, cash equivalents, and short-term investments	$ 297,312	$ 223,783	$ 146,499	$ 133,113	$ 99,343
Working capital	$ 419,122	$ 293,127	$ 193,497	$ 173,417	$ 71,416
Property, plant, and equipment, net	$ 160,165	$ 162,402	$ 148,019	$ 139,340	$ 121,795
Total assets	$1,904,109	$1,745,284	$1,550,675	$1,427,978	$1,223,041
Short-term borrowings and current portion of notes payable	$ 9,590	$ 5,964	$ 15,966	$ 17,544	$ 70,146
Long-term portion of notes payable, deferred revenue, long-term, and other noncurrent liabilities	$ 292,349	$ 287,282	$ 301,397	$ 291,377	$ 223,827
Noncontrolling interest with redemption feature	$ 15,479	$ 12,698	$ 9,266	$ –	$ –
Stockholders' equity	$1,185,294	$1,033,479	$ 866,074	$ 776,714	$ 640,017

(1) We have reduced the numerator of our earnings per share calculation by $4,486 for the year ended January 31, 2014 and $5,272 for the year ended January 31, 2013 for the adjustment to increase the noncontrolling interest with redemption feature to its calculated redemption value, recorded directly to retained earnings.

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

Unless otherwise indicated, numerical references are in millions, except for percentages, per share data, and conversion rate data.

Overview

The following discussion should be read in conjunction with the consolidated financial statements and notes included elsewhere in this Form 10-K. 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 I, Item 1A. "Risk Factors" and in our other Securities and Exchange Commission 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-K. 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-K are made only as of the date of this Form 10-K. 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) tools — advanced computer software and emulation hardware systems used to automate the design, analysis, and testing of complex electro-mechanical systems, electronic hardware, and embedded systems software in electronic systems and components. We market our products and services worldwide, primarily to large companies in the communications, computer, consumer electronics, semiconductor, networking, military and aerospace, 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.

We generally focus on products and design platforms where we have or believe we can attain leading market share. Part of this approach includes developing new applications and exploring new markets where EDA companies have not generally participated. We believe this strategy leads to a more diversified product and customer mix and can help reduce the volatility of our business and our risk as a creditor, while increasing our potential for growth.

We derive system and software revenues primarily from the sale of term software license contracts, which are typically three to four years in length. We generally recognize revenue for these arrangements upon product delivery at the beginning of the license term. Larger enterprise-wide customer contracts, which are approximately 50% or more of our system and software revenue, drive the majority of our period-to-period revenue variances. We identify term licenses where collectibility is not probable and recognize revenue on those licenses when cash is received. Ratable license revenues primarily include short-term term licenses as well as other term licenses where we provide the customer with rights to unspecified or unreleased future products. For these reasons, the timing of large contract renewals, customer circumstances, and license terms are the primary drivers of revenue changes from period to period, with revenue changes also being driven by new contracts and increases in the capacity of existing contracts, to a lesser extent.

The EDA industry is competitive and is characterized by very strong leadership positions in specific segments of the EDA market. These strong leadership positions can be maintained for significant periods of time as the software can be 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 areas in which we are the leader. We expect to 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 where we have the opportunity to build significant market share.

Our products and services are dependent to a large degree on new design projects initiated by customers in the integrated circuit (IC) and electronics system industries. These industries can be 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. Furthermore, extended economic downturns can result in reduced funding for development due to downsizing and other business restructurings. These pressures are offset by the need for the development and introduction of next generation products once an economic recovery occurs.

Known Trends and Uncertainties Impacting Future Results of Operations

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 and the timing of contract renewals.

Ten accounts make up approximately 40% of our receivables, including both short and long-term balances. We have not experienced and do not presently expect to experience collection issues with these customers.

Net of reserves, we have no receivables greater than 60 days past due, and continue to experience no difficulty in factoring our high quality receivables.

Bad debt expense recorded for the year ended January 31, 2014 was not material. However, we do have exposures within our receivables portfolio to customers with weak credit ratings. These receivable balances do not represent a material portion of our portfolio but could have a material adverse effect on earnings in any given quarter, should significant additional allowances for doubtful accounts be necessary.

Bookings during fiscal 2014 increased by approximately 35% compared to fiscal 2013 primarily due to the timing of term license contract renewals and emulation orders. Bookings are the value of executed orders during a period for which revenue has been or will be recognized within six months for software products and within twelve months for emulation hardware systems, professional services, and training. Ten customers for fiscal 2014 accounted for approximately 40% of total bookings compared to 35% for fiscal 2013. The number of new customers for fiscal 2014 remained consistent with the levels experienced during fiscal 2013.

Product Development

During the year ended January 31, 2014, we continued to execute our strategy of focusing on technical 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.

We believe that the development and commercialization of EDA software tools is generally a three to five year process with limited customer adoption and sales in the first years of tool availability. Once tools are adopted, however, their life spans tend to be long. During the year ended January 31, 2014, we introduced new products and upgrades to existing products.

Critical Accounting Policies

We base our discussion and analysis of our financial condition and results of operations upon our consolidated financial statements which have been 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, current facts, 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 and the recording of revenue, costs, and expenses that are not readily apparent from other sources. As future events and their effects cannot be determined with precision, actual results could differ from those estimates.

We believe that the accounting for valuation of accounts receivable, revenue recognition, business combinations, income taxes, goodwill, intangible assets, long-lived assets, special charges, and stock-based compensation are the critical accounting estimates and judgments used in the preparation of our consolidated financial statements. For further discussion of our significant accounting policies, see Note 2. “Summary of Significant Accounting Policies” in Part II, Item 8. “Financial Statements and Supplementary Data.”

Revenue Recognition

We report revenue in two categories based on how 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 to four 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.
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 of the discount on long-term installment receivables in system and software revenues.

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 revenues ratably over the support services term. We record professional service revenues as the services are provided to the customer.

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. With respect to emulation hardware systems, we transfer title to the customer upon shipment. Our software license and

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.

   Significant judgment is involved in assessing whether a fee is fixed or determinable. We must also make these judgments when assessing whether a contract amendment to a term arrangement (primarily in the context of a license extension or renewal) constitutes a concession. Our experience has been that we are able to determine whether a fee is fixed or determinable for term licenses. If we no longer were to have a history of collecting under the original contract without providing concessions on term licenses, revenue from term licenses would be required to be recognized when payments under the installment contract become due and payable. Such a change could have a material impact on our results of operations.

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 involving software licenses – For multiple element arrangements involving software and other software-related deliverables, 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 exists 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 are met.

We base our VSOE for certain 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.

Multiple element arrangements involving hardware – For multiple element arrangements involving our emulation hardware systems, we allocate revenue to each element based on the relative selling price of each deliverable. In order to meet the separation criteria to allocate revenue to each element we must determine the standalone selling price of each element using a hierarchy of evidence.

The authoritative guidance requires that, in the absence of VSOE or third-party evidence, a company must develop an estimated selling price (ESP). ESP is defined as the price at which the vendor would transact if the deliverable was sold by the vendor regularly on a standalone basis. A company should consider market conditions as well as entity-specific factors when estimating a selling price. We base our ESP for certain elements in arrangements on either costs incurred to manufacture a product plus a reasonable profit margin or standalone sales to similar customers. In determining profit margins, we consider current market conditions, pricing strategies related to the class of customer, and the level of penetration we have with the customer. In other cases, we may have limited sales on a standalone basis to the same or similar customers and/or guaranteed pricing on future purchases of the same item.

Valuation of Trade Accounts Receivable

We maintain allowances for doubtful accounts on trade account receivables and term receivables, long-term for estimated losses resulting from the inability of our customers to make required payments. We regularly evaluate the collectibility of our trade accounts receivable based on a combination of factors. When we become aware of a specific customer's inability to meet its financial obligations, such as in the case of bankruptcy or deterioration in the customer's operating results, financial position, or credit rating, we record a specific reserve for bad debt to reduce the related receivable to the amount believed to be collectible. We also record unspecified reserves for bad debt for all other customers based on a variety of factors including length of time the receivables are past due, the financial health of the customers, the current business environment, and historical experience. Current economic conditions we have considered include forecasted spending in the semiconductor industry, consumer spending for electronics, integrated circuit research and development spending, and volatility in gross domestic product. If these factors change or circumstances related to specific customers change, we adjust the estimates of the recoverability of receivables resulting in either additional selling expense or a reduction in selling expense in the period such determination is made.

Income Taxes

Deferred tax assets are recognized for deductible temporary differences, net operating loss carryforwards, and credit carryforwards if it is more likely than not that the tax benefits will be realized. We have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for valuation allowances. We have recorded a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. In the event we determine that we are able to realize our deferred tax assets in the future in excess of our net recorded amount, we would reduce the valuation allowance associated with the deferred tax assets in the period the determination was made, which may result in a tax benefit in the statement of income. Also, if we determine that we are not able to realize all or part of our net deferred tax assets in the future, we would record a valuation allowance on the net deferred tax assets which may result in additional tax expense in the period the determination was made.

We are subject to income taxes in the U.S. and in numerous foreign jurisdictions, and in the ordinary course of business, there are many transactions and calculations where the ultimate tax determination is uncertain. While we believe the positions we have taken are appropriate, we have reserves for taxes to address potential exposures involving tax positions that are being challenged or that could be challenged by the tax authorities. We record a benefit on a tax position when we determine that it is more likely than not that the position is sustainable upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. For tax positions that are more likely than not to be sustained, we measure the tax position at the largest amount of benefit that has a greater than 50 percent likelihood of being realized when it is effectively settled. We review the tax reserves as circumstances warrant and adjust the reserves as events occur that affect our potential liability for additional taxes.

Business Combinations

When we acquire businesses, we allocate the purchase price, including the fair value of contingent consideration, to acquired tangible assets and liabilities and acquired identifiable intangible assets. Any residual purchase price is recorded as goodwill. The allocation of the purchase price requires us to make significant estimates in determining the fair value of contingent consideration as well as acquired assets and assumed liabilities, especially with respect to intangible assets and goodwill. These estimates are based on information obtained from management of the acquired companies, our assessment of this information, and historical experience. These estimates can include, but are not limited to, the cash flows that an acquired business is expected to generate in the future, the cash flows that specific assets acquired with that business are expected to generate in the future, the appropriate weighted-average cost of capital, and the cost savings expected to be derived from acquiring an asset. These estimates are inherently uncertain and unpredictable, and if different estimates were used, the purchase price for the acquisition could be allocated to the acquired assets and liabilities differently from the allocation that we have made to the acquired assets and liabilities. In addition, unanticipated events and circumstances may occur that may affect the accuracy or validity of such estimates, and if such events occur, we may be required to adjust the value allocated to acquired assets or assumed liabilities.

We also make significant judgments and estimates when we assign useful lives to the definite lived intangible assets identified as part of our acquisitions. These estimates are inherently uncertain and if we used different estimates, the useful life over which we amortize intangible assets would be different. In addition, unanticipated events and circumstances may occur that may impact the useful life over which we amortize our intangible assets, which would impact our amortization of intangible assets expense and our results of operations.

Goodwill, Intangible Assets, and Long-Lived Assets

We review long-lived assets, including intangible assets with definite lives, for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. We assess the recoverability of our long-lived assets by determining whether their carrying values are greater than the forecasted undiscounted net cash flows of the related assets. If we determine the assets are impaired, we write down the assets to their estimated fair value. We determine fair value based on forecasted discounted net cash flows or appraised values, depending upon the nature of the assets. Significant management judgment is required in the forecasts of future operating results that are used in the discounted cash flow method of valuation. The estimates we have used are consistent with the plans and estimates that we use to manage our business. It is possible, however, that the plans may change and estimates used may prove to be inaccurate. If our actual results, or the plans and estimates used in future impairment analysis, are lower than the original estimates used to assess the recoverability of these assets, we could incur impairment charges.

We test goodwill and intangible assets with indefinite lives for impairment at least annually and whenever events or changes in circumstances indicate an impairment may exist. In the event that we determine that our goodwill, intangible assets, or other long-lived assets are impaired, we make an adjustment that results in a charge to earnings for the write-down in the period that determination is made.

Special Charges

We record restructuring charges within special charges in the consolidated statements of income in connection with our plans to better align our cost structure with projected operations in the future. We have recorded restructuring charges in connection with employee rebalances based on estimates of the expected costs associated with severance benefits. If the actual cost incurred exceeds the estimated cost, an addition to special charges will be recognized. If the actual cost is less than the estimated cost, a benefit to special charges will be recognized.

Special charges may also include expenses incurred related to certain litigation costs that are unusual in nature due to the significance in variability of timing and amount.

Stock-Based Compensation

We measure stock-based compensation cost at the grant date, based on the fair value of the award, and recognize the expense on a straight-line basis over the employee's requisite service period. For options and stock awards that vest fully on any termination of service, there is no requisite service period and consequently we recognize the expense fully in the period in which the award is granted.

We estimate the fair value of stock options and purchase rights under our employee stock purchase plans using a Black-Scholes option-pricing model. The Black-Scholes option-pricing model incorporates several highly subjective assumptions including expected volatility, expected term, expected dividends, and interest rates. The input factors used in Black-Scholes option-pricing model are based on subjective future expectations combined with management judgment. If there is a difference between the assumptions used in determining stock-based compensation cost and the actual factors which become known over time, we may change the input factors used in determining stock-based compensation costs. These changes may materially impact the results of operations in the period such changes are made. In addition, if we were to modify any awards, additional charges would be taken.

We did not issue any options in fiscal 2014. For fiscal years 2013 and 2012, when determining expected volatility for options, we include the elements listed below at the weighted percentages presented:

- Historical volatility of our shares of common stock at 35%;
- Historical volatility of shares of comparable companies at 20%;
- Implied volatility of our traded options at 30%; and
- Implied volatility of traded options of comparable companies at 15%.

The greatest weighting was provided to the historic volatility of our common stock based on the amount of consistent historic information available. A lesser weighting was applied to the implied volatility of our traded options due to a low volume of trades and shorter terms. We also included the historic and implied volatility of comparable companies in our industry in an effort to capture a broader view of the marketplace.

The relative weighting percentages are periodically reviewed for reasonableness and are subject to change depending on market conditions and our particular facts and circumstances.

In reaching our determination of expected volatility for purchase rights under our employee stock purchase plans, we use the historical volatility of our shares of common stock.

We based the expected term of our stock options on historical experience.

RESULTS OF OPERATIONS

Revenues and Gross Profit

Year ended January 31,	2014	Change	2013	Change	2012
System and software revenues	$ 737.8	8%	$ 681.9	8%	$ 631.5
System and software gross profit	$ 668.9	10%	$ 609.8	8%	$ 566.8
Gross profit percent	91%		89%		90%
Service and support revenues	$ 418.6	3%	$ 406.8	6%	$ 383.1
Service and support gross profit	$ 300.4	4%	$ 289.2	5%	$ 274.4
Gross profit percent	72%		71%		72%
Total revenues	$1,156.4	6%	$1,088.7	7%	$1,014.6
Total gross profit	$ 969.3	8%	$ 899.0	7%	$ 841.2
Gross profit percent	84%		83%		83%

System and Software

Year ended January 31,	2014	Change	2013	Change	2012
Upfront license revenues	$641.6	10%	$584.3	8%	$541.7
Ratable license revenues	96.2	(1)%	97.6	9%	89.8
Total system and software revenues	$737.8	8%	$681.9	8%	$631.5

We derive system and software revenues from the sale of licenses of software products and emulation and other hardware systems, including finance fee revenues from our long-term installment receivables resulting from product sales. Upfront license revenues consist of perpetual licenses and term licenses for which we recognize revenue upon product delivery at the start of a license term. We identify licenses where collectibility is not probable and recognize revenue on those licenses when cash is received. Ratable license revenues primarily consist of short-term term licenses, term licenses where we provide the customer with rights to unspecified or unreleased future products, and finance fees from the accretion of the discount on long-term installment receivables.

Ten customers accounted for approximately 40% of system and software revenues for fiscal 2014 and fiscal 2013 and approximately 45% for fiscal 2012. No single customer accounted for 10% or more of total revenues for fiscal years 2014, 2013, and 2012.

System and software revenues increased for fiscal 2014 compared to fiscal 2013 primarily as a result of increased software license revenues driven by the timing of contract renewals.

System and software revenues increased for fiscal 2013 compared to fiscal 2012 primarily due to an increase in sales of scalable verification products. The effect of acquisitions completed in fiscal 2013 and fiscal 2012 on fiscal 2013 system and software revenues was $13.6.

System and software gross profit percentage was higher for fiscal 2014 compared to fiscal 2013 primarily due to a more favorable product mix and reduced amortization of purchased technology.

Service and Support

We derive service and support revenues from software and hardware post-contract maintenance or support services and professional services, which includes consulting, training, and other services.

Professional services are a lower margin offering which is staffed according to fluctuations in demand. Support services operate under a less variable cost structure.

The increase in service and support revenues for fiscal 2014 compared to fiscal 2013 was driven primarily by increased support revenues of $7.7 resulting from an increase in our installed base.

The increase in service and support revenues for fiscal 2013 compared to fiscal 2012 was driven primarily by increased support revenues of $18.7 due to an increase in installed base including the effect of acquisitions completed in fiscal 2013 and in fiscal 2012 of $9.6.

Geographic Revenues Information

Revenue by Geography

Year ended January 31,	2014	Change	2013	Change	2012
North America	$ 513.2	7%	$ 481.1	16%	$ 416.1
Europe	241.4	(8%)	261.4	6%	247.1
Japan	113.8	(11%)	127.8	10%	116.5
Pacific Rim	288.0	32%	218.4	(7%)	234.9
Total revenue	$1,156.4	6%	$1,088.7	7%	$1,014.6

The decrease in revenues in Japan for fiscal 2014 compared to fiscal 2013 is due to foreign exchange offset in part by the favorable impact of the timing of contract renewals. The increase in revenues in the Pacific Rim for fiscal 2014 compared to fiscal 2013 is primarily due to the timing of contract renewals. The changes in revenues in North America and Japan for fiscal 2013 compared to fiscal 2012 were the result of timing and geographic location of contract renewals.

We recognize additional revenues in periods when the U.S. dollar weakens in value against foreign currencies. Likewise, we recognize lower revenues in periods when the U.S. dollar strengthens in value against foreign currencies. For fiscal year 2014, approximately one-third of European and approximately 90% of Japanese revenues were subject to exchange rate fluctuations as they were booked in local currencies. For fiscal year 2013, approximately one-fourth of European and three-fourths of Japanese revenues were subject to exchange rate fluctuations as they were booked in local currencies. For fiscal year 2012, approximately one-third of European and substantially all Japanese revenues were subject to exchange rate fluctuations as they were booked in local currencies.

Foreign currency had an unfavorable impact of $21.8 for fiscal 2014 compared to fiscal 2013 primarily as a result of the strengthening of the U.S. dollar against the Japanese yen. Foreign currency had an unfavorable impact of $5.4 for fiscal 2013 compared to fiscal 2012 primarily as a result of the strengthening of the U.S. dollar against the Japanese yen and euro.

For additional description of how changes in foreign exchange rates affect our consolidated financial statements, see discussion in Part II, Item 7A., "Quantitative and Qualitative Disclosures About Market Risk–Foreign Currency Risk."

Revenue by Category

We segregate revenues into five categories of similar products and services. Each category includes both product and related support revenues. Revenues for each category as a percent of total revenues are as follows (percentages rounded to the nearest 5%):

Year ended January 31,	2014	2013	2012
Revenues:			
IC Design to Silicon	40%	35%	40%
Scalable Verification	25%	25%	25%
Integrated System Design	20%	25%	20%
New and Emerging Products	5%	5%	5%
Services and Other	10%	10%	10%
Total revenues	100%	100%	100%

Certain reclassifications have been made between categories in the fiscal 2013 and 2012 presentation to be consistent with the fiscal 2014 presentation.

Operating Expenses

Year ended January 31,	2014	Change	2013	Change	2012
Research and development	$348.8	11%	$314.0	1%	$310.8
Marketing and selling	342.8	1%	338.7	4%	326.6
General and administration	75.5	7%	70.7	(5%)	74.8
Equity in earnings of Frontline	(4.1)	128%	(1.8)	(22%)	(2.3)
Amortization of intangible assets	6.2	5%	5.9	– %	5.9
Special charges	16.9	71%	9.9	(25%)	13.2
Total operating expenses	$786.1	7%	$737.4	1%	$729.0

Selected Operating Expenses as a Percentage of Total Revenues

Year ended January 31,	2014	2013	2012
Research and development	30%	29%	31%
Marketing and selling	30%	31%	32%
General and administration	7%	6%	7%
Total selected operating expenses	67%	66%	70%

Research and Development

Research and development expenses increased by $34.8 for fiscal 2014 compared to fiscal 2013 primarily due to an increase in the number of employees, resulting in higher compensation. Research and development expenses increased by $3.2 for fiscal 2013 compared to fiscal 2012. The components of these changes are summarized as follows:

	Change	
Year ended January 31,	2014 vs 2013	2013 vs 2012
Salaries, variable compensation, and benefits expenses	$17.6	$(9.9)
Supplies and equipment	3.4	(0.4)
Expenses associated with acquired businesses	2.7	7.3
Outside services	2.5	0.8
Reduction in tax credits	2.2	0.7
Stock compensation	2.0	0.7
Other expenses	4.4	4.0
Total change in research and development expenses	$34.8	$ 3.2

Marketing and Selling

Marketing and selling expenses increased by $4.1 for fiscal 2014 compared to fiscal 2013 and increased by $12.1 for fiscal 2013 compared to fiscal 2012. The components of these changes are summarized as follows:

	Change	
Year ended January 31,	2014 vs 2013	2013 vs 2012
Salaries, variable compensation, and benefits expenses	$1.2	$ 8.0
Expenses associated with acquired businesses	0.2	5.9
Other expenses	2.7	(1.8)
Total change in marketing and selling expenses	$4.1	$12.1

General and Administration

General and administration expenses increased by $4.8 for fiscal 2014 compared to fiscal 2013 and decreased by $4.1 for fiscal 2013 compared to fiscal 2012. The components of these changes are summarized as follows:

	Change	
Year ended January 31,	2014 vs 2013	2013 vs 2012
Salaries, variable compensation, and benefits expenses	$2.0	$(2.8)
Stock compensation	2.1	(0.5)
Expenses associated with acquired businesses	–	1.8
Other expenses	0.7	(2.6)
Total change in general and administration expenses	$4.8	$(4.1)

We have reclassified litigation costs related to patent litigation involving us, Emulation and Verification Engineering, S.A. and EVE-USA, Inc. (together EVE), and Synopsys, Inc. (Synopsys) from general and administration to special charges for fiscal 2013. A further description is provided in Note 2. "Summary of Significant Accounting Policies" in Part II, Item 8. "Financial Statements and Supplementary Data."

We incur a substantial portion of our operating expenses outside the U.S. in various foreign currencies. We recognize additional operating expense in periods when the U.S. dollar weakens in value against foreign currencies and lower operating expenses in periods when the U.S. dollar strengthens in value against foreign currencies. For fiscal 2014 compared to fiscal 2013, we experienced favorable currency movements of $6.4 in total operating expenses, primarily due to movements in the Japanese yen. For fiscal 2013 compared to fiscal 2012, we experienced favorable currency movements of $13.2 in total operating expenses, primarily due to movements in the euro and the Indian rupee. The impact of these currency effects is reflected in the movements in operating expenses detailed above.

Equity in Earnings of Frontline

We have a 50% interest in a joint venture, Frontline P.C.B. Solutions Limited Partnership (Frontline). Frontline is owned equally by Orbotech, Ltd., an Israeli company, and us.

Frontline reports on a calendar year basis. As such, we record our interest in the earnings of Frontline on a one-month lag. The following presents the summarized financial information of our 50% interest in Frontline for the twelve months ended December 31, 2013, 2012, and 2011:

Year ended December 31,	2013	2012	2011
Mentor's share of net income-as reported	$ 5.5	$ 6.8	$ 7.3
Amortization of purchased technology and other identified intangible assets	(1.4)	(5.0)	(5.0)
Equity in earnings of Frontline	$ 4.1	$ 1.8	$ 2.3

Special Charges

Year ended January 31,	2014	Change	2013	Change	2012
Litigation costs	$11.6	222%	$3.6	–%	$ –
Employee severance and related costs	4.4	10%	4.0	(52%)	8.4
Other costs	0.9	(61%)	2.3	(52%)	4.8
Total special charges	$16.9	71%	$9.9	(25%)	$13.2

Special charges may include expenses incurred related to certain litigation costs, employee severance, acquisitions, excess facility costs, and assets related charges.

Litigation costs consist of professional service fees related to patent litigation involving us, EVE, and Synopsys regarding emulation technology. These costs have been reclassified from general administration for fiscal 2013 as further described in Note 2. "Summary of Significant Accounting Policies" in Part II, Item 8. "Financial Statements and Supplementary Data."

Employee severance and related costs primarily consist of costs incurred for employee terminations due to a reduction of personnel resources driven by modifications of business strategy or business emphasis. Employee severance and related costs include severance benefits, notice pay, and outplacement services. These rebalance charges generally represent the aggregate of numerous unrelated rebalance plans which impact several employee groups, none of which is individually material to our financial position or results of operations. We determine termination benefit amounts based on employee status, years of service, and local statutory requirements. We communicate termination benefits to the affected employees prior to the end of the quarter in which we record the charge.

Interest Expense

Year ended January 31,	2014	Change	2013	Change	2012
Interest Expense	$19.5	3%	$18.9	(40)%	$31.4

The decrease in interest expense for fiscal 2013 compared to fiscal 2012 was primarily due to the higher expenses recorded in fiscal 2012 related to the repayment of debt in April 2011. This resulted in losses of $11.5 on the early extinguishment of debt, which included a $6.2 write-off of the net unamortized debt discount, a $3.5 premium for the redemption of the 6.25% Convertible Subordinated Debentures, and a write-off of $1.8 for the remaining portion of unamortized debt issuance costs.

Provision for Income Taxes

Year ended January 31,	2014	Change	2013	Change	2012
Income tax expense (benefit)	$9.5	252%	$2.7	345%	$(1.1)

In fiscal 2014, our income before taxes of $163.1 consisted of $163.8 of pre-tax income in foreign jurisdictions and a pre-tax loss of $0.7 in the U.S., reflecting substantial earnings by certain foreign operations, including our Irish subsidiaries, and a higher proportion of our operating expenses and financing costs occurring in the U.S.

Generally, the provision for income taxes is the result of the mix of profits and losses earned in various tax jurisdictions with a broad range of income tax rates, withholding taxes (primarily in certain foreign jurisdictions), changes in tax reserves, and the application of valuation allowances on deferred tax assets.

Our effective tax rate was 6% for fiscal 2014. Our tax expense differs from tax expense computed at the U.S. federal statutory rate primarily due to:

- The benefit of lower tax rates on earnings of foreign subsidiaries;
- Utilization of net operating loss carryforwards for which no benefit was previously recognized;
- Reduction in reserves for uncertain tax positions; and
- The application of tax incentives for research and development.

These differences are partially offset by:

- Repatriation of foreign subsidiary earnings to the U.S.;
- Non-deductible equity compensation expense; and
- Withholding taxes.

We repatriated foreign subsidiary earnings to the U.S. in fiscal 2014, but the U.S. tax impacts were offset by net operating loss carryforwards for which no tax benefits had been previously recognized, and therefore the repatriation had no net impact on our tax provision or effective tax rate.

We determine deferred tax assets and liabilities based on differences between the financial reporting and tax basis of assets and liabilities. In addition, we record deferred tax assets for net operating loss carryforwards and tax credit carryovers. We calculate the deferred tax assets and liabilities using the enacted laws and tax rates that will be in effect when we expect the differences to reverse. A valuation allowance is recorded when it is more likely than not that all or some portion of the deferred tax asset will not be realized. Since 2004, we have determined that it is uncertain whether our U.S. entity will generate sufficient taxable income and foreign source income to utilize net operating loss carryforwards, research and experimentation credit carryforwards, and foreign tax credit carryforwards before expiration. Accordingly, we recorded a valuation allowance against those deferred tax assets for which realization does not meet the more likely than not standard. We have established valuation allowances related to certain foreign deferred tax assets based on historical losses as well as future expectations in certain jurisdictions. We continue to evaluate the realizability of our U.S. and foreign deferred tax assets on a periodic basis.

From January 31, 2013 to January 31, 2014, net deferred tax assets decreased from $14.0 to $5.5. Gross deferred tax assets decreased by $10.6 from January 31, 2013 to January 31, 2014, principally due to the utilization of net operating losses in the U.S. There was a $25.6 increase in deferred tax liabilities from January 31, 2013 to January 31, 2014 and a valuation allowance decrease of $27.7 from January 31, 2013 to January 31, 2014. The changes in both the deferred tax liabilities and the valuation allowance principally related to an increase in the amount, and tax thereon, of foreign subsidiary earnings treated as not permanently reinvested.

The liability for income taxes associated with net uncertain tax positions was $18.8 as of January 31, 2014 and $28.2 as of January 31, 2013. As of January 31, 2014, within the liability, $0.4 was classified as short-term liabilities in income tax payable in our consolidated balance sheet as we generally anticipate the settlement of these liabilities will require payment of cash within the next twelve months. The remaining $18.4 of income tax associated with uncertain tax positions was classified as a long-term income tax liability. We expect uncertain tax positions of $18.7, if recognized, would favorably affect our effective tax rate.

Adjustment to Earnings Release

On February 27, 2014, we issued a press release with our balance sheet as of January 31, 2014. In the course of our internal review process for this Annual Report on Form 10-K, we subsequently reclassified and netted deferred taxes of $1.9 affecting current assets and long-term liabilities, which was not reflected in the February 27th earnings release. These changes had no impact on reported net income or earnings per share for the year ended January 31, 2014.

LIQUIDITY AND CAPITAL RESOURCES

Our primary ongoing cash requirements are 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 our revolving credit facility.

We currently have sufficient funds for domestic operations and do not anticipate the need to repatriate funds associated with our permanently reinvested foreign earnings for use in U.S. operations. As of January 31, 2014, we have cash totaling $205.6 held by our foreign subsidiaries. A significant portion of our offshore cash is accessible without a significant tax cost as some of our foreign earnings were previously taxed in the U.S. and other foreign earnings may be sheltered from U.S. tax by net operating loss and tax credit carryforwards. To the extent our foreign earnings are not permanently reinvested, we have provided for the tax consequences that would ensue upon their repatriation. In the event funds which are treated as permanently reinvested are repatriated, we may be required to accrue and pay additional U.S. taxes to repatriate these funds.

To date, we have experienced no loss or lack of access to our invested cash; however, we can provide no assurances that access to our cash and cash equivalents will not be impacted by adverse conditions in the financial markets.

At any point in time, we have significant balances in operating accounts that are with individual third-party financial institutions, which may exceed the Federal Deposit Insurance Corporation insurance limits or other regulatory insurance program limits. While we monitor daily the cash balances in our operating accounts and adjust the cash balances as appropriate, these cash balances could be impacted if the underlying financial institutions fail or are subject to other adverse conditions in the financial markets.

We anticipate that the following will be sufficient to meet our working capital needs on a short-term (twelve months or less) and a long-term (more than twelve months) basis:

- Current cash balances;
- Anticipated cash flows from operating activities, including the effects of selling and financing customer term receivables;
- Amounts available under existing revolving credit facilities; and
- Other available financing sources, such as the issuance of debt or equity securities.

We have experienced no difficulties to date in raising debt. However, capital markets have been volatile, and we cannot assure you that we will be able to raise debt or equity capital on acceptable terms, if at all.

Cash Flow Information

Year ended January 31,	2014	2013
Cash provided by operating activities	$149.7	$139.3
Cash used in investing activities	$ (56.4)	$ (60.8)
Cash (used in) provided by financing activities	$ (21.0)	$ 1.9

Operating Activities

Cash flows from operating activities consist of our net income adjusted for certain non-cash items and changes in operating assets and liabilities. Our cash flows from operating activities are significantly influenced by the payment terms on our license agreements and by our sales of qualifying accounts receivable. Our customers' inability to fulfill payment obligations could adversely affect our cash flow. Though we have not, to date, experienced a material level of defaults, material payment defaults by our customers as a result of negative economic conditions or otherwise could have a material adverse effect on our financial condition. We monitor our accounts receivable portfolio for customers with low or declining credit ratings and increase our collection efforts when necessary.

Trade Accounts and Term Receivables

As of January 31,	2014	2013
Trade accounts receivable	$454.5	$412.2
Term receivables, short-term (included in trade accounts receivable on the balance sheet)	$274.7	$233.9
Term receivables, long-term	$270.4	$250.5
Average days sales outstanding in trade accounts receivable, including the short-term portion of term receivables	102	112
Average days sales outstanding in trade accounts receivable, excluding the short-term portion of term receivables	40	48

The decrease in the average days sales outstanding in short-term receivables as of January 31, 2014 was due to an increase in revenue in the fourth quarter of fiscal 2014 compared to fiscal 2013 partially offset by an increase in accounts receivable as of January 31, 2014 compared to January 31, 2013.

Term receivables are 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. Total term receivables were $545.0 as of January 31, 2014 compared to $484.4 as of January 31, 2013. The increase in term receivables as of January 31, 2014 compared to January 31, 2013 was due to an increase in revenue for fiscal 2014 compared to fiscal 2013.

We enter into agreements to sell qualifying accounts receivable from time to time to certain financing institutions on a non-recourse basis. We received net proceeds from the sale of receivables of $22.9 for fiscal 2014 compared to $20.2 for fiscal 2013. We continue to have no difficulty in factoring receivables and continue to evaluate the economics of the sale of accounts receivable. We have not set a target for the sale of accounts receivables for fiscal 2015.

Investing Activities

Cash used in investing activities for fiscal 2014 primarily consisted of cash paid for capital expenditures and acquisitions of business and equity interests.

Expenditures for property, plant, and equipment decreased to $30.8 for fiscal 2014 compared to $45.1 for fiscal 2013. The expenditures for property, plant, and equipment for fiscal 2014 were primarily a result of spending on information technology and infrastructure improvements within our facilities.

During fiscal 2014, we acquired certain assets of four privately-held companies, each constituting a business, for a total purchase price of $19.3. We plan to finance future business acquisitions through cash and possible common stock issuances. The cash expected to be utilized includes cash on hand, cash generated from operating activities, and borrowings on our revolving credit facility.

During the year ended January 31, 2014, we invested excess cash of $7.8 into certificates of deposit with an annual interest rate of 8.75%. We sold $3.1 of these investments during the year ended January 31, 2014.

Financing Activities

For fiscal 2014, cash used in financing activities consisted primarily repurchases of our common stock and dividends paid, offset in part by proceeds from the issuance of common stock.

In April 2011, we announced a share repurchase program under which we may purchase up to $150.0 of our common stock over a three year period through April 2014. In February 2012, our Board of Directors approved an increase in the amount we may repurchase under this program from $150.0 to $200.0 and on August 21, 2013, our Board of Directors approved an additional increase in the amount we may repurchase under this program of $63.9. During the year ended January 31, 2014, we repurchased 2.6 shares of common stock for $50.0, compared to 2.2 shares for $33.9 during the year ended January 31, 2013. As of January 31, 2014, $90.0 remained available for repurchase under this program.

On March 7, 2013, our Board of Directors announced the adoption of a dividend policy under which we commenced payment of cash dividends at an annual rate of $0.18 per share of common stock.

Accordingly, during the year ended January 31, 2014, we paid quarterly dividends of $0.045 per share of outstanding common stock for a total of $20.4. On February 27, 2014, we announced an increase in the quarterly dividend to $0.05 per share. Future declarations of quarterly dividends and the establishment of future record and payment dates are subject to the quarterly determination of our Board of Directors.

The terms of our revolving credit facility limit the amount of our common stock we can repurchase and the amount of dividends we can pay to $50.0 plus 70% of our cumulative net income for periods after January 31, 2011. An additional $145.2 is available for common stock repurchases or dividend payments under this limit as of January 31, 2014.

Other factors affecting liquidity and capital resources

4.00% Debentures due 2031

In April 2011, we issued $253.0 of the 4.00% Convertible Subordinated Debentures due 2031 (4.00% Debentures). Interest on the 4.00% Debentures is payable semi-annually in April and October.

The 4.00% Debentures are convertible, under certain circumstances, into our common stock at a conversion rate, as of January 31, 2014, of 49.133 shares of our common stock for each one thousand dollars in principal amount of the 4.00% Debentures (equivalent to a conversion price of $20.35 per share) for a total of 12.4 shares. These circumstances include:

- The market price of our common stock exceeding 120% of the conversion price, or $24.42 per share as of January 31, 2014, for at least 20 of the last 30 trading days in the previous fiscal quarter;
- A call for redemption of the 4.00% Debentures;
- Specified distributions to holders of our common stock;
- If a fundamental change, such as a change of control, occurs;
- During the two months prior to, but not on, the maturity date; or
- The market price of the 4.00% Debentures declining to less than 98% of the value of the common stock into which the 4.00% Debentures are convertible.

Upon conversion of any 4.00% Debentures, a holder will receive:

(i) Cash for the lesser of the principal amount of the 4.00% Debentures that are converted or the value of the converted shares; and
(ii) Cash or shares of common stock, at our election, for the excess, if any, of the value of the converted shares over the principal amount.

As of January 31, 2014, the if-converted value of the 4.00% Debentures exceeded the principal amount by $5.6.

If a holder elects to convert their 4.00% Debentures in connection with a fundamental change in the company that occurs prior to April 5, 2016, the holder in some circumstances will also be entitled to receive a make whole premium upon conversion.

As the result of us declaring dividends during the year ended January 31, 2014, the initial conversion rate for the 4.00% Debentures of 48.6902 shares of our common stock for each one thousand dollars in principal amount of the 4.00% Debentures (equivalent to a conversion price of $20.54 per share of our common stock) has been adjusted to 49.133 shares of our common stock for each one thousand dollars in principal amount of the 4.00% Debentures (equivalent to a conversion price of $20.35 per share of our common stock).

We may redeem some or all of the 4.00% Debentures for cash on or after April 5, 2016 at the following redemption prices expressed as a percentage of principal, plus any accrued and unpaid interest:

Period	Redemption Price
Beginning on April 5, 2016 and ending on March 31, 2017	101.143%
Beginning on April 1, 2017 and ending on March 31, 2018	100.571%
On April 1, 2018 and thereafter	100.000%

The holders, at their option, may redeem the 4.00% Debentures in whole or in part for cash on April 1, 2018, April 1, 2021, and April 1, 2026, and in the event of a fundamental change in the company. In each case, the repurchase price will be 100% of the principal amount of the 4.00% Debentures plus any accrued and unpaid interest.

For further information on the 4.00% Debentures, see Note 6. “Notes Payable” in Part II, Item 8. “Financial Statements and Supplementary Data.”

Revolving Credit Facility

On May 24, 2013, we amended our syndicated, senior, unsecured, four-year revolving credit facility extending the termination date to May 24, 2017.

The revolving credit facility has a maximum borrowing capacity of $125.0. We have the option to pay interest on this revolving credit facility based on:

(i) London Interbank Offered Rate (LIBOR) with varying maturities which are commensurate with the borrowing period we select, plus a spread of between 2.00% and 2.50% based on a pricing grid tied to a financial covenant; or
(ii) A base rate plus a spread of between 1.00% and 1.50%, based on a pricing grid tied to a financial covenant.

The base rate is defined as the highest of:

(i) The federal funds rate, as defined, plus 0.5%;
(ii) The prime rate of the lead bank; or
(iii) One-month LIBOR plus 1.0%.

As a result of these interest rate options, 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 0.30% and 0.40% based on a pricing grid tied to a financial covenant.

This revolving credit facility contains certain financial and other covenants, including a limit on the aggregate amount we can pay for dividends and repurchases of our stock over the term of the facility.

We were in compliance with all financial covenants as of January 31, 2014. If we fail to comply with the financial covenants and do not obtain a waiver from our lenders, we would be in default under the revolving credit facility and our lenders could terminate the facility and demand immediate repayment of all outstanding loans under the revolving credit facility.

We had no borrowings against the revolving credit facility during fiscal 2014.

For further information on the revolving credit facility, see Note 5. "Short-Term Borrowings" in Part II, Item 8. "Financial Statements and Supplementary Data."

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.

CONTRACTUAL OBLIGATIONS

We are contractually obligated to make the following payments as of January 31, 2014:

	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Notes payable	$253.0	$ –	$ –	$ –	$253.0
Interest on debt	173.6	10.1	20.2	20.2	123.1
Other liabilities (1)	19.6	5.5	7.0	0.4	6.7
Other borrowings	9.6	9.6	–	–	–
Operating leases	70.2	23.1	30.3	9.9	6.9
Total contractual obligations	$526.0	$48.3	$57.5	$30.5	$389.7

(1) Our balance sheet as of January 31, 2014 includes additional long-term taxes payable of $22.7 related to tax positions for which the timing of the ultimate resolution is uncertain. At this time, we are unable to make a reasonably reliable estimate of the period of cash settlement with the respective the tax authorities and the total amount of taxes payable. The timing of such tax payments may depend on the resolution of current and future tax examinations which cannot be estimated. As a result, this amount is not included in the above table.

OUTLOOK FOR FISCAL 2015

We expect revenues for the first quarter of fiscal 2015 to be approximately $245.0, with earnings per share for the same period of approximately break-even. For the full year fiscal 2015, we expect revenues to be approximately $1.237 billion, with earnings per share of approximately $1.50.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Unless otherwise indicated, all numerical references are in millions, except interest rates and contract rates.

INTEREST RATE RISK

We are exposed to interest rate risk primarily through our investment portfolio, short-term borrowings, and notes payable.

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 January 31, 2014. In accordance with our investment policy, all short-term investments mature in twelve months or less.

Principal (notional) amounts in U.S. dollars	Carrying Amount	Average Fixed Interest Rate
Cash equivalents – fixed rate	$1.3	3.00%
Short-term investments - fixed rate	$4.0	8.75%
Total fixed rate interest bearing instruments	$5.3	7.36%

We have convertible subordinated debentures with a principal balance of $253.0 outstanding with a fixed interest rate of 4.00% as of January 31, 2014 and January 31, 2013. Interest rate changes for fixed rate debt affect the fair value of the debentures but do not affect future earnings or cash flow.

We have a syndicated, senior, unsecured, revolving credit facility, which expires on May 24, 2017. Borrowings under the revolving credit facility are permitted to a maximum of $125.0. As a result of the interest rate options, our interest expense associated with borrowings under this revolving credit facility will vary with market interest rates. This revolving credit facility contains certain financial and other covenants, including restrictions on the payment of dividends and the repurchase of our common stock. As of January 31, 2014 and 2013, we had no balance outstanding against this revolving credit facility. Interest rate changes for variable interest rate debt generally do not affect the fair market value, but do affect future earnings and cash flow. For further information on our revolving credit facility, including interest rate options, see Note 5. "Short-Term Borrowings" in Part II, Item 8. "Financial Statements and Supplementary Data."

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 exchange contracts, with a duration period of a year or less. We enter into contracts with counterparties who are major financial institutions and, as such we do not expect material losses as a result of defaults by our counterparties. We do not hold or issue derivative financial instruments for speculative or trading purposes.

We enter into foreign currency forward contracts to protect against currency exchange risk associated with expected future cash flows. Our practice is to hedge a majority of our existing material foreign currency transaction exposures, which generally represent the excess of expected euro and British pound denominated expenses over expected euro and British pound denominated revenues, and the excess of Japanese yen denominated revenues over expected Japanese yen denominated expenses. We also enter into foreign currency forward contracts to protect against currency exchange risk associated with existing assets and liabilities.

The following table provides volume information about our foreign currency forward program. The information provided is in U.S. dollar equivalent amounts. The table presents the gross notional amounts, at contract exchange rates, and the weighted average contractual foreign currency exchange rates. These forward contracts mature within the next twelve months.

As of January 31,	2014		2013	
	Gross Notional Amount	Weighted Average Contract Rate	Gross Notional Amount	Weighted Average Contract Rate
Forward Contracts:				
Japanese yen	$ 54.7	103.91	$ 40.6	90.11
Euro	29.6	0.74	27.0	0.74
British pound	22.1	0.61	13.9	0.63
Swedish krona	12.7	6.47	13.1	6.52
Indian rupee	12.0	62.03	3.8	54.32
Canadian dollar	6.0	1.10	9.5	0.99
Other (1)	32.3	–	24.9	–
Total forward contracts	$169.4		$132.8	

(1) Other includes currencies which are the Chinese yuan, Armenian dram, Taiwan dollar, Israeli shekel, Russian rubles, Norwegian kroner, Swiss franc, Danish kroner, Polish zloty, Hungarian forints, Korean won, and Singapore dollar.

Item 8. Financial Statements and Supplementary Data

Mentor Graphics Corporation
Consolidated Statements of Income

Year ended January 31,	2014	2013	2012
In thousands, except per share data			
Revenues:			
System and software	$ 737,790	$ 681,881	$ 631,549
Service and support	418,583	406,846	383,089
Total revenues	1,156,373	1,088,727	1,014,638
Cost of revenues:			
System and software	65,288	64,280	54,972
Service and support	118,221	117,609	108,690
Amortization of purchased technology	3,598	7,801	9,796
Total cost of revenues	187,107	189,690	173,458
Gross profit	969,266	899,037	841,180
Operating expenses:			
Research and development	348,817	313,962	310,758
Marketing and selling	342,799	338,653	326,608
General and administration	75,543	70,692	74,811
Equity in earnings of Frontline	(4,092)	(1,764)	(2,268)
Amortization of intangible assets	6,230	5,915	5,905
Special charges	16,929	9,946	13,174
Total operating expenses	786,226	737,404	728,988
Operating income	183,040	161,633	112,192
Other (expense) income, net	(520)	(1,432)	1,576
Interest expense	(19,452)	(18,866)	(31,444)
Income before income tax	163,068	141,335	82,324
Income tax expense (benefit)	9,510	2,701	(1,063)
Net income	$ 153,558	$ 138,634	$ 83,387
Less: Loss attributable to noncontrolling interest	(1,700)	(102)	(485)
Net income attributable to Mentor Graphics shareholders	$ 155,258	$ 138,736	$ 83,872
Net income per share:			
Basic	$ 1.33	$ 1.20	$ 0.76
Diluted	$ 1.29	$ 1.17	$ 0.74
Weighted average number of shares outstanding:			
Basic	113,671	110,998	110,138
Diluted	116,702	114,017	112,915
Cash dividends declared per common share	$ 0.18	$ –	$ –

See accompanying notes to consolidated financial statements.

Mentor Graphics Corporation
Consolidated Statements of Comprehensive Income

Year ended January 31,	2014	2013	2012
In thousands			
Net income	$ 153,558	$ 138,634	$ 83,387
Other comprehensive loss, net of tax:			
Cash flow hedges:			
Change in unrealized gain (loss) on derivative instruments	1,653	829	(402)
Less: reclassification adjustment for net gain (loss) included in net income	1,599	636	(199)
Net change, net of tax expense (benefit) of $ - , $1, $(73)	54	193	(203)
Change in accumulated translation adjustment	(6,790)	(3,110)	(3,149)
Change in pension liability, net of tax expense (benefit) of $72, $(284), $110	135	(420)	212
Other comprehensive loss	(6,601)	(3,337)	(3,140)
Comprehensive income	146,957	135,297	80,247
Less amounts attributable to the noncontrolling interest:			
Net loss	(1,700)	(102)	(485)
Change in accumulated translation adjustment	(5)	(56)	(127)
Comprehensive loss attributable to the noncontrolling interest	(1,705)	(158)	(612)
Comprehensive income attributable to Mentor Graphics shareholders	$ 148,662	$ 135,455	$ 80,859

See accompanying notes to consolidated financial statements.

Mentor Graphics Corporation
Consolidated Balance Sheets

As of January 31,	2014	2013
In thousands		
Assets		
Current assets:		
Cash and cash equivalents	$ 293,322	$ 223,783
Short-term investments	3,990	–
Trade accounts receivable, net of allowance for doubtful accounts of $5,469 as of January 31, 2014 and $5,331 as of January 31, 2013	454,483	412,245
Other receivables	15,506	10,974
Inventory	25,121	18,036
Prepaid expenses and other	24,031	24,941
Deferred income taxes	13,656	14,973
Total current assets	830,109	704,952
Property, plant, and equipment, net	160,165	162,402
Term receivables	270,365	250,497
Goodwill	549,044	535,932
Intangible assets, net	22,799	21,838
Other assets	71,627	69,663
Total assets	$ 1,904,109	$ 1,745,284
Liabilities and Stockholders' Equity		
Current liabilities:		
Short-term borrowings	$ 9,590	$ 5,964
Accounts payable	21,548	20,906
Income taxes payable	3,365	9,180
Accrued payroll and related liabilities	102,848	101,354
Accrued and other liabilities	42,457	40,662
Deferred revenue	231,179	233,759
Total current liabilities	410,987	411,825
Notes payable	224,261	218,546
Deferred revenue	17,398	17,755
Income tax liability	18,431	22,663
Other long-term liabilities	32,259	28,318
Total liabilities	703,336	699,107
Commitments and contingencies (Note 8)		
Noncontrolling interest with redemption feature	15,479	12,698
Stockholders' equity:		
Common stock, no par value, 300,000 shares authorized as of January 31, 2014 and January 31, 2013; 115,722 shares issued and outstanding as of January 31, 2014 and 112,902 shares issued and outstanding as of January 31, 2013	838,939	810,902
Retained earnings	327,552	197,178
Accumulated other comprehensive income	18,803	25,399
Total stockholders' equity	1,185,294	1,033,479
Total liabilities and stockholders' equity	$ 1,904,109	$ 1,745,284

See accompanying notes to consolidated financial statements.

Item 8.

Mentor Graphics Corporation
Consolidated Statements of Cash Flows

Year ended January 31,	2014	2013	2012
In thousands			
Operating Cash Flows:			
Net income	$ 153,558	$ 138,634	$ 83,387
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of property, plant, and equipment	34,563	33,305	31,948
Amortization of intangible assets, debt costs and other	17,891	20,246	22,239
Loss on debt extinguishment	–	–	3,518
Write-off of debt discount and debt issuance costs	–	–	8,010
Stock-based compensation	29,350	23,697	21,658
Deferred income taxes	8,550	(1,634)	2,754
Changes in other long-term liabilities	(3,708)	(6,143)	2,889
Gain on conversion of equity method investment to controlling interest	–	–	(1,519)
Dividends received from unconsolidated entities, net of equity in income	1,290	4,358	4,874
Other	(11)	74	(7)
Changes in operating assets and liabilities, net of effect of acquired businesses:			
Trade accounts receivable, net	(43,811)	(58,389)	(8,915)
Prepaid expenses and other	(17,774)	(21,861)	(16,295)
Term receivables, long-term	(21,285)	(30,980)	(54,637)
Accounts payable and accrued liabilities	4,473	(2,720)	(3,122)
Income taxes receivable and payable	(10,487)	(5,084)	(11,725)
Deferred revenue	(2,896)	45,784	18,881
Net cash provided by operating activities	149,703	139,287	103,938
Investing Cash Flows:			
Proceeds from the sales and maturities of short-term investments	3,112	–	–
Purchases of short-term investments	(7,820)	–	–
Increase in restricted cash	–	–	(3,977)
Purchases of property, plant, and equipment	(30,761)	(45,130)	(41,555)
Acquisitions of businesses and equity interests and other intangible assets, net of cash acquired	(20,906)	(15,652)	(15,260)
Net cash used in investing activities	(56,375)	(60,782)	(60,792)
Financing Cash Flows:			
Proceeds from issuance of common stock	53,013	46,756	37,460
Repurchase of common stock	(49,995)	(33,914)	(89,996)
Tax benefit from share options exercised	386	266	–
Dividends paid	(20,398)	–	–
Net increase (decrease) in short-term borrowing	3,748	(8,149)	(1,284)
Debt and equity issuance costs	–	–	(9,020)
Proceeds from notes payable	–	–	253,000
Repayments of notes payable	–	–	(219,919)
Repayments of other borrowings	(7,762)	(3,016)	–
Net cash (used in) provided by financing activities	(21,008)	1,943	(29,759)
Effect of exchange rate changes on cash and cash equivalents	(2,781)	(3,164)	(1)
Net change in cash and cash equivalents	69,539	77,284	13,386
Cash and cash equivalents at the beginning of the period	223,783	146,499	133,113
Cash and cash equivalents at the end of the period	$ 293,322	$ 223,783	$ 146,499

See accompanying notes to consolidated financial statements.

Mentor Graphics Corporation
Consolidated Statements of Stockholders' Equity

In thousands	Common Stock Shares	Common Stock Amount	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income	Total Stockholders' Equity	Noncontrolling Interest with Redemption Feature
Balance as of January 31, 2011	111,249	$765,179	$ (20,158)	$31,693	$ 776,714	$ –
Net income			83,872		83,872	(485)
Other comprehensive loss				(3,013)	(3,013)	(127)
Convertible debt feature		42,531			42,531	
Acquisition of controlling interest		(815)			(815)	8,196
Adjustment of noncontrolling interest to redemption value			(1,682)		(1,682)	1,682
Stock issued under stock awards and stock purchase plans	4,945	37,460			37,460	
Stock repurchased	(6,805)	(89,996)			(89,996)	
Stock compensation expense		21,516			21,516	
Stock withheld for taxes	(43)	(513)			(513)	
Balance as of January 31, 2012	109,346	$775,362	$ 62,032	$28,680	$ 866,074	$ 9,266
Net income			138,736		138,736	(102)
Other comprehensive loss				(3,281)	(3,281)	(56)
Adjustment of noncontrolling interest to redemption value			(3,590)		(3,590)	3,590
Stock issued under stock awards and stock purchase plans	5,875	46,756			46,756	
Stock repurchased	(2,245)	(33,914)			(33,914)	
Stock compensation expense		23,697			23,697	
Stock withheld for taxes	(74)	(1,265)			(1,265)	
Tax benefit associated with the exercise of stock options		266			266	
Balance as of January 31, 2013	112,902	$810,902	$197,178	$25,399	$1,033,479	$12,698
Net income			155,258		155,258	(1,700)
Other comprehensive loss				(6,596)	(6,596)	(5)
Adjustment of noncontrolling interest to redemption value			(4,486)		(4,486)	4,486
Dividends			(20,398)		(20,398)	
Stock issued under stock awards and stock purchase plans	5,618	53,013			53,013	
Stock repurchased	(2,593)	(49,995)			(49,995)	
Stock compensation expense		29,350			29,350	
Stock withheld for taxes	(205)	(4,717)			(4,717)	
Tax benefit associated with the exercise of stock options		386			386	
Balance as of January 31, 2014	115,722	$838,939	$327,552	$18,803	$1,185,294	$15,479

See accompanying notes to consolidated financial statements.

Mentor Graphics Corporation
Notes to Consolidated Financial Statements

All numerical dollar and share references are in thousands, except for per share data.

1. Nature of Operations

We are a supplier of electronic design automation systems —advanced computer software and emulation hardware systems used to automate the design, analysis, and testing of complex electro-mechanical systems, electronic hardware, and embedded systems software in electronic systems and components. We market our products and services worldwide, primarily to large companies in the communications, computer, consumer electronics, semiconductor, networking, multimedia, military and aerospace, and transportation industries. We sell and license our products through our direct sales force and a channel of distributors and sales representatives. We were incorporated in Oregon in 1981 and our common stock is traded on The NASDAQ Global Select Market under the symbol "MENT." In addition to our corporate offices in Wilsonville, Oregon, we have sales, support, software development, and professional service offices worldwide.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include our financial statements and those of our wholly-owned and majority-owned subsidiaries. All intercompany accounts and transactions have been 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 8. "Commitments and Contingencies."

Foreign Currency Translation

Local currencies are the functional currencies for our foreign subsidiaries except for certain subsidiaries in Ireland, Singapore, Egypt, and the Netherlands Antilles where the United States (U.S.) dollar is used as the functional currency. We translate assets and liabilities of foreign operations, excluding certain subsidiaries in Ireland, Singapore, Egypt, and the Netherlands Antilles to U.S. dollars at current rates of exchange and revenues and expenses using weighted average rates. We include foreign currency translation adjustments in stockholders' equity as a component of accumulated other comprehensive income. We maintain the accounting records for certain subsidiaries in Ireland, Singapore, Egypt, and the Netherlands Antilles in the U.S. dollar and accordingly no translation is necessary. We include foreign currency transaction gains and losses as a component of other income (expense), net.

Use of Estimates

U.S. generally accepted accounting principles require management to make estimates and assumptions that affect the reported amount of assets, liabilities, and contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Such estimates include valuation of accounts receivable, revenue recognition, business combinations, income taxes, goodwill, intangible assets, long-lived assets, special charges, and stock-based compensation. These estimates and assumptions are based on our best judgment. We evaluate our estimates and assumptions on an ongoing basis using historical experience and other factors, including the current economic environment, which we believe to be reasonable under the circumstances. We adjust estimates and assumptions as facts and circumstances dictate. Actual results could differ from these estimates. Any changes in estimates will be reflected in the financial statements in future periods.

Investments

We classify investments with original maturities of 90 days or less as cash equivalents. Short-term investments include certificates of deposit with original maturities in excess of 90 days and less than one year at the time of purchase.

Long-term investments, included in other assets on the accompanying consolidated balance sheets, include investments with maturities in excess of one year from the balance sheet date and equity securities. We determine the appropriate classification of our investments at the time of purchase. For investments in equity securities, we use the equity method of accounting when our investment gives us the ability to exercise significant influence over the operating and financial policies of the investee. Under the equity method, we currently record our share of earnings or losses as a component of other income (expense), net, equal to our proportionate share of the earnings or losses of the investee. For investments in equity securities of private companies without a readily determinable fair value, and as to which we do not exercise significant influence over the investee, we record our investment under the cost method of accounting. Under the cost method of accounting, we carry the investment at historical cost. We periodically evaluate the fair value of all investments to determine if an other-than-temporary decline in value has occurred.

Investment in Frontline

We have a 50% interest in a joint venture, Frontline P.C.B. Solutions Limited Partnership (Frontline), a provider of engineering software solutions for the printed circuit board industry. We use the equity method of accounting for Frontline, which results in reporting our investment as one line within other assets in the consolidated balance sheet and our share of earnings on one line in the consolidated statement of income. Frontline reports on a calendar year basis. As such, we record our interest in the earnings of Frontline on a one-month lag.

Although we do not exert control, we actively participate in regular and periodic activities with respect to Frontline such as budgeting, business planning, marketing, and direction of research and development projects. Accordingly, we have included our interest in the earnings of Frontline as a component of operating income.

Property, Plant, and Equipment, Net

We state property, plant, and equipment at cost and capitalize expenditures for additions to property, plant, and equipment. We expense maintenance and repairs which do not improve or extend the life of the respective asset as incurred. We compute depreciation on a straight-line basis as follows:

	Estimated Useful Lives (in years)
Buildings	40
Land improvements	20
Computer equipment and furniture	3 - 5
Leasehold improvements(1)	3 - 10

(1) Amortized over the shorter of the lease term or estimated life.

A summary of property, plant, and equipment, net is as follows:

As of January 31,	2014	2013
Computer equipment and furniture	$ 319,698	$ 308,229
Buildings and building equipment	101,073	97,989
Land and improvements	21,321	21,345
Leasehold improvements	38,900	35,753
Property, plant, and equipment, gross	480,992	463,316
Less: accumulated depreciation and amortization	(320,827)	(300,914)
Property, plant, and equipment, net	$ 160,165	$ 162,402

Goodwill and Intangible Assets

Goodwill represents the excess of the aggregate purchase price over the fair value of the net tangible assets and other intangible assets acquired in our business combinations. Intangible assets, net primarily includes purchased technology, in-process research and development, backlog, tradename, and customer relationships acquired in our business combinations. We review long-lived assets, including intangible assets with definite lives, for impairment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. We assess the recoverability of our long-lived assets by determining whether the carrying values of the asset groups are greater than the forecasted undiscounted net cash flows of the related asset group. If we determine the assets are impaired, we write down the assets to their estimated fair value. We determine fair value based on forecasted discounted net cash flows or appraised values, depending upon the nature of the assets. In the event we determine our long-lived assets have been impaired, we would make an adjustment that would result in a charge for the write-down in the period that the determination was made.

Goodwill is not amortized, but is tested for impairment at least annually and as necessary if changes in facts and circumstances indicate that the fair value of our reporting unit may be less than the carrying amount. We operate as a single reporting unit for purposes of goodwill evaluation. We completed our annual goodwill impairment test as of January 31, 2014, 2013, and 2012. For purposes of assessing the impairment of goodwill, we estimated the fair value of our reporting unit using its market capitalization as the best evidence of fair value and then compared the fair value to the carrying value of our reporting unit. Our reporting unit passed this step of the goodwill analysis. There were no indicators of impairment to goodwill during fiscal 2014, 2013, and 2012 and accordingly, no impairment charges were recognized during these fiscal periods.

We amortize purchased technology over three to five years to system and software cost of revenues and other intangible asset costs over one to five years to operating expenses. We amortize capitalized in-process research and development (resulting from acquisitions), upon completion of projects to cost of revenues over the estimated useful life of the technology. Alternatively, if we abandon a project, in-process research and development costs are expensed to operating expense when that determination is made.

Total purchased technology and other intangible asset amortization expenses were as follows:

Year ended January 31,	2014	2013	2012
Purchased technology and other intangible asset amortization expenses	$9,828	$13,716	$15,701

As of January 31, 2014, the carrying value of goodwill and intangible assets was as follows:

As of January 31,	2014	2013
Goodwill	$549,044	$535,932
Net purchased technology and in-process research and development(1)	$ 11,210	$ 8,019
Net other intangible assets(2)	$ 11,589	$ 13,819

(1) Includes accumulated amortization of $124,536 as of January 31, 2014 and $121,011 as of January 31, 2013.
(2) Includes accumulated amortization of $71,216 as of January 31, 2014 and $65,049 as of January 31, 2013.

The following table summarizes goodwill activity:

Balance as of January 31, 2012	$ 527,102
Acquisitions	8,437
Earnouts	370
Foreign exchange	23
Balance as of January 31, 2013	$ 535,932
Acquisitions	12,545
Earnouts	288
Foreign exchange	279
Balance as of January 31, 2014	$ 549,044

We estimate the aggregate amortization expense related to purchased technology and other intangible assets will be as follows:

Fiscal years ending January 31,	
2015	$ 9,402
2016	6,516
2017	3,401
2018	2,361
2019	1,071
Thereafter	48
Aggregate amortization expense	$22,799

Noncontrolling Interest with Redemption Feature

As of January 31, 2014, our balance sheet includes a noncontrolling interest resulting from a business combination in which we acquired majority ownership in a privately-held company. In conjunction with this business combination, we also entered into an agreement which provides us a call option to acquire the noncontrolling interest and the noncontrolling interest holders a put option to sell their interests to us for prices based on formulas defined in the agreement. The noncontrolling interest adjusted for this redemption feature based on the put option price formula, is presented on the consolidated balance sheet under the caption "Noncontrolling interest with redemption feature." Because the redemption of the noncontrolling interest is outside of our control, we have presented this interest outside of stockholders' equity.

The noncontrolling interest with redemption feature is recognized at the greater of:

i. The calculated redemption put value as of the balance sheet date; or
ii. The initial noncontrolling interest value adjusted for the noncontrolling interest holders' share of:
   a. cumulative impact of net income (loss); and
   b. other changes in accumulated other comprehensive income.

Increases (or decreases to the extent they offset previous increases) in the calculated redemption feature put value are recorded directly to retained earnings as if the balance sheet date were also the redemption date. Changes in the redemption feature put value, to the extent they are significant, also result in an adjustment to net income attributable to shareholders in the calculation of basic and diluted net income per share.

The results of the majority-owned subsidiary are presented in our consolidated results with an adjustment reflected on the face of our statement of income and the face of our statement of comprehensive income for the noncontrolling investors' interest in the results of the subsidiary.

Income Taxes

We use the asset and liability method of accounting for income taxes. Under this method, we recognize deferred income taxes for the future tax consequences attributable to temporary differences between the financial statement carrying amounts and tax balances of existing assets and liabilities. We calculate deferred tax assets and liabilities using enacted laws and tax rates that will be in effect when we expect the differences to reverse and be applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date. Deferred tax assets are recognized for deductible temporary differences, net operating loss carryforwards, and credit carryforwards if it is more likely than not that the tax benefits will be realized. Deferred tax assets are not recorded, however, in the following circumstances:

- A deferred tax asset is not recorded for net operating loss carryforwards created by excess tax benefits from the exercise of stock options. To the extent such net operating loss carryforwards are utilized, we will increase stockholders' equity. The historical and current deferred tax assets related to excess tax benefits from stock option exercises are excluded in the presentation of our financial results.
- Deferred tax assets are not recorded to the extent they are attributed to uncertain tax positions.

For deferred tax assets that cannot be recognized under the more-likely-than-not-standard, we have established a valuation allowance. In the event we determine that we are able to realize our deferred tax assets in the future in excess of our net recorded amount, we would reverse the valuation allowance associated with such deferred tax assets in the period such determination was made. Also, if we determine that we are not able to realize all or part of our net deferred tax assets in the future, we would record a valuation allowance on such net deferred tax assets with a corresponding increase in expense in the period such determination was made.

We are subject to income taxes in the U.S. and in numerous foreign jurisdictions, and in the ordinary course of business, there are many transactions and calculations where the ultimate tax determination is uncertain. While we believe the positions we have taken are appropriate, we have reserves for taxes to address potential exposures involving tax positions that are being challenged or that could be challenged by the tax authorities. We record a benefit on a tax position when we determine that it is more likely than not that the position is sustainable upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. For tax positions that are more likely than not to be sustained, we measure the tax position at the largest amount of benefit that has a greater than 50 percent likelihood of being realized when it is effectively settled. We review the tax reserves as circumstances warrant and adjust the reserves as events occur that affect our potential liability for additional taxes.

Business Combinations

For each business we acquire, the excess of the fair value of the consideration transferred over the fair value of the net tangible assets acquired and net tangible liabilities assumed was allocated to various identifiable intangible assets and goodwill. Identifiable intangible assets typically consist of purchased technology and customer-related intangibles, which are amortized to expense over their useful lives. Goodwill, representing the excess of the purchase consideration over the fair value of net tangible and identifiable intangible assets, is not amortized.

Acquisitions for the year ended January 31, 2014 consisted of 4 privately-held companies, all of which were accounted for as business combinations. These acquisitions were not material individually or in the aggregate.

Derivative Financial Instruments

We are exposed to fluctuations in foreign currency exchange rates 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 foreign currency exchange contracts. By using derivative instruments, we subject ourselves to credit risk. If a counterparty fails to fulfill its performance obligations under a derivative contract, our credit risk will equal the fair value of the derivative instrument. Generally, when the fair value of our derivative contracts is a net asset, the counterparty owes us, thus creating a receivable risk. We minimize counterparty credit risk by entering into derivative transactions with major financial institutions and, as such, we do not expect material losses as a result of default by our counterparties. We execute foreign currency transactions in exchange-traded or over-the-counter markets for which quoted prices exist. We do not hold or issue derivative financial instruments for speculative or trading purposes.

To manage the foreign currency volatility, we aggregate exposures on a consolidated basis to take advantage of natural offsets. The primary exposures 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 U.S. dollars 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 exposures remain.

To partially offset the net exposures in the euro, British pound, and the Japanese yen, we enter into foreign currency exchange contracts of less than one year which are designated as cash flow hedges. Any gain or loss on Japanese yen contracts is classified as product revenue when the hedged transaction occurs while any gain or loss on euro and British pound contracts is classified as operating expense when the hedged transaction occurs.

We use an income approach to determine the fair value of our foreign currency contracts and record them at fair value utilizing observable market inputs at the measurement date. We report the fair value of derivatives in other receivables, if the balance is an asset, or accrued liabilities, if the balance is a liability, in the consolidated balance sheet. The accounting for changes in the fair value of a derivative depends upon whether it has been designated in a hedging relationship and on the type of hedging relationship. To qualify for designation in a hedging relationship, specific criteria must be met and the appropriate documentation maintained. Hedging relationships, if designated, are established pursuant to our risk management policy and are initially and regularly evaluated to determine whether they are expected to be, and have been, highly effective hedges. We formally document all relationships between foreign currency exchange 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 exchange contracts in offsetting changes in the cash flows of the hedged items. We report the effective portions of the net gains or losses on these foreign currency exchange 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 consolidated statement of income in the same period the forecasted transaction occurs or the hedge is no longer effective. We expect substantially all of the hedge balance in accumulated other comprehensive income to be reclassified to the consolidated statement of income within the next twelve months.

We enter into foreign currency exchange 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. The change in fair value of these derivative instruments not designated as hedging instruments is reported each period in other income (expense), net, in our consolidated statement of income.

Revenue Recognition

We report revenue in two categories based on how 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.

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 of the discount on long-term installment receivables in system and software revenues. Finance fee revenues were approximately 2.0% of total revenues for fiscal 2014, 2013, and 2012.

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 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. With respect to emulation hardware systems, we transfer title to the customer upon shipment. Our software license and 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.

Significant judgment is involved in assessing whether a fee is fixed or determinable. We must also make these judgments when assessing whether a contract amendment to a term arrangement (primarily in the context of a license extension or renewal) constitutes a concession. Our experience has been that we are able to determine whether a fee is fixed or determinable for term licenses. If we no longer were to have a history of collecting under the original contract without providing concessions on term licenses, revenue from term licenses would be required to be recognized when payments under the installment contract become due and payable. Such a change could have a material impact on our results of operations.

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 involving software licenses – For multiple element arrangements involving software and other software-related deliverables, 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 exists 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 are met.

We base our VSOE for certain 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.

Multiple element arrangements involving hardware – For multiple element arrangements involving our emulation hardware systems, we allocate revenue to each element based on the relative selling price of each deliverable. In order to meet the separation criteria to allocate revenue to each element we must determine the standalone selling price of each element using a hierarchy of evidence.

The authoritative guidance requires that, in the absence of VSOE or third-party evidence (TPE), a company must develop an estimated selling price (ESP). ESP is defined as the price at which the vendor would transact if the deliverable was sold by the vendor regularly on a standalone basis. A company should consider market conditions as well as entity-specific factors when estimating a selling price.We base our ESP for certain elements in arrangements on either costs incurred to manufacture a product plus a reasonable profit margin or standalone sales to similar customers. In determining profit margins, we consider current market conditions, pricing strategies related to the class of customer, and the level of penetration we have with the customer. In other cases, we may have limited sales on a standalone basis to the same or similar customers and/or guaranteed pricing on future purchases of the same item.

Software Development Costs

We capitalize software development costs beginning when a product's technological feasibility has been established by either completion of a detail program design or completion of a working model of the product and ending when a product is available for general release to customers. The period between the achievement of technological feasibility and the general release of our products has historically been of short duration. As a result, such capitalizable software development costs were insignificant and have been charged to research and development expense in all periods in the accompanying consolidated statements of income.

We capitalized $3,698 of acquired developed technology during fiscal 2014. We did not capitalize any acquired developed technology during fiscal 2013 or 2012.

Advertising Costs

We expense all advertising costs as incurred. Advertising expense is included in marketing and selling expense in the accompanying consolidated statement of income and was as follows:

Year ended January 31,	2014	2013	2012
Advertising expense	$2,654	$2,326	$3,015

Special Charges
We record restructuring charges within special charges in the consolidated statement of income in connection with our plans to better align our cost structure with projected operations in the future. Special charges primarily consist of costs incurred related to certain litigation, employee severance, acquisitions, excess facilities, and asset related charges. See additional discussion in Note 13. "Special Charges."

Net Income Per Share
We compute basic net income per share using the weighted average number of common shares outstanding during the period. We compute diluted net income 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 restricted stock units, common shares issuable upon exercise of employee stock options, purchase rights from employee stock purchase plans, and common shares issuable upon conversion of the convertible subordinated debentures using the treasury stock method, if dilutive. Net income used to compute basic and diluted net income per share is reduced for the adjustment of the noncontrolling interest with redemption feature to its calculated redemption value at January 31, 2014. See additional discussion in Note 11. "Net Income Per Share."

Accounting for Stock-Based Compensation
We measure stock-based compensation cost at the grant date, based on the fair value of the award, and recognize the expense on a straight-line basis over the employee's requisite service period. For options and stock awards that vest fully on any termination of service, there is no requisite service period and consequently we recognize the expense fully in the period in which the award is granted. We present the excess tax benefit from the exercise of stock options when the benefit that was previously recorded as a financing activity in the consolidated statements of cash flows is utilized.

We have elected to compute the timing of excess tax benefits from the exercise of stock options on the "with-and-without" approach. Under this approach, we will not record an excess tax benefit until such time as a cash tax benefit is recognized. Further, we will include the impact of these excess tax benefits in the calculation of indirect tax attributes, such as the research and development credit and the domestic manufacturing deduction. We will compute the pool of excess tax benefits available to offset any future shortfalls in the tax benefits actually realized on exercises of stock options as a single pool for employees and non-employees.

See a further description of how we estimate the fair value of stock options and purchase rights under our employee stock purchase plans (ESPPs) in Note 9. "Employee Stock and Savings Plans and Stockholders' Equity."

Transfer of Financial Assets
We finance certain software license agreements with customers through the sale, assignment, and transfer of the future payments under those agreements to financing institutions on a non-recourse basis. We retain no interest in the transferred receivable. We record such transfers as sales of the related accounts receivable when we are considered to have surrendered control of such receivables. The gain or loss on the sale of receivables is included in general and administration in operating expenses in our consolidated statement of income. 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 and (ii) the unaccreted interest on the receivables sold. We impute interest on the receivables based on prevailing market rates and record this as a discount against the receivable.

We sold the following receivables to financing institutions on a non-recourse basis and recognized the following gain on the sale of those receivables:

Year ended January 31,	2014	2013	2012
Trade receivables, short-term	$11,705	$ 9,617	$13,645
Term receivables, long-term	11,912	11,094	16,662
Total receivables sold	23,617	20,711	30,307
Net proceeds	22,943	20,198	29,146
Discount on sold receivables	(674)	(513)	(1,161)
Unaccreted interest on sold receivables	890	568	1,273
Gain on sale of receivables	$ 216	$ 55	$ 112

Reclassifications
Certain items have been reclassified within operating expenses for fiscal 2013. We have reclassified certain litigation costs out of general and administration into special charges, related to patent litigation involving Emulation and Verification Engineering S.A. and EVE-USA, Inc. (together EVE), Synopsys, Inc. (Synopsys), and us regarding emulation technology. These litigation costs are included in special charges because of their unusual nature due to the significance in variability of timing and amount. These reclassifications had no impact on total operating expenses, operating income, or net income. See further discussion of these lawsuits in Note 8. "Commitments and Contingencies."

The reclassification of our previously issued fiscal 2013 consolidated statement of operations was made to conform to the current period presentation. The amounts have been reclassified as follows:

	Year ended January 31, 2013	
	As Originally Reported	As Reclassified
General and administration	$74,324	$70,692
Special charges	$ 6,314	$ 9,946

3. Fair Value Measurement
The following table presents information about financial assets and liabilities measured at fair value on a recurring basis as of January 31, 2014:

	Fair Value	Level 1	Level 2	Level 3
Bank certificates of deposit	$ 3,990	$ –	$3,990	$ –
Contingent consideration	(4,571)	–	–	(4,571)
Total	$ (581)	$ –	$3,990	$(4,571)

The following table presents information about financial assets and liabilities measured at fair value on a recurring basis as of January 31, 2013:

	Fair Value	Level 1	Level 2	Level 3
Contingent consideration	$(6,016)	$ –	$ –	$(6,016)

The Financial Accounting Standards Board's authoritative guidance for the hierarchy of valuation techniques is 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. The fair value hierarchy consists of the following three levels:

- 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.

We based the fair value of bank certificates of deposit included in short-term investments on quoted market prices for similar instruments in markets that are not active (Level 2).

In connection with certain acquisitions, payment of a portion of the purchase price is contingent typically upon the acquired business' achievement of certain revenue goals. As of January 31, 2014, of the total recorded balance, $1,565 was included in accrued and other liabilities and $3,006 was included in other long-term liabilities on our consolidated balance sheet. As of January 31, 2013, of the total recorded balance, $1,197 was included in accrued and other liabilities and $4,819 was included in other long-term liabilities on our consolidated balance sheet.

We have estimated the fair value of our contingent consideration as the present value of the expected payments over the term of the arrangements. The fair value measurement of our contingent consideration as of January 31, 2014 encompasses the following significant unobservable inputs:

Unobservable Inputs	Range
Total estimated contingent consideration	$0 - $5,351
Discount rate	9.5% - 16.0%
Timing of cash flows (in years)	0 - 4

Changes in the fair value of our contingent consideration are primarily driven by changes in the estimated amount and timing of payments, resulting from changes in the forecasted revenues of the acquired businesses. Significant changes in any of the inputs in isolation could result in a fluctuation in the fair value measurement of contingent consideration. Changes in fair value are recognized in special charges in our consolidated statement of income in the period in which the change is identified.

The following table summarizes contingent consideration activity:

Balance as of January 31, 2012	$ 6,120
New contingent consideration	1,208
Payments	(1,504)
Adjustments	(42)
Interest accretion	234
Balance as of January 31, 2013	$ 6,016
New contingent consideration	540
Payments	(1,266)
Adjustments	(898)
Interest accretion	179
Balance as of January 31, 2014	$ 4,571

The following table summarizes the fair value and carrying value of notes payable:

As of January 31,	2014	2013
Fair value of notes payable	$306,535	$293,867
Carrying value of notes payable	$224,261	$218,546

We based the fair value of notes payable on the quoted market price at the balance sheet date. The quoted market price for our notes is derived from observable inputs including our stock price, stock volatility, and interest rate (Level 2). Of the total carrying value of notes payable, none was classified as current on our consolidated balance sheet as of January 31, 2014 and January 31, 2013.

The carrying amounts of cash equivalents, trade accounts receivable, net, term receivables, short-term borrowings, accounts payable, and accrued liabilities approximate fair value because of the short-term nature of these instruments or because amounts have been appropriately discounted.

4. Term Receivables and Trade Accounts Receivable

We have long-term installment receivables that are attributable to multi-year, multi-element term license sales agreements. We include balances under term agreements that are due within one year in trade accounts receivable, net and balances that are due more than one year from the balance sheet date in term receivables, long-term. We discount the total product portion of the agreements to reflect the interest component of the transaction. We amortize the interest component of the transaction, using the effective interest method, to system and software revenues over the period in which payments are made and balances are outstanding. We determine the discount rate at the outset of the arrangement based upon the current credit rating of the customer. We reset the discount rate periodically considering changes in prevailing interest rates but do not adjust previously discounted balances.

Term receivable and trade accounts receivable balances were as follows:

As of January 31,	2014	2013
Trade accounts receivable	$ 179,830	$178,351
Term receivables, short-term	$ 274,653	$233,894
Term receivables, long-term	$ 270,365	$250,497

Trade accounts receivable include billed amounts whereas term receivables, short-term is comprised of unbilled amounts. Term receivables, short term represent the portion of long-term installment agreements that are due within one year. Billings for term agreements typically occur thirty days prior to the contractual due date, in accordance with individual contract installment terms. Term receivables, long-term represent unbilled amounts which are scheduled to be collected beyond one year.

We perform a credit risk assessment of all customers using the Standard & Poor's (S&P) credit rating as our primary credit-quality indicator. The S&P credit ratings are based on the most recent S&P score available. For customers that do not have an S&P credit rating, we base our credit risk assessment on an internal credit assessment which is based on selected short-term financial ratios. Our internal credit assessment is based upon results provided in the customer's most recent financial statements.

The credit risk assessment for our long-term receivables was as follows:

As of January 31,	2014	2013
S&P credit rating:		
AAA+ through BBB-	$180,113	$133,773
BB+ and lower	29,654	45,298
	209,767	179,071
Internal credit assessment	60,598	71,426
Total long-term term receivables	$270,365	$250,497

We maintain allowances for doubtful accounts on trade accounts receivable and term receivables, long-term for estimated losses resulting from the inability of our customers to make required payments. We regularly evaluate the collectibility of our trade accounts receivable based on a combination of factors. When we become aware of a specific customer's inability to meet its financial obligations, such as in the case of bankruptcy or deterioration in the customer's operating results, financial position, or credit rating, we record a specific reserve for bad debt to reduce the related receivable to the amount believed to be collectible. We also record unspecified reserves for bad debt for all other customers based on a variety of factors including length of time the receivables are past due, the financial health of the customers, the current business environment, and historical experience. Current economic conditions we have considered include forecasted spending in the semiconductor industry, consumer spending for electronics, integrated circuit research and development spending, and volatility in gross domestic product. If these factors change or circumstances related to specific customers change, we adjust the estimates of the recoverability of receivables resulting in either additional selling expense or a reduction in selling expense in the period the determination is made.

The following shows the change in allowance for doubtful accounts for the years ended January 31, 2014, 2013, and 2012:

Allowance for doubtful accounts	Beginning balance	Charged to expense	Other changes(1)	Ending balance
Year ended January 31, 2014	$5,331	$ 517	$(379)	$5,469
Year ended January 31, 2013	$4,432	$1,147	$(248)	$5,331
Year ended January 31, 2012	$3,941	$ 688	$(197)	$4,432

(1) Specific account write-offs and foreign exchange.

5. Short-Term Borrowings

In May 2013, we amended our syndicated, senior, unsecured, revolving credit facility, extending the termination date to May 24, 2017.

The revolving credit facility has a maximum borrowing capacity of $125,000. As stated in the revolving credit facility, we have the option to pay interest based on:

(i) London Interbank Offered Rate (LIBOR) with varying maturities commensurate with the borrowing period we select, plus a spread of between 2.00% and 2.50% based on a pricing grid tied to a financial covenant, or

(ii) A base rate plus a spread of between 1.00% and 1.50%, based on a pricing grid tied to a financial covenant.

As a result of these interest rate options, our interest expense associated with borrowings under this revolving credit facility will vary with market interest rates.

We had no borrowings against the revolving credit facility during fiscal 2014 or fiscal 2013. Commitment fees are payable on the unused portion of the revolving credit facility at rates between 0.30% and 0.40% based on a pricing grid tied to a financial covenant.

The revolving credit facility contains certain financial and other covenants, including the following:

- Our adjusted quick ratio (ratio of the sum of cash and cash equivalents, short-term investments, and net current receivables to total current liabilities) shall not be less than 1.00;
- Our tangible net worth (stockholders' equity less goodwill and other intangible assets) must exceed the calculated required tangible net worth as defined in the credit agreement;
- Our leverage ratio (ratio of total liabilities less subordinated debt to the sum of subordinated debt and tangible net worth) shall be less than 2.00;
- Our senior leverage ratio (ratio of total debt less subordinated debt to the sum of subordinated debt and tangible net worth) shall not be greater than 0.90; and
- Our minimum cash and accounts receivable ratio (ratio of the sum of cash and cash equivalents, short-term investments, and 42.0% of net current accounts receivable, to outstanding credit agreement borrowings) shall not be less than 1.25.

The revolving credit facility limits the aggregate amount we can pay for dividends and repurchases of our stock over the term of the facility of $50,000 plus 70% of our cumulative net income for periods after January 31, 2011.

We were in compliance with all financial covenants as of January 31, 2014. If we fail to comply with the financial covenants and do not obtain a waiver from our lenders, we would be in default under the revolving credit facility and our lenders could terminate the facility and demand immediate repayment of all outstanding loans under the revolving credit facility.

6. Notes Payable

We have no long-term obligations maturing within the next five years. Our 4.00% Convertible Subordinated Debentures (4.00% Debentures) are due in 2031, but we may be required to repay them earlier under the conversion and redemption provisions described below.

4.00% Debentures due 2031: In April 2011, we issued $253,000 of 4.00% Debentures in a private placement pursuant to the Securities and Exchange Commission Rule 144A under the Securities Act of 1933. Interest on the 4.00% Debentures is payable semi-annually in April and October.

The 4.00% Debentures are convertible, under certain circumstances, into our common stock at a conversion rate, as of January 31, 2014, of 49.133 shares of our common stock for each one thousand dollars in principal amount of the 4.00% Debentures (equivalent to a conversion price of $20.35 per share) for a total of 12,431 shares. These circumstances include:

- The market price of our common stock exceeding 120% of the conversion price, or $24.42 per share as of January 31, 2014, for at least 20 of the last 30 trading days in the previous fiscal quarter;
- A call for redemption of the 4.00% Debentures;
- Specified distributions to holders of our common stock;
- If a fundamental change, such as a change of control, occurs;
- During the two months prior to, but not on, the maturity date; or
- The market price of the 4.00% Debentures declining to less than 98% of the value of the common stock into which the 4.00% Debentures are convertible.

Upon conversion of any 4.00% Debentures, a holder will receive:

(i) Cash for the lesser of the principal amount of the 4.00% Debentures that are converted or the value of the converted shares; and

(ii) Cash or shares of common stock, at our election, for the excess, if any, of the value of the converted shares over the principal amount.

As of January 31, 2014, the if-converted value of the 4.00% Debentures to the note holders exceeded the principal amount by $5,565.

If a holder elects to convert their 4.00% Debentures in connection with a fundamental change in the company that occurs prior to April 5, 2016, the holder will also be entitled to receive a make whole premium upon conversion in some circumstances.

As a result of declaring cash dividends during the year ended January 31, 2014, the initial conversion rate for the 4.00% Debentures of 48.6902 shares of our common stock for each one thousand dollars in principal amount of the 4.00% Debentures (equivalent to a conversion price of $20.54 per share of our common stock) has been adjusted to 49.133 shares of our common stock for each one thousand dollars in principal amount of the 4.00% Debentures (equivalent to a conversion price of $20.35 per share of our common stock).

We may redeem some or all of the 4.00% Debentures for cash on or after April 5, 2016 at the following redemption prices expressed as a percentage of principal, plus any accrued and unpaid interest:

Period	Redemption Price
Beginning on April 5, 2016 and ending on March 31, 2017	101.143%
Beginning on April 1, 2017 and ending on March 31, 2018	100.571%
On April 1, 2018 and thereafter	100.000%

The holders, at their option, may redeem the 4.00% Debentures in whole or in part for cash on April 1, 2018, April 1, 2021, and April 1, 2026, and in the event of a fundamental change in the company. In each case, our repurchase price will be 100% of the principal amount of the 4.00% Debentures plus any accrued and unpaid interest.

The 4.00% Debentures contain a conversion feature allowing for settlement of the debt in cash upon conversion, therefore we separately account for the implied liability and equity components of the 4.00% Debentures. The principal amount, unamortized debt discount, net carrying amount of the liability component, and carrying amount of the equity component of the 4.00% Debentures are as follows:

As of	January 31, 2014	January 31, 2013
Principal amount	$253,000	$253,000
Unamortized debt discount	(28,739)	(34,454)
Net carrying amount of the liability component	$224,261	$218,546
Equity component	$ 43,930	$ 43,930

The unamortized debt discount amortizes to interest expense using the effective interest method through March 2018.

We recognized the following amounts in interest expense in the consolidated statement of operations related to the 4.00% Debentures:

Year ended January 31,	2014	2013	2012
Interest expense at the contractual interest rate	$10,120	$10,120	$8,349
Amortization of debt discount	$ 5,715	$ 5,322	$4,154

The effective interest rate on the 4.00% Debentures was 7.25% for fiscal 2014, fiscal 2013, and fiscal 2012.

6.25% Debentures due 2026: During fiscal 2012, we redeemed the remaining $196,509 principal amount of the 6.25% Convertible Subordinated Debentures (6.25% Debentures) due 2026 utilizing proceeds received from the issuance of the 4.00% Debentures and cash on hand. In connection with this redemption, we incurred a before tax net loss on the early extinguishment of debt of $11,192, which included a $6,190 write-off of net unamortized debt discount, a $3,518 premium on redemption of the 6.25% Debentures, and a write-off of $1,484 for the unamortized debt issuance costs. This loss is included in interest expense in the consolidated statement of income. No balance remained outstanding following this redemption.

We recognized the following amounts in interest expense in the consolidated statements of operations related to the 6.25% Debentures, issued 2006:

Year ended January 31,	2014	2013	2012
Interest expense at the contractual interest rate	$ –	$ –	$2,900
Amortization of debt discount	$ –	$ –	$ 793

Term Loan due 2013: In April 2010, we entered into a three-year term loan (Term Loan) for $20,000 to repay borrowings on our revolving credit facility used to purchase office buildings in Fremont, California. During fiscal 2012, we repaid the remaining obligation of $18,500 under the Term Loan utilizing proceeds received from the issuance of the 4.00% Debentures. In connection with this repayment, we incurred a before tax net loss on early retirement of debt of $312, representing the write-off of the unamortized debt issuance costs. This loss is included in interest expense on the consolidated statement of operations. No balance remained outstanding following this repayment.

7. Income Taxes

Domestic and foreign pre-tax income (loss) was as follows:

Year ended January 31,	2014	2013	2012
Domestic	$ (754)	$ 9,670	$ (62,943)
Foreign	163,822	131,665	145,267
Total pre-tax income	$163,068	$141,335	$ 82,324

The provision (benefit) for income taxes was as follows:

Year ended January 31,	2014	2013	2012
Current:			
Federal	$ (366)	$ (210)	$ 475
State	355	(65)	137
Foreign	6,585	4,964	(2,731)
Total current	6,574	4,689	(2,119)
Deferred:			
Federal and state	1,333	350	695
Foreign	1,603	(2,338)	361
Total deferred	2,936	(1,988)	1,056
Total provision (benefit) for income taxes	$9,510	$ 2,701	$(1,063)

The actual income tax expense (benefit) is different from that which would have been computed by applying the statutory federal income tax rate to our income before income tax. A reconciliation of income tax expense (benefit) as computed at the U.S. federal statutory income tax rate to the provision (benefit) for income taxes is as follows:

Year ended January 31,	2014	2013	2012
Federal tax, at statutory rate	$ 57,074	$ 49,467	$ 28,813
State tax, net of federal benefit	355	(65)	137
Impact of international operations including withholding taxes and other reserves	(46,632)	(50,275)	(53,499)
Repatriation of foreign subsidiary earnings	20,367	12,661	1,364
Foreign tax credits	(5,489)	(8,203)	(411)
Costs incurred for stock of acquired business	–	67	98
Tax credits (excluding foreign tax credits)	(12,571)	(11,782)	(9,677)
Amortization of deferred charge	(2,311)	–	323
Change in valuation allowance	(5,929)	5,978	28,275
Stock-based compensation expense	2,593	1,895	2,947
Non-deductible meals and entertainment	1,087	1,021	1,096
Other, net	966	1,937	(529)
Provision (benefit) for income taxes	$ 9,510	$ 2,701	$ (1,063)

The tax effects of temporary differences and carryforwards, which gave rise to significant portions of deferred tax assets and liabilities, were as follows:

As of January 31,	2014	2013
Deferred tax assets:		
Depreciation of property, plant, and equipment	$ (8)	$ 274
Reserves and allowances	10,733	10,398
Accrued expenses not currently deductible	20,118	20,463
Stock-based compensation expense	7,839	12,394
Net operating loss carryforwards	40,245	55,612
Tax credit carryforwards	90,852	75,639
Purchased technology and other intangible assets	3,267	6,456
Deferred revenue	3,680	3,097
Other, net	4,844	7,853
Total gross deferred tax assets	181,570	192,186
Less valuation allowance	(126,989)	(154,695)
Deferred tax assets	54,581	37,491
Deferred tax liabilities:		
Intangible assets	(5,699)	(8,286)
Undistributed foreign earnings	(32,132)	(1,662)
Convertible debt	(11,276)	(13,519)
Deferred tax liabilities	(49,107)	(23,467)
Net deferred tax assets	$ 5,474	$ 14,024

The above schedule includes short-term and long-term deferred tax assets and liabilities. Net long-term deferred tax liabilities are presented in our balance sheet in other long-term liabilities.

As of January 31, 2014, we had the following foreign and U.S. Federal and state carryforwards for income tax purposes:

Credit or carryforward	As of January 31, 2014	Expiration
Federal credits and carryforwards:		
Research and experimentation credit carryforward	$ 70,201	Fiscal 2019 - 2034
Net operating loss carryforward	$179,123	Fiscal 2019 - 2032
Foreign tax credits	$ 14,335	Fiscal 2015 - 2024
Alternative minimum tax credits	$ 2,683	No expiration
Childcare credits	$ 1,649	Fiscal 2023 - 2034
State income tax credits and carryforwards:		
Net operating loss carryforward	$213,490	Fiscal 2015 - 2033
Research and experimentation	$ 18,026	Fiscal 2015 - 2029
Miscellaneous	$ 1,199	Various
Foreign net operating loss carryforwards	$ 34,122	Generally indefinite

Net operating loss carryforwards created by excess tax benefits from the exercise of stock options are not recorded as deferred tax assets. To the extent such net operating loss carryforwards are utilized, we will increase stockholders' equity. For presentation purposes, we have elected to exclude the historic deferred tax assets related to excess tax benefits from stock option exercises. Our deferred tax assets related to net operating losses and tax credit carryforwards created by excess tax benefits from stock options have been reduced by $38,893 as of January 31, 2014 and $32,794 as of January 31, 2013.

The decrease in the valuation allowance largely resulted from the utilization of U.S. net operating losses and the expected use of additional U.S. net operating losses to offset actual tax impacts of accrued foreign subsidiary repatriations.

We have determined the amounts of our valuation allowances based on our estimates of taxable income by jurisdiction in which we operate over the periods in which the related deferred tax assets will be recoverable. We determined it is not more-likely-than-not that our U.S. entities will generate sufficient taxable income and foreign source income to fully utilize foreign tax credit carryforwards, research and experimentation credit carryforwards, and net operating loss carryforwards before expiration. Accordingly, we recorded a valuation allowance against those deferred tax assets for which realization does not meet the more-likely-than-not standard. Similarly, there is a valuation allowance on our state deferred tax assets due to the same uncertainties regarding future taxable U.S. income. We determine valuation allowances related to certain foreign deferred tax assets based on historical losses as well as future expectations in certain jurisdictions.

We have not provided for income taxes on the undistributed earnings of our foreign subsidiaries to the extent they are considered permanently re-invested outside the U.S. As of January 31, 2014, the cumulative amount of earnings upon which U.S. income taxes have not been provided is approximately $432,481. Upon repatriation, some of these earnings may be sheltered by U.S. loss carryforwards or foreign tax credits, which may reduce the federal tax liability associated with any future foreign dividend. Determination of the amount of unrecognized deferred U.S. income tax liability on permanently re-invested earnings is not practicable. Where the earnings of our foreign subsidiaries are not treated as permanently re-invested, we have considered the impact in our tax provision.

We are subject to income taxes in the U.S. and in numerous foreign jurisdictions. In the ordinary course of business, 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. Furthermore, net operating loss and tax credit carryforwards may be subject to adjustment after the expiration of the statute of limitations of the year such net operating losses and tax credits originated. Our larger jurisdictions generally provide for a statute of limitation from three to five years. For U.S. federal income tax purposes, the tax years which remain open for examination are fiscal years 2011 and forward, although net operating loss and credit carryforwards from all years are subject to examination and adjustment for three years following the year in which utilized. We are currently under examination in various jurisdictions. The examinations are in different stages and timing of their resolution is difficult to predict. The statute of limitations remains open for years on or after fiscal 2010 in Ireland.

We have reserves for taxes to address potential exposures involving tax positions that are being challenged or that could be challenged by the tax 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. Various events, some of which cannot be predicted, such as clarification of tax law by administrative or judicial means, may occur and would require us to increase or decrease our reserves and effective tax rate. It is reasonably possible that existing unrecognized tax benefits may decrease from $0 to $4,000 due to settlements or expiration of the statute of limitations within the next twelve months.

To the extent that uncertain tax positions resolve in our favor, it could have a positive impact on our effective tax rate. A portion of our reserves, which could settle or expire within the next twelve months, may result in deferred tax assets subject to a valuation allowance for which no benefit would be recognized. Income tax-related interest and penalties were a benefit of $1,710 for the year ended January 31, 2014, a benefit of $297 for the year ended January 31, 2013 and an expense of $677 for the year ended January 31, 2012.

The below schedule shows the gross changes in unrecognized tax benefits associated with uncertain tax positions for the years ending January 31, 2014 and 2013:

Unrecognized tax benefits as of January 31, 2012	$ 41,905
Gross increases - tax positions in prior period	457
Gross decreases - tax positions in prior period	(7)
Gross increases - tax positions in current period	4,316
Lapse of statute of limitations	(7,553)
Cumulative translation adjustment	(336)
Unrecognized tax benefits as of January 31, 2013	$ 38,782
Gross increases - tax positions in prior period	3,863
Gross decreases - tax positions in prior period	(10,313)
Gross increases - tax positions in current period	3,900
Gross decreases - tax positions current	–
Settlements	(1,581)
Lapse of statute of limitations	(2,982)
Cumulative translation adjustment	(348)
Unrecognized tax benefits as of January 31, 2014	$ 31,321

The ending balances of unrecognized tax benefits represent the gross amount of exposure in individual jurisdictions and do not reflect any additional benefits expected to be realized if such positions were not sustained, such as the federal deduction that could be realized if an unrecognized state deduction was not sustained. The ending gross balances exclude accrued interest and penalties related to such positions of $7,687 as of January 31, 2014 and $9,538 as of January 31, 2013. We expect that $18,674 of our unrecognized tax benefits, if recognized, would favorably affect our effective tax rate.

8. Commitments and Contingencies Leases

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 and marketing and selling activities.

Rent expense under operating leases was as follows:

Year ended January 31,	2014	2013	2012
Rent expense	$27,240	$26,597	$27,535

Future minimum lease payments under all non-cancelable operating leases are approximately as follows:

Fiscal years ending January 31,	Lease Payments
2015	$23,117
2016	18,372
2017	11,927
2018	6,601
2019	3,343
Thereafter	6,907
Total	$70,267

Indemnifications

Our license and services agreements generally include a limited indemnification provision for claims from third parties relating to our intellectual property. The indemnification is generally limited to the amount paid by the customer, a multiple of the amount paid by the customer, or a set cap. As of January 31, 2014, 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 in 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 our 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. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, we base accruals 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.

In some instances, we are unable to reasonably estimate any potential loss or range of loss. The nature and progression of litigation can make it difficult to predict the impact a particular lawsuit will have. There are many reasons why we cannot make these assessments, including, among others, one or more of the following: the early stages of a proceeding; damages sought that are unspecific, unsupportable, unexplained or uncertain; discovery not having been started or incomplete; the complexity of the facts that are in dispute; the difficulty of assessing novel claims; the parties not having engaged in any meaningful settlement discussions; the possibility that other parties may share in any ultimate liability; and/or the often slow pace of litigation.

In December 2012, Synopsys filed a lawsuit claiming patent infringement against us in federal district court in the Northern District of California, alleging that our Veloce family of products infringes on four Synopsys United States Patents. On May 2, 2013, Synopsys also filed a claim against us in federal district court in Oregon, similarly alleging that our Veloce family of products infringes on two additional Synopsys United States Patents. These cases seek compensatory damages and a permanent injunction against the licensing of several of our software and hardware products relating to our emulation and field programmable gate arrays synthesis products. We believe these actions were filed in response to patent lawsuits we filed in 2010 and 2012 against EVE, which Synopsys acquired in October 2012. Our lawsuits, which allege that EVE's Zebu emulation products infringe several of our patents, were filed against EVE in federal district court of Oregon. We also filed a patent lawsuit against EVE in Tokyo district court. Our litigation in Oregon and Japan seeks compensatory damages and an injunction against the sale of EVE emulation products. We do not have sufficient information upon which to determine that a loss in connection with this matter is probable, reasonably possible or estimable, and thus no liability has been established nor has a range of loss been disclosed.

9. Employee Stock and Savings Plans and Stockholders' Equity

Stock Options Plans and Stock Plans

Our 2010 Omnibus Incentive Plan (Incentive Plan) is administered by the Compensation Committee of our Board of Directors and permits accelerated vesting of outstanding options, restricted stock units, restricted stock awards, and other equity incentives upon the occurrence of certain changes in control of our company.

Stock options and restricted stock units under the Incentive Plan are generally expected to vest over four years. Stock options have an expiration date of ten years from the date of grant and an exercise price no less than the fair market value of the shares on the date of grant. The source of shares issued under the Incentive Plan is new shares.

During fiscal 2014, restricted stock units with a performance condition were granted to certain officers. Vesting of these restricted stock units occurs after three years and is dependent upon attainment of goals for operating income margin.

As of January 31, 2014, a total of 3,993 shares of common stock were available for future grant under the Incentive Plan.

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

	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Terms (Years)	Aggregate Intrinsic Value
Balance as of January 31, 2013	6,717	$11.08		
Granted	–	–		
Exercised	(3,124)	$12.43		
Forfeited	3	$ 4.20		
Expired	(9)	$12.37		
Balance as of January 31, 2014	3,587	$ 9.87	5.38	$39,195
Options exercisable as of January 31, 2014	2,933	$ 8.94	4.79	$34,784
Options vested as of January 31, 2014 and options expected to vest after January 31, 2014	3,587	$ 9.87	5.38	$39,195

The total intrinsic value of options exercised and cash received from options exercised was as follows:

Year ended January 31,	2014	2013	2012
Intrinsic value	$26,769	$21,647	$15,802
Cash received	$38,830	$24,262	$15,194

The following table summarizes restricted stock activity (including the target number of shares awarded under performance-based restricted stock units):

	Restricted Stock Units	Weighted Average Grant Date Fair Value	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Nonvested as of January 31, 2013	3,996	$13.39		
Granted	1,616	$22.42		
Vested	(1,374)	$12.93		
Forfeited	(155)	$14.83		
Nonvested as of January 31, 2014	4,083	$17.07	1.60	$84,925

The following table summarizes the fair value of restricted stock units vested:

Year ended January 31,	2014	2013	2012
Total fair value of restricted stock units vested	$17,736	$11,698	$5,446

Employee Stock Purchase Plans

We have an ESPP for U.S. employees and an ESPP for certain foreign subsidiary employees. The ESPPs provide for six month offerings commencing on January 1 and July 1 of each year with purchases on June 30 and December 31 of each year. Each eligible employee may purchase up to six thousand shares of stock on each purchase date at prices no less than 85% of the lesser of the fair market value of the shares on the offering date or on the purchase date. As of January 31, 2014, 2,547 shares remain available for future purchase under the ESPPs.

The following table summarizes shares issued under the ESPPs:

Year ended January 31,	2014	2013	2012
Shares issued under the ESPPs	1,554	1,884	2,099
Cash received for the purchase of shares under the ESPPs	$23,895	$22,645	$22,155
Weighted average purchase price per share	$ 15.38	$ 12.02	$ 10.55

Stock-Based Compensation Expense

We estimate the fair value of the purchase rights under our ESPPs and stock options 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.

In determining expected volatility for options, we include the elements listed below at the weighted percentages presented:

- Historical volatility of our shares of common stock at 35%;
- Historical volatility of shares of comparable companies at 20%;
- Implied volatility of our traded options at 30%; and
- Implied volatility of traded options of comparable companies at 15%.

The greatest weighting is provided to our historic volatility based on the amount of consistent historic information available. A lesser weighting is applied to the implied volatility of our traded options due to a low volume of trades and shorter terms. We also include the historic and implied volatility of comparable companies in our industry in an effort to capture a broader view of the marketplace.

The relative weighting percentages are periodically reviewed for reasonableness and are subject to change depending on market conditions and our particular facts and circumstances.

The expected volatility for the purchase rights for our ESPPs is based on the historical volatility of our shares of common stock. The expected term for the purchase rights for our ESPPs is the 6 month offering period.

We base the expected term of our stock options on historical experience.

The risk-free interest rate for periods within the contractual life of the purchase rights under our ESPPs and stock options is based on the U.S. Treasury yield curve in effect at the time of the grant.

The fair value of restricted stock units is the market value as of the grant date.

The weighted average grant date fair values are summarized as follows:

Year ended January 31,	2014	2013	2012
Options granted	$ –	$ 7.18	$ 5.43
Restricted stock units granted	$22.42	$16.74	$10.91
ESPP purchase rights	$ 4.30	$ 3.82	$ 3.19

The fair value calculations used the following assumptions:

Year ended January 31,	2014	2013	2012
Stock Option Plans			
Risk-free interest rate	–	0.9% - 1.3%	1.2%
Dividend yield	–	0%	0%
Expected life (in years)	–	5.8 - 6.3	6.3
Volatility (range)	–	43% - 53%	53%
Volatility (weighted average)	–	43%	53%

Year ended January 31,	2014	2013	2012
Employee Stock Purchase Plans			
Risk-free interest rate	0.09% - 0.14%	0.05% - 0.15%	0.05% - 0.18%
Dividend yield (range)	0% - 1%	0%	0%
Dividend yield (weighted average)	0.5%	0%	0%
Expected life (in years)	0.5	0.5	0.5
Volatility (range)	22% -33%	33% -43%	32% - 38%
Volatility (weighted average)	29%	39%	35%

The following table summarizes stock-based compensation expense included in the results of operations and the tax benefit associated with the exercise of stock options:

Year ended January 31,	2014	2013	2012
Cost of revenues:			
Service and support	$ 1,992	$ 1,529	$ 1,065
Operating expense:			
Research and development	11,182	9,206	8,203
Marketing and selling	7,777	6,654	5,874
General and administration	8,399	6,308	6,516
Equity plan-related compensation expense	$29,350	$23,697	$21,658
Tax effect of the exercise of stock options	$ 386	$ 266	$ –

As of January 31, 2014, we had $3,580 in unrecognized compensation cost related to nonvested options which is expected to be recognized over a weighted average period of 1.1 years and

$58,964 in unrecognized compensation cost related to nonvested restricted stock units which is expected to be recognized over a weighted average period of 1.5 years.

Employee Savings Plan

We have an employee savings plan (the Savings Plan) that qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the Savings Plan, participating U.S. employees may defer a portion of their pretax earnings, up to the Internal Revenue Service annual contribution limit. We currently match 50% of eligible employee's contributions, up to a maximum of 6% of the employee's earnings. Employer matching contributions vest over five years, 20% for each year of service completed. Our matching contributions to the Savings Plan were as follows:

Year ended January 31,	2014	2013	2012
Employer matching contribution	$7,708	$7,181	$7,141

Dividends

On March 7, 2013, our Board of Directors announced the adoption of a dividend policy under which we commenced payment of cash dividends at an annual rate of $0.18 per share of common stock. On February 27, 2014, we announced an increase to the quarterly dividend to $0.05 per share. The following table summarizes the dividends declared:

Declaration Date	Record Date	Payment Date	Per Share Amount	Total Amount
3/7/2013	3/22/2013	4/10/2013	$0.045	$5,064
5/23/2013	6/10/2013	7/1/2013	$0.045	$5,079
8/22/2013	9/10/2013	9/30/2013	$0.045	$5,096
11/21/2013	12/10/2013	1/2/2014	$0.045	$5,159
2/27/2014	3/10/2014	3/31/2014	$ 0.05	

Future declarations of quarterly dividends and the establishment of future record and payment dates are subject to the quarterly determination of our Board of Directors.

10. Incentive Stock Rights

Our Board of Directors has the authority to issue incentive stock in one or more series and to determine the relative rights and preferences of the incentive stock. On June 24, 2010, we adopted an Incentive Stock Purchase Rights Plan and declared a dividend distribution of one right for each outstanding share of common stock, payable to holders of record on July 6, 2010. On December 23, 2011 our Board of Directors amended the Stock Purchase Rights Plan to, among other things, extend the expiration date of the rights and increase the exercise price of each right. On June 28, 2013, our Board of Directors amended the Stock Purchase Rights Plan to extend the expiration date of the rights, change the ownership threshold for certain types of investors, increase the exercise price of each right, and add a qualifying offer provision. As long as the rights are attached to our common stock, we will issue one right with each new share of common stock so that all such shares will have attached rights. Under certain conditions, each right may be exercised to purchase 1/10,000 of a share of Series B Junior Participating Incentive Stock at a purchase price of ninety dollars, subject to adjustment. The rights are not presently exercisable and will only become exercisable if a person or group acquires or commences a tender offer to acquire 15% (20% for certain types of "passive institutional investors") or more of our common stock.

If a person or group acquires 15% (20% for certain types of "passive institutional investors") or more of our common stock, each right will be adjusted to entitle its holder to receive, upon exercise, common stock (or, in certain circumstances, other assets of ours) having a value equal to two times the exercise price of the right, or each right will be adjusted to entitle its holder to receive, upon exercise, common stock of the acquiring company having a value equal to two times the exercise price of the right, depending on the circumstances. The rights expire on June 30, 2015 and may be redeemed by us for $0.001 per right. The rights do not have voting or dividend rights and have no dilutive effect on our earnings.

11. Net Income Per Share

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

Year ended January 31,	2014	2013	2012
Net income attributable to Mentor Graphics shareholders	$155,258	$138,736	$ 83,872
Noncontrolling interest adjustment to redemption value	(4,486)	(5,272)	–
Adjusted net income attributable to Mentor Graphics shareholders	$150,772	$133,464	$ 83,872
Weighted average common shares used to calculate basic net income per share	113,671	110,998	110,138
Employee stock options, restricted stock units and employee stock purchase plan	3,031	3,019	2,777
Weighted average common and potential common shares used to calculate diluted net income per share	116,702	114,017	112,915
Net income per share attributable to Mentor Graphics shareholders:			
Basic	$ 1.33	$ 1.20	$ 0.76
Diluted	$ 1.29	$ 1.17	$ 0.74

We excluded from the computation of diluted net income per share stock options, restricted stock units, and ESPP purchase rights to purchase 1,195 shares of common stock for the year ended January 31, 2014, 1,975 for fiscal 2013, and 4,056 for fiscal 2012. The stock options, restricted stock units, and ESPP purchase rights were determined to be anti-dilutive as a result of applying the treasury stock method.

We have decreased the numerator of our basic and diluted earnings per share calculation for the adjustment of the noncontrolling interest with redemption feature to its calculated redemption value at January 31, 2014 and January 31, 2013, recorded directly to retained earnings. For the year ended January 31, 2012, we excluded a similar adjustment of $1,682 from the calculation of basic and diluted earnings per share, as the amount was not significant.

The effect of the conversion of the 4.00% Debentures was anti-dilutive and therefore excluded from the computation of diluted net income per share. We assume that the 4.00% Debentures will be settled in common stock for purposes of calculating the dilutive effect on net income per share. If the 4.00% Debentures had been dilutive we would have included additional income of $2,075 for the years ended January 31, 2014, 2013 and 2012. Dilutive net income per share would have included no incremental shares for the years ended January 31, 2014, 2013, or 2012 as the average stock price for the period was below the conversion rate.

The conversion features of the 4.00% Debentures, which allow for settlement in cash, common stock, or a combination of cash and common stock, are further described in Note 6. "Notes Payable."

12. Accumulated Other Comprehensive Income

The following table summarizes the components of accumulated other comprehensive income, net of tax:

As of January 31,	2014	2013
Foreign currency translation adjustment	$18,361	$25,146
Unrealized gain (loss) on derivatives	42	(12)
Pension liability	400	265
Total accumulated other comprehensive income	$18,803	$25,399

13. Special Charges

The following is a summary of the components of the special charges:

Year ended January 31,	2014	2013	2012
Litigation costs	$11,597	$3,632	$ –
Employee severance and related costs	4,392	4,016	8,437
Other	940	2,298	4,737
Total special charges	$16,929	$9,946	$13,174

Special charges may include expenses incurred related to certain litigation costs, employee severance, acquisitions, excess facility costs, and asset related charges.

Litigation costs consist of professional service fees for services rendered, related to patent litigation involving us, EVE, and Synopsys regarding emulation technology. For the year ended January 31, 2013, these costs have been reclassified from general and administration to special charges as further described in Note 2. "Summary of Significant Accounting Policies."

Employee severance and related costs include severance benefits, notice pay, and outplacement services. These rebalance charges generally represent the aggregate of numerous unrelated rebalance plans which impact several employee groups, none of which is individually material to our financial position or results of operations. We determine termination benefit amounts based on employee status, years of service, and local statutory requirements. We communicate termination benefits to the affected employees prior to the end of the quarter in which we record the charge.

Approximately 80% of the employee severance and related costs for fiscal 2014 were paid during fiscal 2014. We expect to pay the remainder during fiscal 2015. Approximately 60% of the employee severance and related costs for fiscal 2013 were paid during fiscal 2013. Costs remaining as of January 31, 2013 were paid in fiscal 2014. Approximately 61% of the employee severance and related costs for fiscal 2012 were paid during fiscal 2012. Costs remaining as of January 31, 2012 were paid in fiscal 2013. There have been no significant modifications to the amount of these charges.

Other special charges for fiscal 2012 primarily consisted of costs of $4,066 for advisory fees associated with our proxy contest.

Accrued special charges are included in accrued and other liabilities and other long-term liabilities in the consolidated balance sheets. The following table shows changes in accrued special charges during the year ended January 31, 2014:

	Accrued special charges as of January 31, 2013	Charges during the year ended January 31, 2014	Payments during the year ended January 31, 2014	Accrued special charges as of January 31, 2014 (1)
Litigation costs	$ 624	$11,597	$ (7,366)	$4,855
Employee severance and related costs	2,028	4,392	(5,416)	1,004
Other costs	2,889	940	(1,842)	1,987
Accrued special charges	$5,541	$16,929	$(14,624)	$7,846

(1) Of the $7,846 total accrued special charges as of January 31, 2014, $587 represented the long-term portion, which primarily included accrued lease termination fees and other facility costs, net of sublease income and other long-term costs. The remaining balance of $7,259 represented the short-term portion of accrued special charges.

The following table shows changes in accrued special charges during the year ended January 31, 2013:

	Accrued special charges as of January 31, 2012	Charges during the year ended January 31, 2013	Payments during the year ended January 31, 2013	Accrued special charges as of January 31, 2013 (1)
Litigation costs	$ –	$3,632	$ (3,008)	$ 624
Employee severance and related costs	3,668	4,016	(5,656)	2,028
Other costs	2,811	2,298	(2,220)	2,889
Accrued special charges	$6,479	$9,946	$(10,884)	$5,541

(1) Of the $5,541 total accrued special charges as of January 31, 2013, $2,213 represented the long-term portion, which primarily included accrued lease termination fees and other facility costs, net of sublease income. The remaining balance of $3,328 represented the short-term portion of accrued special charges.

The following table shows changes in accrued special charges during the year ended January 31, 2012:

	Accrued special charges as of January 31, 2011	Charges during the year ended January 31, 2012	Payments during the year ended January 31, 2012	Accrued special charges as of January 31, 2012 (1)
Employee severance and related costs	$2,664	$ 8,437	$ (7,433)	$3,668
Other costs	4,266	4,737	(6,192)	2,811
Accrued special charges	$6,930	$13,174	$(13,625)	$6,479

(1) Of the $6,479 total accrued special charges as of January 31, 2012, $2,173 represented the long-term portion, which primarily included accrued lease termination fees and other facility costs, net of sublease income. The remaining balance of $4,306 represented the short-term portion of accrued special charges.

14. Other Income (Expense), Net

Other income (expense), net was comprised of the following:

Year ended January 31,	2014	2013	2012
Interest income	$ 2,360	$ 1,944	$ 2,195
Foreign currency exchange loss	(1,872)	(2,394)	(718)
Gain on conversion of equity method investment to controlling interest	–	–	1,519
Other, net	(1,008)	(982)	(1,420)
Other income (expense), net	$ (520)	$(1,432)	$ 1,576

In fiscal 2012, we exchanged one of our product lines for a controlling interest in a privately-held company. Prior to acquiring this controlling interest, we had a noncontrolling interest, which was accounted for under the equity method of accounting. As a result of this transaction, we recognized a gain of $1,519 to adjust the carrying value of our equity method investment in the company to its fair value based on an income approach valuation method.

15. Related Party Transactions

Certain members of our Board of Directors also serve as officers or directors for some of our customers. Management believes the transactions between these customers and us were carried out on an arm's-length basis. As of January 31, 2014, we had amounts receivable from these customers of $95,789. As of January 31, 2013, accounts receivable from these customers were not significant. The following table shows revenue recognized from these customers:

Year ended January 31,	2014	2013	2012
Revenue from customers	$85,037	$56,878	$35,944
Percentage of total revenues	7.4%	5.2%	3.5%

16. Supplemental Cash Flow Information

The following provides information concerning supplemental disclosures of cash flow activities:

Year ended January 31,	2014	2013	2012
Cash paid for:			
Interest	$12,225	$11,981	$14,686
Income taxes	$11,871	$10,777	$ 8,707

We have an investment in Frontline. We received returns on investment of $5,500 during fiscal 2014, $6,250 during fiscal 2013 and $7,015 during fiscal 2012 which is included in net cash provided by operating activities in our consolidated statement of cash flows.

17. Segment Reporting

Our Chief Operating Decision Makers (CODMs), which consist of the Chief Executive Officer and the President, review our consolidated results within one operating segment. In making operating decisions, our CODMs primarily consider consolidated financial information accompanied by disaggregated revenue information by geographic region.

We eliminate all intercompany revenues in computing revenues by geographic regions. Revenues and property, plant and equipment, net, related to operations in the geographic areas were:

Year ended January 31,	2014	2013	2012
Revenues:			
United States	$ 497,954	$ 467,595	$ 397,801
Other North America	15,250	13,544	18,361
Total North America	513,204	481,139	416,162
Europe	241,417	261,371	247,079
Japan	113,796	127,789	116,469
Pacific Rim	287,956	218,428	234,928
Total revenues	$1,156,373	$1,088,727	$1,014,638

For the years ended January 31, 2014, 2013 and 2012, no single customer accounted for 10% or more of our total revenues.

As of January 31,	2014	2013
Property, plant, and equipment, net:		
United States	$116,954	$121,179
Other North America	141	269
Total North America	117,095	121,448
Europe	34,800	33,029
Japan	637	979
Pacific Rim	7,633	6,946
Total property, plant and equipment, net	$160,165	$162,402

18. Quarterly Financial Information – Unaudited

A summary of quarterly financial information follows:

Quarter ended	April 30	July 31	October 31	January 31
Fiscal 2014				
Total revenues	$226,515	$253,216	$275,642	$401,000
Gross profit	$186,334	$208,359	$229,570	$345,003
Operating income	$ 5,893	$ 26,578	$ 33,372	$117,197
Net income attributable to Mentor Graphics shareholders	$ 205	$ 23,982	$ 25,535	$105,536
Net income per share, basic (1)	$ 0.01	$ 0.19	$ 0.21	$ 0.91
Net income per share, diluted (1)	$ 0.01	$ 0.19	$ 0.20	$ 0.89
Fiscal 2013				
Total revenues	$247,918	$240,811	$268,760	$331,238
Gross profit	$202,535	$194,235	$218,497	$283,770
Operating income	$ 32,822	$ 19,907	$ 37,809	$ 71,095
Net income attributable to Mentor Graphics shareholders	$ 28,182	$ 18,167	$ 30,641	$ 61,746
Net income per share, basic (1)	$ 0.26	$ 0.17	$ 0.27	$ 0.50
Net income per share, diluted (1)	$ 0.25	$ 0.16	$ 0.27	$ 0.49

(1) We have adjusted the numerator of our earnings per share calculation by the following for the adjustment of our noncontrolling interest to the calculated redemption value, recorded directly to retained earnings:

Quarter ended	April 30	July 31	October 31	January 31
Fiscal 2014	$468	$(2,349)	$(2,032)	$ (573)
Fiscal 2013	$ –	$ –	$ –	$(5,272)

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Mentor Graphics Corporation:

We have audited the accompanying consolidated balance sheets of Mentor Graphics Corporation and subsidiaries as of January 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended January 31, 2014. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mentor Graphics Corporation and subsidiaries as of January 31, 2014 and 2013, and the results of their operations and their cash flows for each of the years in the three-year period ended January 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Mentor Graphics Corporation's internal control over financial reporting as of January 31, 2014, based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 17, 2014 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

(signed) KPMG LLP
Portland, Oregon
March 17, 2014

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

None.

Item 9A. Controls and Procedures

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended (the Exchange Act). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with United States generally accepted accounting principles.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of our internal control over financial reporting as of January 31, 2014, and has concluded that our internal control over financial reporting was effective. In making its assessment of internal control over financial reporting, management used the criteria established in Internal Control-Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Our independent registered public accounting firm, KPMG LLP, has audited our internal control over financial reporting as of January 31, 2014, as stated in their report included in this Annual Report on Form 10-K.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Mentor Graphics Corporation:

We have audited Mentor Graphics Corporation's internal control over financial reporting as of January 31, 2014, based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Mentor Graphics Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Mentor Graphics Corporation maintained, in all material respects, effective internal control over financial reporting as of January 31, 2014, based on criteria established in *Internal Control – Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Mentor Graphics Corporation and subsidiaries as of January 31, 2014 and 2013, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the years in the three-year period ended January 31, 2014, and our report dated March 17, 2014 expressed an unqualified opinion on those consolidated financial statements.

(signed) KPMG LLP
Portland, Oregon
March 17, 2014

CHANGES IN INTERNAL CONTROL 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.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

We maintain disclosure controls and procedures, as defined by Exchange Act Rules 13a–15(e) and 15d-15(e), 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 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 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.

Item 9B. Other Information

None.

Part III

Item 10. Directors, Executive Officers, and Corporate Governance

The information required by this item concerning our Directors will be included under “Election of Directors” in our 2014 Proxy Statement and is incorporated herein by reference. The information concerning our Executive Officers is included in the section titled “Executive Officers of the Registrant.” The information required by Item 405 of Regulation S-K will be included under “Section 16(a) Beneficial Ownership Reporting Compliance” in our 2014 Proxy Statement and is incorporated herein by reference. The information required by Item 406 of Regulation S-K will be included under “Ethics Policies” in our 2014 Proxy Statement and is incorporated herein by reference. The information required by Items 407(c)(3), 407(d)(4), and 407(d)(5) of Regulation S-K will be included under “Information Regarding the Board of Directors – Board Leadership, Corporate Governance, Board Independence, Committees and Meetings” in our 2014 Proxy Statement and is incorporated herein by reference.

Item 11. Executive Compensation

The information required by this item will be included under “Director Compensation in Fiscal Year 2014,” “Information Regarding Executive Officer Compensation,” “Compensation Discussion and Analysis,” “Compensation Committee Report,” and “Compensation Risk Assessment” in our 2014 Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this item will be included under “Election of Directors,” “Information Regarding Beneficial Ownership of Principal Shareholders and Management,” and “Equity Compensation Plan Information” in our 2014 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this item will be included under “Information Regarding the Board of Directors – Board Leadership, Corporate Governance, Board Independence, Committees and Meetings” in our 2014 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this item will be included under “Independent Auditors” in our 2014 Proxy Statement and is incorporated herein by reference.

Part IV

Item 15. Exhibits, Financial Statement Schedules

(a) 1 Financial Statements:

The following consolidated financial statements are included in Part II, Item 8. “Financial Statements and Supplementary Data”:

(a) 2 Financial Statement Schedule:

All financial statement schedules have been omitted since they are not required, not applicable, or the information is included in the Consolidated Financial Statements or Notes.

(a) 3 Exhibits

3. A. 1987 Restated Articles of Incorporation, as amended. Incorporated by reference to Exhibit 3.A to the Company's Quarterly Report on Form 10-Q for the quarter ended July 31, 2010.
   B. Bylaws of the Company. Incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on December 27, 2011.
4. A. Credit Agreement dated as of April 26, 2011 between the Company, Bank of America, N.A. as agent and the other lenders. Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 27, 2011.
   B. First Amendment to Credit Agreement dated as of May 24, 2013 between the Company, Bank of America, N.A. as agent and other lenders. Incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended April 30, 2013.
   C. Second Amendment to Credit Agreement dated as of September 30, 2013 between the Company, Bank of America, N.A. as agent and the other lenders. Incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended October 31, 2013.
   D. Indenture dated April 4, 2011 between the Company and Wilmington Trust Company, as Trustee, related to 4.00% Convertible Subordinated Debentures due 2031. Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on April 4, 2011.
   E. Second Amended and Restated Rights Agreement, dated as of June 28, 2013 between the Company and American Stock Transfer & Trust Company, LLC, as rights agent, related to the Incentive Stock Purchase Rights Plan. Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on July 1, 2013.

10. *A. 2010 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.A to the Company's Current Report on Form 8-K filed on July 2, 2010.

*B. Form of Restricted Stock Unit Award Agreement for grants of restricted stock units to non-employee directors under our 2010 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.B to the Company's Quarterly Report on Form 10-Q for the quarter ended July 31, 2010.

*C. Form of Stock Option Agreement for grants of stock options to non-employee directors under our 2010 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.C to the Company's Quarterly Report on Form 10-Q for the quarter ended July 31, 2010.

*D. Form of Stock Option Agreement Terms and Conditions containing standard terms of stock options granted to our executive officers under our 2010 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.E to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2011.

*E. Form of Stock Option Agreement Terms and Conditions containing standard terms of stock options granted in fiscal years 2009 and 2010 to executive officers under the Company's stock option plans. Incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the quarter ended April 30, 2009.

*F. Form of Stock Option Agreement Terms and Conditions containing standard terms of stock options granted on October 9, 2007 to executive officers under our stock option plans. Incorporated by reference to Exhibit 10.A to the Company's Quarterly Report on Form 10-Q for the quarter ended October 31, 2007.

*G. Form of Amendment to Nonqualified Stock Options containing additional standard terms of nonqualified stock options granted to executives under the Company's stock option plans. Incorporated by reference to Exhibit 10.B to the Company's Current Report on Form 8-K filed on November 2, 2004.

*H. Form of Performance-Based Restricted Stock Unit Award Agreement Terms and Conditions containing standard terms of performance-based restricted stock units granted to executive officers under our 2010 Omnibus Incentive Plan. Incorporated by reference to Exhibit 10.A to the Company's Current Report on Form 8-K filed on September 16, 2013.

*I. Form of Restricted Stock Unit Award Agreement Terms and Conditions containing standard terms of time-based restricted stock units granted to executive officers under our 2010 Omnibus Incentive Plan.

*J. Executive Variable Incentive Plan. Incorporated by reference to Exhibit 10.A to the Company's Current Report on Form 8-K filed on June 5, 2012.

*K. Form of Indemnity Agreement entered into between the Company and each of its executive officers and current and future directors. Incorporated by reference to Exhibit 10.I to the Company's Quarterly Report on Form 10-Q for the quarter ended July 31, 2008.

*L. Form of Severance Agreement entered into between the Company and each executive officer of the Company and certain other employees. Incorporated by reference to Exhibit 10.A to the Company's Current Report on Form 8-K filed on March 16, 2010.

*M. Officer Stock Ownership Policy. Incorporated by reference to Exhibit 10.N to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2011.

*N. Form of Agreement to Policy for Recovery of Incentive Compensation. Incorporated by reference to Exhibit 10.O to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2011.

21. List of Subsidiaries of the Company.

23. Consent of KPMG, LLP Independent Registered Public Accounting Firm.

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. Certification 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.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

* Management contract or compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

MENTOR GRAPHICS CORPORATION

Dated: March 17, 2014

By /S/ WALDEN C. RHINES
Walden C. Rhines
Chief Executive Officer

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

(1) Principal Executive Officer:

/S/ WALDEN C. RHINES Walden C. Rhines	Chief Executive Officer	March 17, 2014

(2) Principal Financial Officer:

/S/ GREGORY K. HINCKLEY Gregory K. Hinckley	President, Chief Financial Officer	March 17, 2014

(3) Principal Accounting Officer:

/S/ RICHARD P. TREBING Richard P. Trebing	Corporate Controller, Chief Accounting Officer	March 17, 2014

(4) Directors:

/S/ WALDEN C. RHINES Walden C. Rhines	Chairman of the Board	March 17, 2014
/S/ GREGORY K. HINCKLEY Gregory K. Hinckley	Director	March 17, 2014
/S/ KEITH L. BARNES Keith L. Barnes	Director	March 8, 2014
/S/ SIR PETER L. BONFIELD Sir Peter L. Bonfield	Director	March 8, 2014
/S/ J. DANIEL MCCRANIE J. Daniel McCranie	Director	March 14, 2014
/S/ KEVIN C. MCDONOUGH Kevin C. McDonough	Director	March 9, 2014
/S/ PATRICK B. MCMANUS Patrick B. McManus	Director	March 8, 2014
/S/ DAVID SCHECHTER David Schechter	Director	March 17, 2014

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Supplemental Financial Information

MENTOR GRAPHICS CORPORATION
UNAUDITED RECONCILIATION OF NON-GAAP ADJUSTMENTS
(In thousands, except earnings per share data)

	Twelve Months Ended January 31, 2014	Twelve Months Ended January 31, 2013
GAAP net income attributable to Mentor Graphics shareholders	$ 155,258	$ 138,736
Non-GAAP adjustments:		
Equity plan-related compensation: (1)		
Cost of revenues	1,992	1,529
Research and development	11,182	9,206
Marketing and selling	7,777	6,654
General and administration	8,399	6,308
Acquisition - related items:		
Amortization of purchased assets		
Cost of revenues (2)	3,598	7,801
Frontline purchased technology and intangible assets (3)	1,430	4,968
Amortization of intangible assets (4)	6,230	5,915
Special charges (5)	16,929	9,946
Other income (expense), net (6)	(119)	(128)
Interest expense (7)	5,715	5,322
Non-GAAP income tax effects (8)	(28,944)	(31,105)
Noncontrolling interest (9)	(971)	(699)
Total of non-GAAP adjustments	33,218	25,717
Non-GAAP net income attributable to Mentor Graphics shareholders	$ 188,476	$ 164,453
GAAP and Non-GAAP weighted average shares (diluted)	116,702	114,017
Net income per share attributable to Mentor Graphics shareholders:		
GAAP (diluted)	$ 1.29	$ 1.17
Noncontrolling interest adjustment (10)	0.04	0.05
Non-GAAP adjustments detailed above	0.29	0.22
Non-GAAP (diluted)	$ 1.62	$ 1.44

(1) Equity plan-related compensation expense is the fair value of all share-based payments to employees for stock options and restricted stock units, and purchases made as a result of the employee stock purchase plans.

(2) Amount represents amortization of purchased technology resulting from acquisitions. Purchased intangible assets are amortized over two to five years.

(3) Amount represents amortization of purchased technology and other identified intangible assets identified as part of the fair value of the Frontline P.C.B. Solutions Limited Partnership (Frontline) joint venture investment. Mentor Graphics has a 50% interest in Frontline. The purchased technology was amortized over three years from the March 2010 acquisition date, other identified intangible assets will be amortized over three to four years, and are reflected in the income statement in the equity in earnings of Frontline. This expense is the same type as being adjusted for in note (2) above and (4) below.

(4) Other identified intangible assets are amortized to other operating expense over two to five years. Other identified intangible assets include trade names, customer relationships, and backlog which are the result of acquisition transactions.

(5) *Twelve months ended January 31, 2014:* Special charges consist of (i) $11,597 for EVE litigation costs, (ii) $4,392 of costs incurred for employee rebalances which includes severance benefits, notice pay, and outplacement services, and (iii) $940 in other adjustments.

Twelve months ended January 31, 2013: Special charges consist of (i) $3,632 for EVE litigation costs, (ii) $4,016 of costs incurred for employee rebalances which includes severance benefits, notice pay, and outplacement services, and (iii) $2,298 in other adjustments.

(6) Income from investment accounted for under the equity method of accounting.

(7) Amortization of original issuance debt discount.

(8) Non-GAAP income tax expense adjustment reflects the application of our assumed normalized effective 17% tax rate, instead of our GAAP tax rate, to our non-GAAP pre-tax income.

(9) Adjustment for the impact of amortization of intangible assets, equity plan-related compensation, and income tax expense on noncontrolling interest.

(10) Non-GAAP EPS excludes from the numerator of our earnings per share calculation the adjustment of the noncontrolling interest to the calculated redemption value, recorded directly to retained earnings.

MENTOR GRAPHICS CORPORATION
RECONCILIATION OF GAAP FINANCIAL MEASURES TO NON-GAAP FINANCIAL MEASURES
(In thousands, except percentages)

Year Ended January 31,	2014
GAAP operating income	$ 183,040
Reconciling items to non-GAAP operating income	
Equity plan-related compensation	29,350
Amortization of purchased intangible assets:	
Purchased technology	3,598
Frontline purchased technology and intangible assets	1,430
Other identified intangible assets	6,230
Special charges	16,929
Non-GAAP operating income	$ 240,577

GAAP operating income as a percent of total revenues	15.8%
Non-GAAP adjustments detailed above	5.0%
Non-GAAP operating income as a percent of total revenues	20.8%

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BOARD OF DIRECTORS-FY2014

Dr. Walden C. Rhines
Chairman of the Board and Chief Executive Officer,
Mentor Graphics Corporation

Gregory K. Hinckley
President and Chief Financial Officer,
Mentor Graphics Corporation

Keith L. Barnes
Self-employed Business Advisor and Private Investor

Sir Peter L. Bonfield
Self-employed International Business Advisor

J. Daniel McCranie
Executive Vice President of Sales and Applications,
Cypress Semiconductor Corporation

Kevin C. McDonough
President, Kammstone LLC

Patrick B. McManus
Private Investor

David S. Schechter
Portfolio Manager of the Sargon Portfolio,
Icahn Capital LP

Executive Officers

Dr. Walden C. Rhines
Chairman of the Board and Chief Executive Officer

Gregory K. Hinckley
President and Chief Financial Officer

L. Don Maulsby
Senior Vice President
World Trade

Brian M. Derrick
Vice President
Corporate Marketing

Dean M. Freed
Vice President
General Counsel and Secretary

Michael H. Vishny
Vice President and
Chief Human Resources Officer

Richard P. Trebing
Corporate Controller and Chief Accounting Officer

Corporate Headquarters
Mentor Graphics Corporation
8005 SW Boeckman Road
Wilsonville, Oregon 97070-7777
United States of America
Phone: 503-685-7000
Fax: 503-685-1202
www.mentor.com

Stock Trading
Mentor Graphics Corporation's common stock is traded on the Nasdaq National Market under the symbol "MENT"

Stock Transfer Agent
American Stock Transfer & Trust Co.
59 Maiden Lane
New York, New York 10038
Phone: 718-921-8293
Fax: 718-921-8334

Investor Relations
For additional financial and company information, contact:
Investor Relations
Mentor Graphics Corporation
8005 SW Boeckman Road
Wilsonville, Oregon 97070-7777
503-685-1462

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