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

For the quarterly period ended July 31, 2014

Or

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

For the transition period from to

Commission File No. 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, Wilsonville, Oregon 97070-7777
(Address of principal executive offices) (Zip Code)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☑ No ☐

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ☒  Accelerated filer ☐  Non-accelerated filer ☐  Smaller reporting company ☐
(Do not check if a smaller reporting company)

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

Number of shares of common stock, no par value, outstanding as of September 2, 2014: 113,676,219
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Mentor Graphics Corporation  
Condensed Consolidated Statements of Income  
(Unaudited)

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<thead>
<tr>
<th></th>
<th>Three months ended July 31, 2014</th>
<th>Three months ended July 31, 2013</th>
<th>Six months ended July 31, 2014</th>
<th>Six months ended July 31, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System and software</td>
<td>$149,480</td>
<td>$150,203</td>
<td>$297,709</td>
<td>$273,487</td>
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<tr>
<td>Service and support</td>
<td>110,753</td>
<td>103,013</td>
<td>214,675</td>
<td>206,244</td>
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<tr>
<td><strong>Total revenues</strong></td>
<td>260,233</td>
<td>253,216</td>
<td>512,384</td>
<td>479,731</td>
</tr>
<tr>
<td><strong>Cost of revenues:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>System and software</td>
<td>16,185</td>
<td>15,236</td>
<td>43,156</td>
<td>24,135</td>
</tr>
<tr>
<td>Service and support</td>
<td>30,903</td>
<td>28,909</td>
<td>60,014</td>
<td>58,984</td>
</tr>
<tr>
<td>Amortization of purchased technology</td>
<td>1,841</td>
<td>712</td>
<td>3,202</td>
<td>1,919</td>
</tr>
<tr>
<td><strong>Total cost of revenues</strong></td>
<td>48,929</td>
<td>44,857</td>
<td>106,372</td>
<td>85,038</td>
</tr>
<tr>
<td><strong>Gross profit</strong></td>
<td>211,304</td>
<td>208,359</td>
<td>406,012</td>
<td>394,693</td>
</tr>
<tr>
<td><strong>Operating expenses:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research and development</td>
<td>87,542</td>
<td>80,307</td>
<td>171,993</td>
<td>160,024</td>
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<tr>
<td>Marketing and selling</td>
<td>82,305</td>
<td>79,811</td>
<td>166,939</td>
<td>158,918</td>
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<tr>
<td>General and administration</td>
<td>19,473</td>
<td>17,198</td>
<td>37,155</td>
<td>33,535</td>
</tr>
<tr>
<td>Equity in earnings of Frontline</td>
<td>(2,062)</td>
<td>(950)</td>
<td>(3,441)</td>
<td>(1,347)</td>
</tr>
<tr>
<td>Amortization of intangible assets</td>
<td>2,026</td>
<td>1,556</td>
<td>3,776</td>
<td>3,210</td>
</tr>
<tr>
<td>Special charges</td>
<td>5,108</td>
<td>3,859</td>
<td>11,034</td>
<td>7,882</td>
</tr>
<tr>
<td><strong>Total operating expenses</strong></td>
<td>194,392</td>
<td>181,781</td>
<td>387,456</td>
<td>362,222</td>
</tr>
<tr>
<td><strong>Operating income</strong></td>
<td>16,912</td>
<td>26,578</td>
<td>18,556</td>
<td>32,471</td>
</tr>
<tr>
<td>Other income (expense), net</td>
<td>(104)</td>
<td>(272)</td>
<td>(362)</td>
<td>(1,231)</td>
</tr>
<tr>
<td><strong>Interest expense</strong></td>
<td>(4,807)</td>
<td>(4,897)</td>
<td>(9,392)</td>
<td>(9,682)</td>
</tr>
<tr>
<td><strong>Income before income tax</strong></td>
<td>12,001</td>
<td>21,409</td>
<td>8,802</td>
<td>21,558</td>
</tr>
<tr>
<td><strong>Income tax benefit</strong></td>
<td>(1,768)</td>
<td>(2,338)</td>
<td>(1,942)</td>
<td>(1,770)</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>13,769</td>
<td>23,747</td>
<td>10,744</td>
<td>23,328</td>
</tr>
<tr>
<td>Less: Loss attributable to noncontrolling interest</td>
<td>(403)</td>
<td>(235)</td>
<td>(877)</td>
<td>(859)</td>
</tr>
<tr>
<td><strong>Net income attributable to Mentor Graphics shareholders</strong></td>
<td>$14,172</td>
<td>$23,982</td>
<td>$11,621</td>
<td>$24,187</td>
</tr>
<tr>
<td><strong>Net income per share:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>$0.13</td>
<td>$0.19</td>
<td>$0.12</td>
<td>$0.20</td>
</tr>
<tr>
<td>Diluted</td>
<td>$0.13</td>
<td>$0.19</td>
<td>$0.11</td>
<td>$0.19</td>
</tr>
<tr>
<td><strong>Weighted average number of shares outstanding:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic</td>
<td>113,868</td>
<td>112,988</td>
<td>114,396</td>
<td>112,851</td>
</tr>
<tr>
<td>Diluted</td>
<td>116,551</td>
<td>116,295</td>
<td>116,960</td>
<td>116,014</td>
</tr>
<tr>
<td><strong>Cash dividends declared per common share</strong></td>
<td>$0.050</td>
<td>$0.045</td>
<td>$0.100</td>
<td>$0.090</td>
</tr>
</tbody>
</table>

See accompanying notes to unaudited condensed consolidated financial statements.
## Condensed Consolidated Statements of Comprehensive Income
(Unaudited)

### Three months ended July 31, Six months ended July 31,

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2013</th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Income</strong></td>
<td>$13,769</td>
<td>$23,747</td>
<td>$10,744</td>
<td>$23,328</td>
</tr>
<tr>
<td><strong>Other comprehensive income (loss), net of tax:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash flow hedges:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in unrealized loss on derivative instruments</td>
<td>(232)</td>
<td>(15)</td>
<td>(149)</td>
<td>(270)</td>
</tr>
<tr>
<td>Less: reclassification adjustment for net loss included in net income</td>
<td>(238)</td>
<td>(23)</td>
<td>(83)</td>
<td>(267)</td>
</tr>
<tr>
<td>Net change</td>
<td>6</td>
<td>8</td>
<td>(66)</td>
<td>(3)</td>
</tr>
<tr>
<td>Change in accumulated translation adjustment</td>
<td>(3,665)</td>
<td>(2,119)</td>
<td>(703)</td>
<td>(7,436)</td>
</tr>
<tr>
<td>Change in pension liability</td>
<td>(2)</td>
<td>(2)</td>
<td>(4)</td>
<td>(4)</td>
</tr>
<tr>
<td>Other comprehensive loss</td>
<td>(3,661)</td>
<td>(2,113)</td>
<td>(773)</td>
<td>(7,443)</td>
</tr>
<tr>
<td><strong>Comprehensive income</strong></td>
<td>10,108</td>
<td>21,634</td>
<td>9,971</td>
<td>15,885</td>
</tr>
<tr>
<td><strong>Less amounts attributable to the noncontrolling interest:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net loss</td>
<td>(403)</td>
<td>(235)</td>
<td>(877)</td>
<td>(859)</td>
</tr>
<tr>
<td>Change in accumulated translation adjustment</td>
<td>15</td>
<td>5</td>
<td>5</td>
<td>48</td>
</tr>
<tr>
<td><strong>Comprehensive loss attributable to the noncontrolling interest</strong></td>
<td>(388)</td>
<td>(230)</td>
<td>(872)</td>
<td>(811)</td>
</tr>
<tr>
<td><strong>Comprehensive income attributable to Mentor Graphics shareholders</strong></td>
<td>$10,496</td>
<td>$21,864</td>
<td>$10,843</td>
<td>$16,696</td>
</tr>
</tbody>
</table>

*See accompanying notes to unaudited condensed consolidated financial statements.*
### Condensed Consolidated Balance Sheets

**Mentor Graphics Corporation**  
**(Unaudited)**

**As of**  

<table>
<thead>
<tr>
<th>Assets</th>
<th>July 31, 2014</th>
<th>January 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$174,361</td>
<td>$293,322</td>
</tr>
<tr>
<td>Short-term investments</td>
<td>—</td>
<td>$3,990</td>
</tr>
<tr>
<td>Trade accounts receivable, net of allowance for doubtful accounts of $3,294 as of July 31, 2014 and $5,469 as of January 31, 2014</td>
<td>423,699</td>
<td>454,483</td>
</tr>
<tr>
<td>Other receivables</td>
<td>16,085</td>
<td>15,506</td>
</tr>
<tr>
<td>Inventory</td>
<td>24,174</td>
<td>25,121</td>
</tr>
<tr>
<td>Prepaid expenses and other</td>
<td>25,311</td>
<td>24,031</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>10,107</td>
<td>13,656</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td>$673,737</td>
<td>$830,109</td>
</tr>
<tr>
<td><strong>Property, plant, and equipment, net of accumulated depreciation of $333,014 as of July 31, 2014 and $320,827 as of January 31, 2014</strong></td>
<td>158,474</td>
<td>160,165</td>
</tr>
<tr>
<td><strong>Term receivables</strong></td>
<td>236,743</td>
<td>270,365</td>
</tr>
<tr>
<td><strong>Goodwill</strong></td>
<td>597,912</td>
<td>549,044</td>
</tr>
<tr>
<td><strong>Intangible assets, net of accumulated amortization of $202,602 as of July 31, 2014 and $195,752 as of January 31, 2014</strong></td>
<td>52,967</td>
<td>22,799</td>
</tr>
<tr>
<td><strong>Other assets</strong></td>
<td>73,397</td>
<td>71,627</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>$1,793,230</td>
<td>$1,904,109</td>
</tr>
</tbody>
</table>

**Liabilities and Stockholders’ Equity**

<table>
<thead>
<tr>
<th>Liabilities and Stockholders’ Equity</th>
<th>July 31, 2014</th>
<th>January 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term borrowings</td>
<td>$3,640</td>
<td>$9,590</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>11,360</td>
<td>21,548</td>
</tr>
<tr>
<td>Income taxes payable</td>
<td>372</td>
<td>3,365</td>
</tr>
<tr>
<td>Accrued payroll and related liabilities</td>
<td>51,548</td>
<td>102,848</td>
</tr>
<tr>
<td>Accrued and other liabilities</td>
<td>40,455</td>
<td>42,457</td>
</tr>
<tr>
<td>Deferred revenue</td>
<td>223,610</td>
<td>231,179</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td>330,985</td>
<td>410,987</td>
</tr>
<tr>
<td><strong>Notes payable</strong></td>
<td>227,276</td>
<td>224,261</td>
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<tr>
<td><strong>Deferred revenue</strong></td>
<td>22,266</td>
<td>17,398</td>
</tr>
<tr>
<td><strong>Income tax liability</strong></td>
<td>17,565</td>
<td>18,431</td>
</tr>
<tr>
<td><strong>Other long-term liabilities</strong></td>
<td>32,001</td>
<td>32,259</td>
</tr>
<tr>
<td><strong>Total liabilities</strong></td>
<td>630,093</td>
<td>703,336</td>
</tr>
<tr>
<td><strong>Commitments and contingencies (Note 8)</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Noncontrolling interest with redemption feature</strong></td>
<td>13,296</td>
<td>15,479</td>
</tr>
<tr>
<td><strong>Stockholders’ equity:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock, no par value, 300,000 shares authorized as of July 31, 2014 and January 31, 2014; 113,635 shares issued and outstanding as of July 31, 2014 and 115,722 shares issued and outstanding as of January 31, 2014</td>
<td>802,352</td>
<td>838,939</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>329,264</td>
<td>327,552</td>
</tr>
<tr>
<td>Accumulated other comprehensive income</td>
<td>18,025</td>
<td>18,803</td>
</tr>
<tr>
<td>Noncontrolling interest</td>
<td>13,296</td>
<td>15,479</td>
</tr>
<tr>
<td><strong>Total stockholders’ equity</strong></td>
<td>1,149,841</td>
<td>1,185,294</td>
</tr>
<tr>
<td><strong>Total liabilities and stockholders’ equity</strong></td>
<td>$1,793,230</td>
<td>$1,904,109</td>
</tr>
</tbody>
</table>

See accompanying notes to unaudited condensed consolidated financial statements.
Mentor Graphics Corporation
Condensed Consolidated Statements of Cash Flows
(Unaudited)

In thousands

### Operating Cash Flows:

<table>
<thead>
<tr>
<th>Description</th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income</td>
<td>$ 10,744</td>
<td>$ 23,328</td>
</tr>
<tr>
<td>Adjustments to reconcile net income to net cash provided by operating activities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation of property, plant, and equipment</td>
<td>17,076</td>
<td>17,218</td>
</tr>
<tr>
<td>Amortization of intangible assets, debt costs and other</td>
<td>11,173</td>
<td>8,910</td>
</tr>
<tr>
<td>Stock-based compensation</td>
<td>17,289</td>
<td>13,843</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>1,109</td>
<td>4,590</td>
</tr>
<tr>
<td>Changes in other long-term liabilities</td>
<td>(191)</td>
<td>(2,377)</td>
</tr>
<tr>
<td>Dividends received from unconsolidated entities, net of equity in income (loss)</td>
<td>(474)</td>
<td>1,360</td>
</tr>
<tr>
<td>Other</td>
<td>87</td>
<td>(12)</td>
</tr>
<tr>
<td>Changes in operating assets and liabilities, net of effect of acquired businesses:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trade accounts receivable, net</td>
<td>46,837</td>
<td>44,408</td>
</tr>
<tr>
<td>Prepaid expenses and other</td>
<td>(3,045)</td>
<td>(11,833)</td>
</tr>
<tr>
<td>Term receivables, long-term</td>
<td>36,705</td>
<td>33,037</td>
</tr>
<tr>
<td>Accounts payable and accrued liabilities</td>
<td>(77,068)</td>
<td>(58,645)</td>
</tr>
<tr>
<td>Income taxes payable</td>
<td>(5,818)</td>
<td>(8,701)</td>
</tr>
<tr>
<td>Deferred revenue</td>
<td>(15,862)</td>
<td>(29,967)</td>
</tr>
<tr>
<td>Net cash provided by operating activities</td>
<td>38,562</td>
<td>35,159</td>
</tr>
</tbody>
</table>

### Investing Cash Flows:

<table>
<thead>
<tr>
<th>Description</th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from the sales and maturities of short-term investments</td>
<td>4,124</td>
<td>3,112</td>
</tr>
<tr>
<td>Purchases of short-term investments</td>
<td>—</td>
<td>(7,820)</td>
</tr>
<tr>
<td>Purchases of property, plant, and equipment</td>
<td>(13,315)</td>
<td>(13,821)</td>
</tr>
<tr>
<td>Acquisitions of businesses and other intangible assets, net of cash acquired</td>
<td>(75,900)</td>
<td>(2,928)</td>
</tr>
<tr>
<td>Net cash used in investing activities</td>
<td>(85,091)</td>
<td>(21,457)</td>
</tr>
</tbody>
</table>

### Financing Cash Flows:

<table>
<thead>
<tr>
<th>Description</th>
<th>2014</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proceeds from issuance of common stock</td>
<td>16,177</td>
<td>28,619</td>
</tr>
<tr>
<td>Repurchase of common stock</td>
<td>(70,053)</td>
<td>(39,995)</td>
</tr>
<tr>
<td>Dividends paid</td>
<td>(11,471)</td>
<td>(10,143)</td>
</tr>
<tr>
<td>Net decrease in short-term borrowing</td>
<td>(5,949)</td>
<td>(1,722)</td>
</tr>
<tr>
<td>Repayments of other borrowings</td>
<td>(1,691)</td>
<td>(2,712)</td>
</tr>
<tr>
<td>Proceeds from the sale of subsidiary shares to non-controlling interest</td>
<td>251</td>
<td>—</td>
</tr>
<tr>
<td>Net cash used in financing activities</td>
<td>(72,736)</td>
<td>(25,953)</td>
</tr>
<tr>
<td>Effect of exchange rate changes on cash and cash equivalents</td>
<td>304</td>
<td>(1,968)</td>
</tr>
<tr>
<td>Net change in cash and cash equivalents</td>
<td>(118,961)</td>
<td>(14,219)</td>
</tr>
<tr>
<td>Cash and cash equivalents at the beginning of the period</td>
<td>293,322</td>
<td>223,783</td>
</tr>
<tr>
<td>Cash and cash equivalents at the end of the period</td>
<td>$ 174,361</td>
<td>$ 209,564</td>
</tr>
</tbody>
</table>

See accompanying notes to unaudited condensed consolidated financial statements.
Notes to Unaudited Condensed Consolidated Financial Statements

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

(1) General

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with United States (U.S.) generally accepted accounting principles (GAAP) and reflect all material normal recurring adjustments. However, certain information and footnote disclosures normally included in consolidated financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). In the opinion of management, the condensed consolidated financial statements include adjustments necessary for a fair presentation of the results of the interim periods presented. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes included in our Annual Report on Form 10-K for the fiscal year ended January 31, 2014.

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions 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. Actual results could differ from these estimates. Any changes in estimates will be reflected in the financial statements in future periods.

The condensed 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.

(2) Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU is based on the principle that the amount of revenue recognized should reflect the consideration an entity expects to be entitled to in exchange for the transfer of goods and services to customers. This ASU requires disclosures enabling users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The ASU also requires qualitative and quantitative disclosure about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. We will be required to implement this guidance in the first quarter of fiscal year 2018. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures. We have not yet selected a transition method, nor have we determined the effect of the standard on our ongoing financial reporting.

In April 2014, the FASB issued ASU 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. This ASU states that only disposals of components of an entity representing a strategic shift in operations that have or will have a major impact on operations and financial results will be presented as discontinued operations. This update requires the assets and liabilities of a discontinued operation to be presented separately in the statement of financial position for the current year and all prior periods presented. ASU 2014-08 is to be applied prospectively. We will be required to implement this guidance in the first quarter of fiscal year 2016. This update is not expected to have a material impact on our consolidated financial statements.

(3) Fair Value Measurement

The following table presents information about financial assets and liabilities measured at fair value on a recurring basis as of July 31, 2014:

<table>
<thead>
<tr>
<th>Description</th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contingent consideration</td>
<td>($4,561)</td>
<td>—</td>
<td>—</td>
</tr>
</tbody>
</table>

The following table presents information about financial assets and liabilities measured at fair value on a recurring basis as of January 31, 2014:
The FASB’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 July 31, 2014, of the total recorded balance, $1,663 was included in accrued and other liabilities and $2,898 was included in other long-term liabilities on our condensed consolidated balance sheet. 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 condensed 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 July 31, 2014 encompasses the following significant unobservable inputs:

<table>
<thead>
<tr>
<th>Unobservable Inputs</th>
<th>Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total estimated contingent consideration</td>
<td>$0 - $5,187</td>
</tr>
<tr>
<td>Discount rate</td>
<td>9.5% - 16.0%</td>
</tr>
<tr>
<td>Timing of cash flows (in years)</td>
<td>0 - 4</td>
</tr>
</tbody>
</table>

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 condensed consolidated statement of income in the period in which the change is identified.

The following table summarizes contingent consideration activity:

<table>
<thead>
<tr>
<th>Balance as of January 31, 2014</th>
<th>$ 4,571</th>
</tr>
</thead>
<tbody>
<tr>
<td>New contingent consideration</td>
<td>1,450</td>
</tr>
<tr>
<td>Payments</td>
<td>(1,514)</td>
</tr>
<tr>
<td>Interest accretion</td>
<td>54</td>
</tr>
<tr>
<td>Balance as of July 31, 2014</td>
<td>$ 4,561</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>As of</th>
<th>July 31, 2014</th>
<th>January 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of notes payable</td>
<td>$ 294,856</td>
<td>$ 306,535</td>
</tr>
<tr>
<td>Carrying value of notes payable</td>
<td>$ 227,276</td>
<td>$ 224,261</td>
</tr>
</tbody>
</table>

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 payable is derived from observable inputs including our stock price, stock volatility, and interest rate (Level 2). Of the
The total carrying value of notes payable, none was classified as current on our condensed consolidated balance sheet as of July 31, 2014 and January 31, 2014.

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) 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 is 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 during the six months ended July 31, 2014**

<table>
<thead>
<tr>
<th></th>
<th>Total Consideration</th>
<th>Net Tangible Assets Acquired</th>
<th>Identifiable Intangible Assets Acquired</th>
<th>Goodwill</th>
</tr>
</thead>
<tbody>
<tr>
<td>Berkeley Design Automation, Inc.</td>
<td>$51,303</td>
<td>$2,335</td>
<td>$24,770</td>
<td>$24,198</td>
</tr>
<tr>
<td>Other</td>
<td>39,094</td>
<td>1,606</td>
<td>12,540</td>
<td>24,948</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$90,397</strong></td>
<td><strong>$3,941</strong></td>
<td><strong>$37,310</strong></td>
<td><strong>$49,146</strong></td>
</tr>
</tbody>
</table>

On March 20, 2014, we acquired for cash all of the outstanding common shares of Berkeley Design Automation, Inc. (BDA), a leader in nanometer analog, mixed signal, and radio frequency circuit verification. The acquisition of BDA aligns with Mentor's goal to deliver technologies with superior performance and automation for the growing challenges of Analog/Mixed-Signal verification. The total cash consideration consisted of $46,832 paid during the six months ended July 31, 2014 and a deferred payment valued at $4,471.

The identified intangible assets acquired consisted of purchased technology with a fair value of $11,200 and other intangibles with a fair value of $13,570. The fair values of the identified intangible assets were valued using an income approach with significant unobservable inputs (Level 3). The significant unobservable inputs include annual revenue derived from each identified intangible asset and a selected discount rate of 15%. We are amortizing purchased technology to cost of revenues over five years and other intangibles to operating expenses over two to five years. The goodwill created by the transaction is not deductible for tax purposes. Key factors that make up the goodwill created by the transaction include expected synergies from the combination of operations and products and the knowledge and experience of the acquired workforce.

Other acquisitions for the six months ended July 31, 2014 consisted of two privately-held companies which were accounted for as business combinations. These acquisitions were not material individually or in the aggregate.

The separate results of operations for the acquisitions during the six months ended July 31, 2014 were not material, individually or in the aggregate, compared to our overall results of operations and accordingly pro forma financial statements of the combined entities have been omitted.

(5) 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 July 31, 2014    January 31, 2014
Trade accounts receivable  $112,530  $179,830
Term receivables, short-term  $311,169  $274,653
Term receivables, long-term  $236,743  $270,365

Trade accounts receivable include billed amounts whereas term receivables, short-term are 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 customers’ most recent financial statements. We determine whether or not to extend credit to these customers based on the results of our internal credit assessment, thus, mitigating our risk of loss.

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

<table>
<thead>
<tr>
<th>As of</th>
<th>July 31, 2014</th>
<th>January 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>S&amp;P credit rating:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AAA+ through BBB-</td>
<td>$137,088</td>
<td>$180,113</td>
</tr>
<tr>
<td>BB+ and lower</td>
<td>$28,091</td>
<td>29,654</td>
</tr>
<tr>
<td>Internal credit assessment</td>
<td>71,564</td>
<td>60,598</td>
</tr>
<tr>
<td>Total long-term term receivables</td>
<td>$236,743</td>
<td>$270,365</td>
</tr>
</tbody>
</table>

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.

We reduced our allowance for doubtful accounts during the six months ended July 31, 2014 by $1,691, to reflect a change in estimate of our unspecified reserves resulting from sustained low write-off experience and strong collections. The adjustment was recorded in marketing and selling expense in our results of operations.

The following shows the change in allowance for doubtful accounts:

<table>
<thead>
<tr>
<th>Allowance for doubtful accounts</th>
<th>Beginning balance</th>
<th>Expense adjustment</th>
<th>Other deductions(1)</th>
<th>Ending balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Six months ended July 31, 2014</td>
<td>$5,469</td>
<td>$(1,951)</td>
<td>$(224)</td>
<td>$3,294</td>
</tr>
<tr>
<td>Six months ended July 31, 2013</td>
<td>$5,331</td>
<td>$(331)</td>
<td>$(186)</td>
<td>$4,814</td>
</tr>
</tbody>
</table>

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

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 $11,405 for the six months ended July 31, 2014.
compared to $9,578 for the six months ended July 31, 2013. Amounts collected from customers on accounts receivable previously sold on a non-recourse basis to financial institutions are included in short-term borrowings on the balance sheet. These amounts are remitted to the financial institutions in the month following quarter-end.

(6) **Short-Term Borrowings**

We have a syndicated, senior, unsecured, revolving credit facility, which expires on 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. 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. We had no borrowings against the revolving credit facility during the six months ended July 31, 2014 and 2013.

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 of $50,000 plus 70% of our cumulative net income for the periods after January 31, 2011.

We were in compliance with all financial covenants as of July 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.

(7) **Notes Payable**

We have no long-term obligations maturing within the next five years. Our 4.00% Convertible Subordinated Debentures are due 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% Convertible Subordinated Debentures (4.00% Debentures) due 2031 in a private placement pursuant to the SEC Rule 144A under the Securities Act of 1933. Interest on the 4.00% Debentures is payable semi-annually in April and October.

As of July 31, 2014, each one thousand dollars in principal amount of the 4.00% Debentures is convertible, under certain circumstances, into 49.365 shares of our common stock (equivalent to a conversion price of $20.26 per share) for a total of 12,489 shares. The circumstances for conversion include:

- The market price of our common stock exceeding 120.0% of the conversion price, or $24.31 per share as of July 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.

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 fiscal year ended January 31, 2014 and the six months ended July 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 49.365 shares of our common stock for each one thousand dollars in principal amount of the 4.00% Debentures (equivalent to a conversion price of $20.26 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:

<table>
<thead>
<tr>
<th>Period</th>
<th>Redemption Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning on April 5, 2016 and ending on March 31, 2017</td>
<td>101.143%</td>
</tr>
<tr>
<td>Beginning on April 1, 2017 and ending on March 31, 2018</td>
<td>100.571%</td>
</tr>
<tr>
<td>On April 1, 2018 and thereafter</td>
<td>100.000%</td>
</tr>
</tbody>
</table>

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 that the debt may be settled 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:

<table>
<thead>
<tr>
<th>As of</th>
<th>July 31, 2014</th>
<th>January 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal amount</td>
<td>$253,000</td>
<td>$253,000</td>
</tr>
<tr>
<td>Unamortized debt discount</td>
<td>(25,724)</td>
<td>(28,739)</td>
</tr>
<tr>
<td>Net carrying amount of the liability component</td>
<td>$227,276</td>
<td>$224,261</td>
</tr>
<tr>
<td>Equity component</td>
<td>$43,930</td>
<td>$43,930</td>
</tr>
</tbody>
</table>

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 condensed consolidated statement of income related to the 4.00% Debentures:

| | Three months ended July 31, | Six months ended July 31, |
| | 2014 | 2013 | 2014 | 2013 |
| Interest expense at the contractual interest rate | $2,530 | $2,530 | $5,060 | $5,060 |
| Amortization of debt discount | $1,521 | $1,416 | $3,015 | $2,807 |

The effective interest rate on the 4.00% Debentures was 7.25% for the six months ended July 31, 2014 and 2013.

(8) Commitments and Contingencies

Indemnifications

Our license and services agreements generally include a limited indemnification provision for claims from third parties relating to our intellectual property (IP). 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 July 31, 2014, we were not aware of any material liabilities arising from these indemnification obligations.
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 IP 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, Inc. (Synopsys) filed a lawsuit claiming patent infringement against us in federal district court in the Northern District of California, alleging that our Velocé® 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 Velocé family of products infringes on two additional Synopsys United States patents. The California case seeks compensatory damages relating to our emulation and field programmable gate arrays synthesis products; Synopsys' Oregon claims have been dismissed.

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 litigation, which now alleges that EVE's Zebu emulation products infringe on one of our United States patents, was filed against EVE in federal district court in Oregon. We also filed a patent lawsuit against EVE in Tokyo district court. Our lawsuits in Oregon and Japan seek compensatory damages and an injunction against the sale of EVE emulation products. The Oregon litigation currently is scheduled for trial in September 2014, with the Japanese litigation scheduled for trial in October 2014. The California litigation is scheduled for trial in January 2015. 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.

Stockholders' Equity

Dividends

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

<table>
<thead>
<tr>
<th>Declaration Date</th>
<th>Record Date</th>
<th>Payment Date</th>
<th>Per Share</th>
<th>Total Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>3/7/2013</td>
<td>3/22/2013</td>
<td>4/10/2013</td>
<td>$0.045</td>
<td>$5,064</td>
</tr>
<tr>
<td>5/23/2013</td>
<td>6/10/2013</td>
<td>7/1/2013</td>
<td>$0.045</td>
<td>$5,079</td>
</tr>
<tr>
<td>8/22/2013</td>
<td>9/10/2013</td>
<td>9/30/2013</td>
<td>$0.045</td>
<td>$5,096</td>
</tr>
<tr>
<td>11/21/2013</td>
<td>12/10/2013</td>
<td>1/2/2014</td>
<td>$0.045</td>
<td>$5,159</td>
</tr>
<tr>
<td>2/27/2014</td>
<td>3/10/2014</td>
<td>3/31/2014</td>
<td>$0.05</td>
<td>$5,778</td>
</tr>
<tr>
<td>5/22/2014</td>
<td>6/10/2014</td>
<td>6/30/2014</td>
<td>$0.05</td>
<td>$5,693</td>
</tr>
<tr>
<td>8/21/2014</td>
<td>9/10/2014</td>
<td>9/30/2014</td>
<td>$0.05</td>
<td></td>
</tr>
</tbody>
</table>

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.

Stock-Based Compensation
Stock Option 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 time-based 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. Performance-based restricted stock units vest after three years depending on attainment of goals for operating income margin.

Employee Stock Purchase Plans

We have an employee stock purchase plan (ESPP) for U.S. employees and an ESPP for certain foreign subsidiary employees. The ESPPs 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 (subject to a plan limit on the total fair market value) at prices no less than 85.0% of the lesser of the fair market value of the shares on the offering date or on the purchase date.

Stock-Based Compensation Expense

The following table summarizes stock-based compensation expense recognized:

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31, 2014</th>
<th>Three months ended July 31, 2013</th>
<th>Six months ended July 31, 2014</th>
<th>Six months ended July 31, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of revenues</td>
<td>$544</td>
<td>$458</td>
<td>$1,079</td>
<td>$918</td>
</tr>
<tr>
<td>Operating expenses:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Research and development</td>
<td>3,311</td>
<td>2,543</td>
<td>6,552</td>
<td>5,153</td>
</tr>
<tr>
<td>Marketing and selling</td>
<td>2,143</td>
<td>1,771</td>
<td>4,321</td>
<td>3,653</td>
</tr>
<tr>
<td>General and administration</td>
<td>3,162</td>
<td>2,505</td>
<td>5,337</td>
<td>4,119</td>
</tr>
<tr>
<td>Equity plan-related compensation expense</td>
<td>$9,160</td>
<td>$7,277</td>
<td>$17,289</td>
<td>$13,843</td>
</tr>
</tbody>
</table>

(11) 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 Incentive 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 Incentive 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.

(12) 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 common shares issuable upon
vesting of restricted stock units, exercise of stock options and ESPP purchase rights, and conversion of the 4.00% Debentures using the treasury stock method, if dilutive.

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

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31</th>
<th>Six months ended July 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net income attributable to Mentor Graphics shareholders</td>
<td>$14,172</td>
<td>$11,621</td>
</tr>
<tr>
<td>Noncontrolling interest adjustment to redemption value</td>
<td>$23,982</td>
<td>$24,187</td>
</tr>
<tr>
<td>Adjusted net income attributable to Mentor Graphics shareholders</td>
<td>$15,067</td>
<td>$13,183</td>
</tr>
<tr>
<td>Weighted average common shares used to calculate basic net income per share</td>
<td>113,868</td>
<td>114,396</td>
</tr>
<tr>
<td>Employee stock options, restricted stock units and employee stock purchase plan</td>
<td>3,307</td>
<td>3,163</td>
</tr>
<tr>
<td>Weighted average common and potential common shares used to calculate diluted net income per share</td>
<td>116,551</td>
<td>116,960</td>
</tr>
<tr>
<td>Net income per share attributable to Mentor Graphics shareholders:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic net income per share</td>
<td>$0.13</td>
<td>$0.12</td>
</tr>
<tr>
<td>Diluted net income per share</td>
<td>$0.13</td>
<td>$0.11</td>
</tr>
</tbody>
</table>

We excluded from the computation of diluted net income per share 20 shares of common stock for stock options for the three months ended July 31, 2014 and 701 shares of common stock for stock options and ESPP purchase rights for the six months ended July 31, 2014 compared to 531 shares of common stock for stock options for the three months ended July 31, 2013 and 674 shares of common stock for stock options, restricted stock units and ESPP purchase rights for the six months ended July 31, 2013. These 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 increased the numerator of our basic and diluted earnings per share calculation by $895 for the three months ended July 31, 2014 and $1,562 for the six months ended July 31, 2014 for the decrease of the noncontrolling interest with redemption feature to its calculated redemption value, recorded directly to retained earnings. We decreased the numerator of our basic and diluted earnings per share calculation by $(2,349) for the three months ended July 31, 2013 and $(1,881) for the six months ended July 31, 2013 for the increase of the noncontrolling interest with redemption feature to its calculated redemption value, recorded directly to retained earnings.

We assume that the 4.00% Debentures will be settled in common stock for purposes of calculating their dilutive effect. The assumed conversion of the 4.00% Debentures was anti-dilutive and therefore excluded from the computation of diluted net income per share. The conversion feature of the 4.00% Debentures, which allow for settlement in cash or a combination of cash and common stock, are further described in Note 7. “Notes Payable.”

(13) Accumulated Other Comprehensive Income

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

<table>
<thead>
<tr>
<th>As of</th>
<th>July 31, 2014</th>
<th>January 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign currency translation adjustment</td>
<td>$17,653</td>
<td>$18,361</td>
</tr>
<tr>
<td>Unrealized gain (loss) on derivatives</td>
<td>(24)</td>
<td>42</td>
</tr>
<tr>
<td>Pension liability</td>
<td>396</td>
<td>400</td>
</tr>
<tr>
<td>Total accumulated other comprehensive income</td>
<td>$18,025</td>
<td>$18,803</td>
</tr>
</tbody>
</table>

(14) Special Charges

The following is a summary of the components of special charges:
### Litigation costs

Litigation costs consist of professional service fees for services rendered, related to patent litigation involving us, EVE, and Synopsys regarding emulation technology.

### Employee severance and related costs

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 65% of the employee severance and related costs for the six months ended July 31, 2014 were paid during the period. We expect to pay the remainder during the fiscal year ending January 31, 2015. Substantially all of the employee severance and related costs for the six months ended July 31, 2013 were paid during the fiscal year ending January 31, 2014. There were no significant modifications to the amount of those charges.

### Accrued special charges

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

<table>
<thead>
<tr>
<th></th>
<th>Accrued special charges as of January 31, 2014</th>
<th>Charges during the six months ended July 31, 2014</th>
<th>Payments during the six months ended July 31, 2014</th>
<th>Accrued special charges as of July 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Litigation costs</td>
<td>$4,855</td>
<td>$8,189</td>
<td>$(9,556)</td>
<td>$3,488</td>
</tr>
<tr>
<td>Employee severance and related costs</td>
<td>1,004</td>
<td>1,700</td>
<td>$(1,987)</td>
<td>717</td>
</tr>
<tr>
<td>Other costs, net</td>
<td>1,987</td>
<td>1,145</td>
<td>$(2,018)</td>
<td>1,114</td>
</tr>
<tr>
<td>Total accrued special charges</td>
<td>$7,846</td>
<td>$11,034</td>
<td>$(13,561)</td>
<td>$5,319</td>
</tr>
</tbody>
</table>

(1) Of the $5,319 total accrued special charges as of July 31, 2014, $422 represents the long-term portion, which primarily includes accrued lease termination fees and other facility costs, net of sublease income and other long-term costs. The remaining balance of $4,897 represents the short-term portion of accrued special charges.

### Other Income (Expense), Net

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

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31, 2014</th>
<th>Six months ended July 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest income</td>
<td>$397</td>
<td>$530</td>
</tr>
<tr>
<td>Foreign currency exchange loss</td>
<td>(193)</td>
<td>(494)</td>
</tr>
<tr>
<td>Other, net</td>
<td>(308)</td>
<td>(308)</td>
</tr>
<tr>
<td>Other income (expense), net</td>
<td>$(104)</td>
<td>$(272)</td>
</tr>
</tbody>
</table>

### Related Party Transactions

Certain members of our Board of Directors also serve as executive 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. We had
amounts receivable from these customers of $45,552 as of July 31, 2014 and $95,789 as of January 31, 2014. The following table shows revenue recognized from these customers:

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31</th>
<th>Six months ended July 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
<td>2013</td>
</tr>
<tr>
<td>Revenues from customers</td>
<td>$5,105</td>
<td>$7,801</td>
</tr>
<tr>
<td>Percentage of total revenues</td>
<td>2.0%</td>
<td>3.1%</td>
</tr>
</tbody>
</table>

(17) **Income Taxes**

The provision for income taxes was comprised of the following:

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31</th>
<th>Six months ended July 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
<td>2013</td>
</tr>
<tr>
<td>Income tax benefit</td>
<td>$ (1,768)</td>
<td>$ (2,338)</td>
</tr>
<tr>
<td>Effective tax rate</td>
<td>(14.7)%</td>
<td>(10.9)%</td>
</tr>
</tbody>
</table>

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. Accounting guidance for interim reporting requires that we evaluate our provision for income tax expense (benefit) based on our projected results of operations for the full year and record adjustments in each quarter. Such adjustments consider period specific items and a separate determination of tax expense for entities in our consolidated group that are projected to have losses for which no tax benefit will be recognized.

Our effective tax rate is (22.1)% for the six months ended July 31, 2014, after the inclusion of $(3,174) in net favorable period specific items. The period specific items primarily relate to reductions in liabilities for uncertain tax positions. For our full year forecast, we have projected a 10.0% effective tax rate. This rate is inclusive of period specific items recognized through July 31, 2014. Our projected rate for the full year differs from tax computed at the U.S. federal statutory rate of 35.0% primarily due to:

- The benefit of lower tax rates on earnings of foreign subsidiaries;
- Reduction in liabilities for uncertain tax positions; and
- Forecasted utilization of net operating loss carryforwards and tax credit carryforwards for which no previous benefit was recognized.

These differences are partially offset by:

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

Actual results may differ significantly from our current projections. Further, our effective tax rate could fluctuate considerably on a quarterly basis and could be significantly affected to the extent our actual mix of earnings among individual jurisdictions is different than our expectations.

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 carryforwards. We calculate the deferred tax assets and liabilities using the enacted tax rates and laws 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 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 will continue to evaluate the realizability of the deferred tax assets on a periodic basis.

As of July 31, 2014, we had a liability of $17,937 for income taxes associated with uncertain income tax positions. Of this liability, $372 was classified as short-term liabilities in income taxes payable in our condensed consolidated balance sheet as we generally anticipate the settlement of such liabilities will require payment of cash within the next twelve months. The
remaining $17,565 of income tax associated with uncertain tax positions was classified as long-term liabilities. Certain liabilities may result in the reduction of deferred tax assets rather than settlement in cash. We are not able to reasonably estimate the timing of any cash payments required to settle the long-term liabilities and do not believe that the ultimate settlement of these liabilities will materially affect our liquidity.

(18) Supplemental Cash Flow Information

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

<table>
<thead>
<tr>
<th>Cash paid, net for:</th>
<th>Six months ended July 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
</tr>
<tr>
<td>Interest</td>
<td>$ 5,865</td>
</tr>
<tr>
<td>Income taxes</td>
<td>$ 6,408</td>
</tr>
</tbody>
</table>

We have an investment in Frontline PCB Solutions Limited Partnership (Frontline). We received returns on investment from Frontline of $2,900 during the six months ended July 31, 2014 and $2,800 during the six months ended July 31, 2013, which is included in net cash provided by operating activities in our condensed consolidated statement of cash flows.

(19) 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 related to operations in the geographic regions were:

<table>
<thead>
<tr>
<th>Revenues:</th>
<th>Three months ended July 31,</th>
<th>Six months ended July 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
<td>2013</td>
</tr>
<tr>
<td>United States</td>
<td>$ 111,692</td>
<td>$ 91,527</td>
</tr>
<tr>
<td>Europe</td>
<td>55,462</td>
<td>45,701</td>
</tr>
<tr>
<td>Japan</td>
<td>20,973</td>
<td>16,477</td>
</tr>
<tr>
<td>Pacific Rim</td>
<td>62,963</td>
<td>94,451</td>
</tr>
<tr>
<td>Other</td>
<td>9,143</td>
<td>5,060</td>
</tr>
<tr>
<td>Total revenues</td>
<td>$ 260,233</td>
<td>$ 253,216</td>
</tr>
</tbody>
</table>

For the three months ended July 31, 2014, no customer accounted for 10.0% or more of our total revenues. For the three months ended July 31, 2013, two customers each accounted for 13.0% of our total revenues. For the six months ended July 31, 2014, one customer accounted for 11.0% of our total revenues. For the six months ended July 31, 2013, no single customer accounted for 10.0% or more of our total revenues.
Management’s Discussion and Analysis of Financial Condition and Results of Operations

Overview

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

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

The Company

We are a supplier of electronic design automation (EDA) 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/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, product development, and professional service offices worldwide.

We 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. 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 additional purchases under 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 30% 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 first six months of fiscal 2015 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 the first six months of fiscal 2015 decreased by approximately 30% compared to the first six months of fiscal 2014 primarily due to a decrease in emulation bookings. 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 accounted for approximately 35% of total bookings for the first six months of fiscal 2015 compared to 65% for the first six months of fiscal 2014. The number of new customers during the first six months of fiscal 2015 increased approximately 10% from the levels experienced during the first six months of fiscal 2014.

**Product Development**

During the first six months of fiscal 2015, 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 first six months of fiscal 2015, we introduced new products and upgrades to existing products and did not have any significant products reaching the end of their useful economic life.

**Critical Accounting Policies**

We base our discussion and analysis of our financial condition and results of operations upon our condensed 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 revenue recognition, valuation of trade accounts receivable, income taxes, business combinations, 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 condensed consolidated financial statements. For further discussion of our critical accounting policies, see Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies” in Part II of our Annual Report on Form 10-K for the year ended January 31, 2014.
RESULTS OF OPERATIONS

Revenues and Gross Profit

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31, 2014</th>
<th>Change</th>
<th>Six months ended July 31, 2014</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>System and software revenues</td>
<td>$149.5</td>
<td>—%</td>
<td>$297.7</td>
<td>9%</td>
</tr>
<tr>
<td>System and software gross profit</td>
<td>$131.5</td>
<td>(2)%</td>
<td>$251.3</td>
<td>2%</td>
</tr>
<tr>
<td>Gross profit percent</td>
<td>88%</td>
<td>89%</td>
<td>84%</td>
<td>90%</td>
</tr>
<tr>
<td>Service and support revenues</td>
<td>$110.7</td>
<td>7%</td>
<td>$214.7</td>
<td>4%</td>
</tr>
<tr>
<td>Service and support gross profit</td>
<td>$79.8</td>
<td>8%</td>
<td>$154.7</td>
<td>5%</td>
</tr>
<tr>
<td>Gross profit percent</td>
<td>72%</td>
<td>72%</td>
<td>72%</td>
<td>71%</td>
</tr>
<tr>
<td>Total revenues</td>
<td>$260.2</td>
<td>3%</td>
<td>$512.4</td>
<td>7%</td>
</tr>
<tr>
<td>Total gross profit</td>
<td>$211.3</td>
<td>1%</td>
<td>$406.0</td>
<td>3%</td>
</tr>
<tr>
<td>Gross profit percent</td>
<td>81%</td>
<td>82%</td>
<td>79%</td>
<td>82%</td>
</tr>
</tbody>
</table>

System and Software

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31, 2014</th>
<th>Change</th>
<th>Six months ended July 31, 2014</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upfront license revenues</td>
<td>$124.9</td>
<td>(2)%</td>
<td>$249.7</td>
<td>10%</td>
</tr>
<tr>
<td>Ratable license revenues</td>
<td>$24.6</td>
<td>9%</td>
<td>$48.0</td>
<td>5%</td>
</tr>
<tr>
<td>Total system and software revenues</td>
<td>$149.5</td>
<td>—%</td>
<td>$297.7</td>
<td>9%</td>
</tr>
</tbody>
</table>

We derive system and software revenues from the sale of licenses of software products and emulation hardware systems, including finance fee revenues from our long-term installment receivables resulting from term 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 term 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 and finance fees from the accretion of the discount on long-term installment receivables.

Ten customers accounted for approximately 55% of system and software revenues for the three months ended July 31, 2014 and 45% for the six months ended July 31, 2014 compared to approximately 70% for the three months ended July 31, 2013 and 55% for the six months ended July 31, 2013.

System and software revenues increased for the six months ended July 31, 2014 compared to the six months ended July 31, 2013 primarily as a result of increased sales of emulation hardware systems.

For the three months ended July 31, 2014, no single customer accounted for 10% or more of total revenues. For the three months ended July 31, 2013, two customers each accounted for 13% of total revenues. For the six months ended July 31, 2014, one customer accounted for 11% of total revenues. For the six months ended July 31, 2013, no single customer accounted for 10% or more of total revenues.

System and software gross profit percent was lower for the six months ended July 31, 2014 compared to the six months ended July 31, 2013 primarily due to increased sales of lower-margin emulation hardware systems.

Service and Support

We derive service and support revenues from software and hardware post-contract maintenance or support services and professional services, which include consulting, training, and other services. Professional services are lower margin offerings which are staffed according to fluctuations in demand. Support services operate under a less variable cost structure.

The increase in service and support revenues for the three and six months ended July 31, 2014 compared to the three and six months ended July 31, 2013 was primarily due to increased support revenues resulting from an increase in our installed base.
**Geographic Revenues Information**

**Revenue by Geography**

<table>
<thead>
<tr>
<th>Region</th>
<th>Three months ended July 31, 2014</th>
<th>Change</th>
<th>Six months ended July 31, 2014</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>$120.8</td>
<td>25%</td>
<td>$96.6</td>
<td>22%</td>
</tr>
<tr>
<td>Europe</td>
<td>55.4</td>
<td>21%</td>
<td>45.7</td>
<td>22%</td>
</tr>
<tr>
<td>Japan</td>
<td>21.0</td>
<td>27%</td>
<td>16.5</td>
<td>(2)%</td>
</tr>
<tr>
<td>Pacific Rim</td>
<td>63.0</td>
<td>(33)%</td>
<td>94.4</td>
<td>(27)%</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td><strong>$260.2</strong></td>
<td><strong>3%</strong></td>
<td><strong>$253.2</strong></td>
<td><strong>7%</strong></td>
</tr>
</tbody>
</table>

The changes in revenues in all geographic regions for the three months ended July 31, 2014 compared to the three months ended July 31, 2013 were primarily due to the timing of contract renewals. The changes in revenues in North America and Europe for the six months ended July 31, 2014 compared to the six months ended July 31, 2013 were primarily due to increased sales of emulation hardware systems and the timing of contract renewals. The change in revenues in the Pacific Rim for the six months ended July 31, 2014 compared to the six months ended July 31, 2013 was primarily due to the timing 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 the three and six months ended July 31, 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.

Foreign currency had a nominal impact for the three months ended July 31, 2014 compared to the three months ended July 31, 2013, as the unfavorable impact of the weak Japanese yen was offset by the favorable impact of the strong euro. Foreign currency had an unfavorable impact of $1.6 for the six months ended July 31, 2014 compared to the six months ended July 31, 2013, primarily as a result of the strengthening of the U.S. dollar against the Japanese yen, partially offset by the favorable impact of the strengthening of the euro against the U.S. dollar.

For additional description of how changes in foreign exchange rates affect our condensed consolidated financial statements, see discussion in Part I, “Item 3. 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%):

<table>
<thead>
<tr>
<th>Category</th>
<th>Three months ended July 31, 2014</th>
<th>Three months ended July 31, 2013</th>
<th>Six months ended July 31, 2014</th>
<th>Six months ended July 31, 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>IC Design to Silicon</td>
<td>30%</td>
<td>50%</td>
<td>25%</td>
<td>45%</td>
</tr>
<tr>
<td>Scalable Verification</td>
<td>25%</td>
<td>20%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>Integrated System Design</td>
<td>25%</td>
<td>20%</td>
<td>25%</td>
<td>25%</td>
</tr>
<tr>
<td>New &amp; Emerging Products</td>
<td>10%</td>
<td>5%</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>Services &amp; Other</td>
<td>10%</td>
<td>5%</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td><strong>100%</strong></td>
<td><strong>100%</strong></td>
<td><strong>100%</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>
**Operating Expenses**

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31</th>
<th></th>
<th></th>
<th>Six months ended July 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
<td>Change</td>
<td>2013</td>
<td>2014</td>
<td>Change</td>
<td>2013</td>
</tr>
<tr>
<td>Research and development</td>
<td>$87.5</td>
<td>9%</td>
<td>$80.3</td>
<td>$172.0</td>
<td>8%</td>
<td>$160.0</td>
</tr>
<tr>
<td>Marketing and selling</td>
<td>82.3</td>
<td>3%</td>
<td>79.8</td>
<td>166.9</td>
<td>5%</td>
<td>158.9</td>
</tr>
<tr>
<td>General and administration</td>
<td>19.5</td>
<td>13%</td>
<td>17.2</td>
<td>37.2</td>
<td>11%</td>
<td>33.5</td>
</tr>
<tr>
<td>Equity in earnings of Frontline</td>
<td>(2.0)</td>
<td>100%</td>
<td>(1.0)</td>
<td>(3.4)</td>
<td>162%</td>
<td>(1.3)</td>
</tr>
<tr>
<td>Amortization of intangible assets</td>
<td>2.0</td>
<td>25%</td>
<td>1.6</td>
<td>3.8</td>
<td>19%</td>
<td>3.2</td>
</tr>
<tr>
<td>Special charges</td>
<td>5.1</td>
<td>31%</td>
<td>3.9</td>
<td>11.0</td>
<td>39%</td>
<td>7.9</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>$194.4</td>
<td>7%</td>
<td>$181.8</td>
<td>$387.5</td>
<td>7%</td>
<td>$362.2</td>
</tr>
</tbody>
</table>

**Selected Operating Expenses as a Percentage of Total Revenues**

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31</th>
<th></th>
<th></th>
<th>Six months ended July 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
<td></td>
<td>2013</td>
<td>2014</td>
<td></td>
<td>2013</td>
</tr>
<tr>
<td>Research and development</td>
<td>34%</td>
<td></td>
<td>32%</td>
<td>34%</td>
<td></td>
<td>33%</td>
</tr>
<tr>
<td>Marketing and selling</td>
<td>32%</td>
<td></td>
<td>32%</td>
<td>33%</td>
<td></td>
<td>33%</td>
</tr>
<tr>
<td>General and administration</td>
<td>7%</td>
<td></td>
<td>7%</td>
<td>7%</td>
<td></td>
<td>7%</td>
</tr>
<tr>
<td>Total selected operating expenses</td>
<td>73%</td>
<td></td>
<td>71%</td>
<td>74%</td>
<td></td>
<td>73%</td>
</tr>
</tbody>
</table>

**Research and Development**

Research and development expenses increased by $7.2 for the three months ended July 31, 2014 compared to the three months ended July 31, 2013 and $12.0 for the six months ended July 31, 2014 compared to the six months ended July 31, 2013. The components of this increase are summarized as follows:

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31</th>
<th></th>
<th></th>
<th>Six months ended July 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries, variable compensation, and benefits expenses</td>
<td>$2.8</td>
<td>$5.1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenses associated with acquired businesses</td>
<td>3.8</td>
<td>6.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other expenses</td>
<td>0.6</td>
<td>0.9</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total change in research and development expenses</td>
<td>$7.2</td>
<td>$12.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Marketing and Selling**

Marketing and selling expenses increased by $2.5 for the three months ended July 31, 2014 compared to the three months ended July 31, 2013 and increased by $8.0 for the six months ended July 31, 2014 compared to the six months ended July 31, 2013. The components of these changes are summarized as follows:

<table>
<thead>
<tr>
<th></th>
<th>Three months ended July 31</th>
<th></th>
<th></th>
<th>Six months ended July 31</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries, variable compensation, and benefits expenses</td>
<td>$ (0.3)</td>
<td></td>
<td>$4.3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenses associated with acquired businesses</td>
<td>1.6</td>
<td>2.4</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bad debt expense</td>
<td>(0.2)</td>
<td></td>
<td>(1.5)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other expenses</td>
<td>1.4</td>
<td>2.8</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total change in marketing and selling expenses</td>
<td>$2.5</td>
<td>$8.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**General and Administration**

General and administration expenses increased by $2.3 for the three months ended July 31, 2014 compared to the three months ended July 31, 2013 and $3.6 for the six months ended July 31, 2014 compared to the six months ended July 31, 2013.
Salaries, variable compensation, and benefits expenses  
| | Three months ended July 31, | Six months ended July 31, |
| | $ | 0.6 | $ | 0.7 |

Professional services  
0.9  
1.2

Stock compensation  
0.7  
1.2

Other expenses  
0.1  
0.5

Total change in general and administrative expenses  
$ | 2.3  | $ | 3.6 |

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. We experienced unfavorable currency movements in total operating expenses of approximately $(1.7) for the three months ended July 31, 2014 compared to the three months ended July 31, 2013, and approximately $(1.2) for the six months ended July 31, 2014 compared to the six months ended July 31, 2013. The impact of these currency movements is reflected in the changes 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; therefore 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 three and six months ended June 30, 2014 and 2013:

| | Three months ended June 30, | Six months ended June 30, |
| | 2014 | 2013 | 2014 | 2013 |
| Net income, as reported | $ | 2.0 | $ | 1.2 | $ | 3.5 | $ | 2.3 |
| Amortization of purchased technology and other identified intangible assets | — | (0.2) | (0.1) | (1.0) |
| Equity in earnings of Frontline | $ | 2.0 | $ | 1.0 | $ | 3.4 | $ | 1.3 |

**Special Charges**

| | Three months ended July 31, | Six months ended July 31, |
| | 2014 | Change | 2013 | | 2014 | Change | 2013 |
| Litigation costs | $ | 4.2 | 27% | $ | 3.3 | | $ | 8.2 | 58% | $ | 5.2 |
| Employee severance and related costs | 0.6 | —% | 0.6 | 1.7 | (37)% | 2.7 |
| Other costs, net | 0.3 | —% | — | 1.1 | —% | — |
| Total special charges | $ | 5.1 | 31% | $ | 3.9 | | $ | 11.0 | 39% | $ | 7.9 |

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, Emulation and Verification Engineering S.A. and EVE-USA, Inc. (together EVE), and Synopsys, Inc. regarding emulation technology.

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.

**Provision for Income Taxes**
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. The provision considers that a significant amount of our earnings are in certain foreign operations, including our Irish subsidiaries. Accounting guidance for interim reporting requires that we evaluate our provision for income tax expense (benefit) based on our projected results of operations for the full year, and record adjustments in each quarter. Such adjustments consider period specific items and a separate determination of tax expense for entities in our consolidated group that are projected to have losses for which no tax benefit will be recognized.

For the six months ended July 31, 2014, we have a 14% effective tax rate without period specific items. This current period effective tax rate differs from our effective tax rate for the six months ended July 31, 2013 due to the application of the accounting guidance for interim periods with respect to jurisdictions with projected losses before tax for which no tax benefits will be recognized and the variability in the mix of profits and losses earned in various tax jurisdictions with a broad range of income tax rates.

For our full year forecast, we have projected a 10% effective tax rate. This rate is inclusive of period specific items recognized through July 31, 2014. Our projected rate differs from tax computed at the U.S. federal statutory rate of 35% primarily due to:

- The benefit of lower tax rates on earnings of foreign subsidiaries;
- Reduction in liabilities for uncertain tax positions; and
- Forecasted utilization of net operating loss carryforwards and tax credit carryforwards for which no benefit was previously recognized.

These differences are partially offset by:

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

We have not provided for income taxes on the undistributed earnings of our foreign subsidiaries to the extent they are considered permanently reinvested outside of the U.S. Upon repatriation, some of these earnings may be sheltered by U.S. loss carryforwards, research and development credits and foreign tax credits, which may reduce the federal tax liability associated with any future foreign dividend. Where the earnings of our foreign subsidiaries are not treated as permanently reinvested, we have considered the impact in our 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 varies 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 limitations 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 tax credit carryforwards from all years are subject to examination and adjustment for three years following the year in which they were 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 taxing authorities even though we believe that the positions we have taken are appropriate. We believe our tax reserves are adequate to cover potential liabilities. We review the tax reserves quarterly and as circumstances warrant and adjust
the reserves as events occur that affect our potential liability for additional taxes. Many of these events cannot be predicted, such as clarifications of tax law by administrative or judicial means, and it is often difficult to predict the final outcome or timing of resolution of any particular tax matter. To the extent that uncertain tax positions resolve in our favor, it could have a positive impact on our effective tax rate.

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 on 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 July 31, 2014, we have cash totaling $159.3 held by our foreign subsidiaries. A significant portion of our offshore cash is accessible without a significant tax cost as the repatriation of foreign earnings may be sheltered from U.S. federal tax by net operating losses and tax credits. 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 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 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. We monitor daily the cash balances in our operating accounts and adjust the cash balances as appropriate; however, 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 that we will be able to raise debt or equity capital on acceptable terms, if at all.

Cash Flow Information

<table>
<thead>
<tr>
<th></th>
<th>Six months ended July 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2014</td>
</tr>
<tr>
<td>Cash provided by operating activities</td>
<td>$ 38.6</td>
</tr>
<tr>
<td>Cash used in investing activities</td>
<td>$ (85.1)</td>
</tr>
<tr>
<td>Cash used in financing activities</td>
<td>$ (72.7)</td>
</tr>
</tbody>
</table>

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.

Trade Accounts and Term Receivables
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 consisted of the following:

<table>
<thead>
<tr>
<th>As of</th>
<th>July 31, 2014</th>
<th>January 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade accounts receivable, net</td>
<td>$ 423.7</td>
<td>$ 454.5</td>
</tr>
<tr>
<td>Term receivables, short-term</td>
<td>$ 311.2</td>
<td>$ 274.7</td>
</tr>
<tr>
<td>Term receivables, long-term</td>
<td>$ 236.7</td>
<td>$ 270.4</td>
</tr>
<tr>
<td>Average days sales outstanding</td>
<td>147 days</td>
<td>102 days</td>
</tr>
<tr>
<td>Average days sales outstanding</td>
<td>39 days</td>
<td>40 days</td>
</tr>
</tbody>
</table>

The increase in the average days sales outstanding in term receivables, short-term as of July 31, 2014, was primarily due to a decrease in revenue in the second quarter of fiscal 2015 compared to the fourth quarter of fiscal 2014.

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, on our balance sheet 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 $547.9 as of July 31, 2014 compared to $545.0 as of January 31, 2014.

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 $11.4 for the six months ended July 31, 2014 compared to $9.6 for the six months ended July 31, 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 the remainder of fiscal 2015.

**Accrued Payroll and Related Liabilities**

<table>
<thead>
<tr>
<th>As of</th>
<th>July 31, 2014</th>
<th>January 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accrued payroll and related</td>
<td>$ 51.5</td>
<td>$ 102.8</td>
</tr>
<tr>
<td>liabilities</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The decrease in accrued payroll and related liabilities as of July 31, 2014 compared to January 31, 2014 was primarily due to incentive payments made during fiscal 2015 on fiscal 2014 year-end accruals. We generally experience higher accrued payroll and related liability balances at year-end primarily due to increased commission accruals associated with an increase in revenues in the fourth quarter. Additionally, we generally experience an increase in variable compensation at year-end due to the full year achievement of results.

**Investing Activities**

Cash used in investing activities for the six months ended July 31, 2014 primarily consisted of cash paid for acquisitions of businesses and capital expenditures.

On March 20, 2014, we acquired for cash all of the outstanding common shares of Berkeley Design Automation, Inc. (BDA), a leader in nanometer analog, mixed signal, and radio frequency circuit verification for total consideration of $51.3, including current period cash payments of $46.8 ($45.5, net of $1.3 of acquired cash). The acquisition of BDA aligns with Mentor's goal to deliver technologies with superior performance and automation for the growing challenges of Analog/Mixed-Signal verification.

During the three months ended July 31, 2014, we acquired two privately-held companies which were accounted for as business combinations for total consideration of $39.1, including current period cash payments of $33.9 ($30.4, net of $3.5 of acquired...
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.

Expenditures for property, plant, and equipment were $13.3 for the six months ended July 31, 2014 compared to $13.8 for the six months ended July 31, 2013. The expenditures for property, plant, and equipment for the six months ended July 31, 2014 were primarily a result of spending on information technology and infrastructure improvements within facilities. We expect total capital expenditures for property, plant, and equipment for fiscal 2015 to be approximately $35.0. We plan to finance these capital expenditures using cash on hand.

**Financing Activities**

For the six months ended July 31, 2014, cash used in financing activities consisted primarily of repurchases of our common stock, a net decrease in short-term borrowings, and the payment of dividends.

In April 2014, our previous three-year share repurchase program expired. On June 12, 2014, we announced a new share repurchase program approved by our Board of Directors, authorizing the repurchase of up to $200 million of our common stock over a three-year period. During the six months ended July 31, 2014, we repurchased 3.2 shares of common stock for $70.1 under these programs. As of July 31, 2014, $175.0 remained available for purchase under the program approved in June 2014.

During the six months ended July 31, 2014, we paid two quarterly dividends of $0.05 per share of outstanding common stock for a total of $1.15. On August 21, 2014, we announced a quarterly dividend of $0.05 per share of outstanding common stock, payable on September 30, 2014 to shareholders of record as of the close of business on September 10, 2014. 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 combination of 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 $71.8 is available for common stock purchases or dividend payments under this limit as of July 31, 2014.

**Other factors affecting liquidity and capital resources**

*4.00% Convertible Subordinated Debentures due 2031*

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

As of July 31, 2014, each one thousand dollars in principal amount of the 4.00% Debentures is convertible, under certain circumstances, into 49.365 shares of our common stock (equivalent to a conversion price of $20.26 per share) for a total of 12.5 shares. These circumstances include:

- The market price of our common stock exceeding 120% of the conversion price, or $24.31 per share as of July 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.
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 the result of us declaring cash dividends during the fiscal year ended January 31, 2014 and the six months ended July 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 49.365 shares of our common stock for each one thousand dollars in principal amount of the 4.00% Debentures (equivalent to a conversion price of $20.26 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:

<table>
<thead>
<tr>
<th>Period</th>
<th>Redemption Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning on April 5, 2016 and ending on March 31, 2017</td>
<td>101.143%</td>
</tr>
<tr>
<td>Beginning on April 1, 2017 and ending on March 31, 2018</td>
<td>100.571%</td>
</tr>
<tr>
<td>On April 1, 2018 and thereafter</td>
<td>100.000%</td>
</tr>
</tbody>
</table>

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 7. “Notes Payable” in Part I, Item 1. “Financial Statements.”

Revolving Credit Facility

We have a revolving credit facility with a maximum borrowing capacity of $125.0, which expires on May 24, 2017. 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. 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. We had no borrowings against the revolving credit facility during the six months ended July 31, 2014 and 2013.

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 July 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.

For further information on our revolving credit facility, see Note 6. “Short-Term Borrowings” in Part I, Item 1. “Financial Statements.”

OUTLOOK FOR FISCAL 2015

We expect revenues for the third quarter of fiscal 2015 to be approximately $275.0 with earnings per share for the same period of approximately $0.07 per diluted share. For the full fiscal year 2015, we expect revenues of approximately $1.237 billion with earnings per share of $1.37 per diluted share.
Item 3.  Quantitative and Qualitative Disclosures about Market Risk

Unless otherwise indicated, all numerical references in tables 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 do not use derivative financial instruments for speculative or trading purposes.

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

The table below presents the carrying amount and related weighted-average fixed interest rates for our investment portfolio. The carrying amount approximates fair value as of July 31, 2014. In accordance with our investment policy, all short-term investments mature in twelve months or less.

<table>
<thead>
<tr>
<th>Principal (notional) amounts in United States dollars</th>
<th>Carrying Amount</th>
<th>Average Fixed Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash equivalents - fixed rate</td>
<td>$</td>
<td>4.8</td>
</tr>
</tbody>
</table>

We have convertible subordinated debentures with a principal balance of $253.0 outstanding with a fixed interest rate of 4.00% as of July 31, 2014 and July 31, 2013. Generally, interest rate changes for fixed rate debt affect the fair value of the debt 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. Under this 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 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. As of July 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, see Note 6, “Short-Term Borrowings” in Part I, Item 1. “Financial Statements.”

We had other short-term borrowings of $1.0 outstanding as of July 31, 2014 and $1.1 as of July 31, 2013 with variable rates based on market indexes. Interest rate changes for variable interest rate debt generally do not affect the fair market value, but do affect future earnings and cash flow.

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 monetary assets and liabilities.
The following table provides volume information about our foreign currency forward program. The information provided is in United States 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.

<table>
<thead>
<tr>
<th>As of</th>
<th>July 31, 2014</th>
<th>January 31, 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Gross Notional Amount</td>
<td>Weighted Average Contract Rate</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>$ 65.1</td>
<td>101.78</td>
</tr>
<tr>
<td>Euro</td>
<td>34.6</td>
<td>0.74</td>
</tr>
<tr>
<td>British pound</td>
<td>28.5</td>
<td>0.59</td>
</tr>
<tr>
<td>Indian rupee</td>
<td>15.0</td>
<td>60.38</td>
</tr>
<tr>
<td>Swedish krona</td>
<td>11.3</td>
<td>6.83</td>
</tr>
<tr>
<td>Other (1)</td>
<td>39.6</td>
<td>—</td>
</tr>
<tr>
<td>Total forward contracts</td>
<td>$ 194.1</td>
<td>$ 169.4</td>
</tr>
</tbody>
</table>

(1) Other includes the Israeli shekel, Chinese yuan, Canadian dollar, Armenian dollar, Russian ruble, Swiss franc, Korean won, Danish kroner, Norwegian kroner, Polish zloty, Taiwan dollar, Hungarian forint, and Singapore dollar.
Item 4. Controls and Procedures

(1) Evaluation of Disclosure Controls and Procedures

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

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

(2) Changes in Internal Controls Over Financial Reporting

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

Item 1. Legal Proceedings

In December 2012, Synopsys, Inc. (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. The California case seeks compensatory damages related to our emulation and field programmable gate arrays synthesis products; Synopsys' Oregon claims have been dismissed.

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 litigation, which now alleges that EVE’s Zebu emulation products infringe on one of our United States patents, was filed against EVE in federal district court in Oregon. We also filed a patent lawsuit against EVE in Tokyo district court. Our lawsuits in Oregon and Japan seek compensatory damages and an injunction against the sale of EVE emulation products. The Oregon litigation currently is scheduled for trial in September 2014, with the Japanese litigation scheduled for trial in October 2014. The California litigation is scheduled for trial in January 2015. 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 1A. Risk Factors

The forward-looking statements contained under “Outlook for Fiscal 2015” in Part I, Item 2., “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and all other statements contained in this report that are not statements of historical fact, including without limitation, statements containing the words “believes,” “expects,” “projections,” and words of similar meaning, constitute forward-looking statements that involve a number of risks and uncertainties that are difficult to predict. Moreover, from time to time, we may issue other forward-looking statements. Forward-looking statements regarding financial performance in future periods, including the statements under “Outlook for Fiscal 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.

Weakening 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 (EDA) software, hardware, and consulting services. Periods of economic uncertainty, such as the 2008 worldwide recession, weakness in the European Union related to 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 integrated circuit (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 and semiconductor equipment that have acquired or internally developed their own EDA products.

We may experience difficulty in manufacturing our emulation hardware.

We currently contract with 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 (PCBs); natural disasters such as weather or earthquakes; 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.

New conflict minerals regulations may cause us to incur additional expenses and may adversely impact our ability to conduct our business.

The Securities and Exchange Commission (SEC) has adopted disclosure rules for companies that use conflict minerals (commonly referred to as tantalum, tin, tungsten, and gold) in their products, with substantial supply chain verification requirements if the materials come from, or could have come from, the Democratic Republic of the Congo or adjoining countries. We have incurred and expect to continue to incur costs designing and implementing processes to discover the origin of the conflict minerals used in our hardware products. Implementing these requirements could affect the sourcing, availability and pricing of materials used in our hardware products as well as the companies we use to manufacture our products and their components. As a result, there may only be a limited pool of suppliers who provide conflict-free metals, and we cannot assure you that we will be able to obtain products in sufficient quantities or at competitive prices. The costs of complying with these laws could adversely affect our current or future business.

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 United States (U.S.) and we generate approximately 40% 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; issues relating to complying with complex customs regulations and paying customs duties and value added taxes; 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 (IP) rights. If we violate laws related to our business, we could be subject to penalties, fines, or other sanctions and could be prohibited or restricted 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
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.

**Pre-announcing products may adversely impact current sales.**

We or our competitors sometimes pre-announce or provide "road maps" of the expected availability of new hardware or software products or product features. Such pre-announcements, whether offered by the pre-announcing company or vendors of competitive products, can result in customers canceling or deferring orders for currently offered products as customers anticipate that currently offered products may be uncompetitive or lacking in features or performance. In the case of hardware products, slowing sales may cause inventories to increase or become obsolete and as a result the vendor may need to discount or reduce production of the current products.

**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.

**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 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 local or foreign tax authorities. The tax authorities in the countries where we do business regularly examine our income and other tax returns. The ultimate outcome of these examinations cannot be predicted with certainty.
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 (GAAP). 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.

Many of the countries where we are subject to taxes, such as the U.S. and numerous foreign jurisdictions, including France, Ireland, Israel, India and Japan, could have significant changes in their legislation and regulations concerning taxation. Additionally, certain tax policy efforts by the European Union and the Organisation for Economic Co-operation and Development could have a material effect on the taxation of international business and in particular, companies which publish software. Such changes, if brought into tax legislation, regulations and policy, could increase our effective tax rates in countries where we have significant operations and our overall tax rate could be materially affected, impacting our operating results, cash flows and financial condition.

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 U.S. such as the SEC, 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 generally analyze 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. GAAP, 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 IP, 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 IP licensed from third parties, and we may have to seek new licenses or renew existing licenses for software and other IP in the future. Failure to obtain software or other IP 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. IP 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, Inc. Further information regarding these lawsuits is contained in Part II, Item 1. "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 U.S. In particular, approximately 14% of our workforce, and a larger percentage of our engineers, are located in our offices in Israel, Egypt, Pakistan, Armenia, and Russia and 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 July 31, 2014, we had $257 million of outstanding indebtedness, which includes principal of $253 million of 4.00% Convertible Subordinated Debentures due 2031 (4.00% Debentures) and $4 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 July 31, 2014 of $20.26 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 $24.31 per share as of July 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. At this time, we believe it is unlikely that the holders of a significant amount of our 4.00% Debentures would elect to convert, since the current market price of the 4.00% Debentures substantially exceeds the conversion value.

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 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 of $50,000 plus 70% of our cumulative net income for the periods after January 31, 2011. We were in compliance with all financial covenants as of July 31, 2014. If we fail to comply with the financial covenants and are unable to obtain a waiver from our lenders, we would be in default under the revolving credit facility and our board could decide to reduce or eliminate our current dividend. In addition, our board may decrease or discontinue payment of dividends at any time, which could cause the market price of our stock to decline.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

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

<table>
<thead>
<tr>
<th>Period</th>
<th>Total number of shares purchased</th>
<th>Average price paid per share</th>
<th>Total number of shares purchased as part of publicly announced programs</th>
<th>Maximum dollar value of shares that may yet be purchased under the programs</th>
</tr>
</thead>
<tbody>
<tr>
<td>May 1 - May 31, 2014</td>
<td>—</td>
<td>$</td>
<td>—</td>
<td>$</td>
</tr>
<tr>
<td>June 1 - June 30, 2014</td>
<td>485,000</td>
<td>21.44</td>
<td>485,000</td>
<td>189,601,889</td>
</tr>
<tr>
<td>July 1 - July 31, 2014</td>
<td>674,055</td>
<td>21.66</td>
<td>674,055</td>
<td>175,000,019</td>
</tr>
<tr>
<td></td>
<td>1,159,055</td>
<td>21.57</td>
<td>1,159,055</td>
<td></td>
</tr>
</tbody>
</table>

In April 2014 our previous three-year share repurchase program expired. On June 12, 2014, we announced a new share repurchase program approved by our Board of Directors, authorizing the repurchase of up to $200 million of our common stock over a three-year period.
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### Item 6. Exhibits

<table>
<thead>
<tr>
<th>Item</th>
<th>Description</th>
</tr>
</thead>
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<td>3.A</td>
<td>1987 Restated Articles of Incorporation, as amended.</td>
</tr>
<tr>
<td>10.A</td>
<td>2010 Omnibus Incentive Plan, as amended.</td>
</tr>
<tr>
<td>10.B</td>
<td>Form of Restricted Stock Unit Award Agreement for grants of restricted stock units to non-employee directors under our 2010 Omnibus Incentive Plan.</td>
</tr>
<tr>
<td>31.1</td>
<td>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.</td>
</tr>
<tr>
<td>31.2</td>
<td>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.</td>
</tr>
<tr>
<td>32</td>
<td>Certifications of Chief Executive Officer and Chief Financial Officer of Registrant Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</td>
</tr>
<tr>
<td>101.INS</td>
<td>XBRL Instance Document</td>
</tr>
<tr>
<td>101.SCH</td>
<td>XBRL Taxonomy Extension Schema Document</td>
</tr>
<tr>
<td>101.CAL</td>
<td>XBRL Taxonomy Extension Calculation Linkbase Document</td>
</tr>
<tr>
<td>101.DEF</td>
<td>XBRL Taxonomy Extension Definition Linkbase Document</td>
</tr>
<tr>
<td>101.LAB</td>
<td>XBRL Taxonomy Extension Label Linkbase Document</td>
</tr>
<tr>
<td>101.PRE</td>
<td>XBRL Taxonomy Extension Presentation Linkbase Document</td>
</tr>
</tbody>
</table>
SIGNATURES

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

Dated: September 4, 2014

MENTOR GRAPHICS CORPORATION
(Registrant)

/S/ GREGORY K. HINCKLEY
Gregory K. Hinckley
President, Chief Financial Officer
MENTOR GRAPHICS CORPORATION

1987 RESTATED ARTICLES OF INCORPORATION
(as amended as of June 24, 2014)

The following version of the 1987 Restated Articles of Incorporation has been prepared for filing with the Securities and Exchange Commission, and includes all amendments reflected in Articles of Amendment filed with the Oregon Secretary of State through June 24, 2014.

ARTICLE I

The name of this Corporation shall be MENTOR GRAPHICS CORPORATION and its duration shall be perpetual.

ARTICLE II

The Corporation shall have the power to engage in any lawful activity for which corporations may be organized under the Oregon Business Corporation Act.

ARTICLE III

A. The Corporation shall have authority to issue 301,200,000 shares of capital stock without par value. The shares shall be divided into two classes, designated as follows:

<table>
<thead>
<tr>
<th>Designation of Class</th>
<th>Number of Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common Stock</td>
<td>300,000,000</td>
</tr>
<tr>
<td>Incentive Stock</td>
<td>1,200,000</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>301,200,000</strong></td>
</tr>
</tbody>
</table>

B. The Board of Directors of the Corporation shall have authority to divide the Incentive Stock into as many series as the Board of Directors shall from time to time determine and to issue the Incentive Stock in such series. The Board of Directors shall determine the number of shares comprising each series of Incentive Stock, which number may, unless otherwise provided by the Board of Directors in creating such series, be increased or decreased from time to time by action of the Board of Directors. Each series of Incentive Stock shall be so designated as to distinguish the shares thereof from the shares of all other series. All shares of each series of Incentive Stock shall be identical. All series of Incentive Stock shall be of equal rank and have the same powers, preferences and rights, and shall be subject to the same qualifications, limitations and restrictions, without distinction between shares of different series thereof; provided, however, that there may be variations among different series of Incentive Stock as to dividend rates; prices, terms and conditions of redemption, if any; liquidation rights; and terms and conditions of conversion, if any, which variations may be fixed and determined by the Board of Directors of the Corporation in accordance with the provisions of this Article III.

C. The relative rights, preferences, privileges and restrictions granted to or imposed upon the respective classes of the shares of capital stock or the holders thereof are as follows:

1. Dividends. No dividend other than a stock dividend shall be paid on any share of Common Stock (the “Common Dividend”) unless at the same time there shall be paid a dividend on each share of Incentive Stock (the “Incentive Dividend”) in an amount to be fixed and determined by the Board of Directors of the Corporation at the time of the establishment of the series in which such shares of Incentive Stock were issued. The Board of Directors when fixing and determining the amount of the Incentive Dividend required hereunder may express such amount in dollars, in a formula based upon the Common Dividend, or both.
2. **Liquidation Preference.** In the event of any liquidation or dissolution of the Corporation, either voluntary or involuntary, distributions to the shareholders of the Corporation shall be made in the following manner:

   (a) The holders of the Incentive Stock shall be entitled to receive, prior and in preference to any distribution of any of the assets or surplus funds of the Corporation to the holders of the Common Stock by reason of their ownership of such stock, an amount per share for each share of Incentive Stock then held by them, adjusted for any combinations, consolidations, or stock distributions or dividends with respect to such shares, as fixed and determined by the Board of Directors of the Corporation at the time of the establishment of the series in which such shares of Incentive Stock were issued. The Board of Directors when fixing and determining the amount which the Incentive Stock is entitled to receive hereunder may express such amount in dollars, in a formula based upon the amount to be distributed among the holders of the Common Stock as set forth in subparagraph 2(b), or both.

   (b) After payment to the holders of Incentive Stock of the full preferential amounts set forth in subparagraph 2(a), the remaining assets and funds of the Corporation legally available for distribution, if any, shall be distributed among the holders of the Common Stock in proportion to the shares of Common Stock then held by them.

   (c) A consolidation or merger of the Corporation with or into any other corporation or corporations, or a sale of all or substantially all of the assets of the Corporation, shall not be deemed to be a liquidation or dissolution, within the meaning of this paragraph.

3. **Redemption.** The Board of Directors of the Corporation may when establishing any series of Incentive Stock determine whether shares of such series may be redeemed and, if so, the redemption prices and the terms and conditions of redemption.

4. **Voting Rights.** Except as otherwise provided by law, the Incentive Stock shall not be entitled to vote on any matter submitted to the shareholders.

5. **Conversion.** The Board of Directors of the Corporation may when establishing any series of Incentive Stock fix and determine terms and conditions, if any, on which shares of such series may be converted into shares of any other series or class of stock.

D. This Article III.D sets forth the designation, preferences, limitations and relative rights of a series of Incentive Stock of the Corporation as determined by the Board of Directors of the Corporation (the “Board of Directors” or the “Board”) pursuant to its authority under ORS 60.134 and Article III.B of these Articles of Incorporation.

1. **Designation and Amount.** The shares of such series shall be designated as “Series A Junior Participating Incentive Stock” (the “Series A Incentive Stock”) and the number of shares constituting the Series A Incentive Stock shall be 1,000,000.

2. **Dividends and Distributions.**

   (A) Subject to the prior and superior rights of the holders of any shares of any class or series of stock of this Corporation ranking prior and superior to the Series A Incentive Stock with respect to dividends, the holders of shares of Series A Incentive Stock, in preference to the holders of Common Stock, no par value (the “Common Stock”), of the Corporation, and of any other stock ranking junior to the Series A Incentive Stock, shall be entitled to receive, when, as and if declared by the Board of Directors out of funds legally available for the purpose, quarterly dividends payable in cash on the first day of March, June, September and December in each year (each such date being referred to herein as a “Quarterly Dividend Payment Date”), commencing on the first Quarterly Dividend Payment Date after the first issuance of a share or fraction of a share of Series A Incentive Stock, in an amount per share (rounded to the nearest cent) equal to the greater of (a) $1.00 or (b) subject to the provision for adjustment hereinafter set forth, 100 times the aggregate per share amount of all cash dividends, and 100 times the aggregate per share amount (payable in kind) of all non-cash dividends or other distributions, other than a dividend payable in shares
of Common Stock or a subdivision of the outstanding shares of Common Stock (by reclassification or otherwise), declared on the Common Stock since the immediately preceding Quarterly Dividend Payment Date or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of Series A Incentive Stock. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision, combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount to which holders of shares of Series A Incentive Stock were entitled immediately prior to such event under clause (b) of the preceding sentence shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(B) The Corporation shall declare a dividend or distribution on the Series A Incentive Stock as provided in paragraph (A) of this Section 2 immediately after it declares a dividend or distribution on the Common Stock (other than a dividend payable in shares of Common Stock); provided that, in the event no dividend or distribution shall have been declared on the Common Stock during the period between any Quarterly Dividend Payment Date and the next subsequent Quarterly Dividend Payment Date, a dividend of $1.00 per share on the Series A Incentive Stock shall nevertheless be payable on such subsequent Quarterly Dividend Payment Date.

(C) Dividends shall begin to accrue and be cumulative on outstanding shares of Series A Incentive Stock from the Quarterly Dividend Payment Date next preceding the date of issue of such shares, unless the date of issue of such shares is prior to the record date for the first Quarterly Dividend Payment Date, in which case dividends on such shares shall begin to accrue from the date of issue of such shares, or unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of shares of Series A Incentive Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from such Quarterly Dividend Payment Date. Accrued but unpaid dividends shall not bear interest. Dividends paid on the shares of Series A Incentive Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding. The Board of Directors may fix a record date for the determination of holders of shares of Series A Incentive Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be not more than 60 days prior to the date fixed for the payment thereof.

3. Voting Rights. Except as otherwise provided by law, the holders of shares of Series A Incentive Stock shall not be entitled to vote on any matter submitted to the vote of stockholders.


(A) Whenever quarterly dividends or other dividends or distributions payable on the Series A Incentive Stock as provided in Section 2 are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series A Incentive Stock outstanding shall have been paid in full, the Corporation shall not:

(i) declare or pay dividends, or make any other distributions, on any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Incentive Stock;

(ii) declare or pay dividends, or make any other distributions, on any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Incentive Stock, except dividends paid ratably on the Series A Incentive Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled;
(iii) redeem or purchase or otherwise acquire for consideration shares of any stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Incentive Stock, provided that the Corporation may at any time redeem, purchase or otherwise acquire shares of any such junior stock in exchange for shares of any stock of the Corporation ranking junior (both as to dividends and upon dissolution, liquidation or winding up) to the Series A Incentive Stock; or

(iv) redeem or purchase or otherwise acquire for consideration any shares of Series A Incentive Stock, or any shares of stock ranking on a parity with the Series A Incentive Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of such shares upon such terms as the Board of Directors, after consideration of the respective annual dividend rates and other relative rights and preferences of the respective series and classes, shall determine in good faith will result in fair and equitable treatment among the respective series or classes.

(B) The Corporation shall not permit any subsidiary of the Corporation topurchase or otherwise acquire for consideration any shares of stock of the Corporation unless the Corporation could, under paragraph (A) of this Section 4, purchase or otherwise acquire such shares at such time and in such manner.

5. Reacquired Shares. Any shares of Series A Incentive Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be restored to the status of authorized but unissued shares after the acquisition thereof. All such shares shall upon any such restoration become authorized but unissued shares of Incentive Stock and may be reissued as part of a new series of Incentive Stock subject to the conditions and restrictions on issuance set forth herein, in the Restated Articles of Incorporation, or in any amendment thereto creating a series of Incentive Stock or any similar stock or as otherwise required by law.


(A) Upon any liquidation, dissolution or winding up of the Corporation, voluntary or otherwise no distribution shall be made (1) to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series A Incentive Stock unless, prior thereto, the holders of shares of Series A Incentive Stock shall have received an amount per share (the “Series A Liquidation Preference”) equal to $100 per share, plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment, provided that the holders of shares of Series A Incentive Stock shall be entitled to receive an aggregate amount per share, subject to the provision for adjustment hereinafter set forth, equal to 100 times the aggregate amount to be distributed per share to holders of shares of Common Stock, or (2) to the holders of shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series A Incentive Stock, except distributions made ratably on the Series A Incentive Stock and all such parity stock in proportion to the total amounts to which the holders of all such shares are entitled upon such liquidation, dissolution or winding up. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision, combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the aggregate amount to which holders of shares of Series A Incentive Stock were entitled immediately prior to such event under the proviso in clause (1) of the preceding sentence shall be adjusted by multiplying such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that are outstanding immediately prior to such event.

(B) In the event, however, that there are not sufficient assets available to permit payment in full of the Series A Liquidation Preference and the liquidation preferences of all other classes and series of stock of the Corporation, if any, that rank on a parity with the Series A Incentive Stock in respect thereof, then the assets available for such distribution shall be distributed ratably to the holders of the Series A Incentive Stock and the holders of such parity shares in proportion to their respective liquidation preferences.
(C) Neither the merger or consolidation of the Corporation into or with another corporation nor the merger or consolidation of any other corporation into or with the Corporation shall be deemed to be a liquidation, dissolution or winding up of the Corporation within the meaning of this Section 6.

7. **Consolidation, Merger, etc.** In case the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case each share of Series A Incentive Stock shall at the same time be similarly exchanged or changed into an amount per share, subject to the provision for adjustment hereinafter set forth, equal to 100 times the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision, combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount set forth in the preceding sentence with respect to the exchange or change of shares of Series A Incentive Stock shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

8. **No Redemption.** The shares of Series A Incentive Stock shall not be redeemable by the Company.

9. **Rank.** The Series A Incentive Stock shall rank, with respect to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up, junior to all series of any other class of the Corporation’s Incentive Stock, except to the extent that any such other series specifically provides that it shall rank on a parity with or junior to the Series A Incentive Stock.

10. **Amendment.** The Articles of Incorporation of the Corporation shall not be amended in any manner which would materially alter or change the powers, preferences or special rights of the Series A Incentive Stock so as to affect them adversely without the affirmative vote of the holders of at least two-thirds of the outstanding shares of Series A Incentive Stock, voting separately as a single class.

11. **Fractional Shares.** Series A Incentive Stock may be issued in fractions of a share that shall entitle the holder, in proportion to such holder’s fractional shares, to receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series A Incentive Stock.

E. This Article III.E sets forth the designation, preferences, limitations and relative rights of a series of Incentive Stock of the Corporation as determined by the Board of Directors of the Corporation (the “Board of Directors” or the “Board”) pursuant to its authority under ORS 60.134 and Article III.B of these Articles of Incorporation.

1. **Designation and Amount.** The shares of such series shall be designated as “Series B Junior Participating Incentive Stock” (the “Series B Incentive Stock”) and the number of shares constituting the Series B Incentive Stock shall be 20,000.

2. **Dividends and Distributions.**

(A) Subject to the prior and superior rights of the holders of any shares of any class or series of stock of this Corporation ranking prior and superior to the Series B Incentive Stock with respect to dividends, the holders of shares of Series B Incentive Stock, in preference to the holders of Common Stock, no par value (the “Common Stock”), of the Corporation, and of any other stock ranking junior to the Series B Incentive Stock, shall be entitled to receive, when, as and if declared by the Board of Directors out of funds legally available for the purpose, quarterly dividends payable in cash on the first day of March, June, September and December in each year (each such date being referred to herein as a “Quarterly Dividend Payment Date”), commencing on the first Quarterly Dividend Payment Date after the first issuance of a share or fraction of a share of Series B Incentive Stock, in an amount per share (rounded to the nearest cent) equal to the greater of (a) $100.00 or (b) subject to the provision for adjustment
hereinafter set forth, 10,000 times the aggregate per share amount of all cash dividends, and 10,000 times the aggregate per share amount (payable in kind) of all non-cash dividends or other distributions, other than a dividend payable in shares of Common Stock or a subdivision of the outstanding shares of Common Stock (by reclassification or otherwise), declared on the Common Stock since the immediately preceding Quarterly Dividend Payment Date or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of Series B Incentive Stock. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision, combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount to which holders of shares of Series B Incentive Stock were entitled immediately prior to such event under clause (b) of the preceding sentence shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

(B) The Corporation shall declare a dividend or distribution on the Series B Incentive Stock as provided in paragraph (A) of this Section 2 immediately after it declares a dividend or distribution on the Common Stock (other than a dividend payable in shares of Common Stock); provided that, in the event no dividend or distribution shall have been declared on the Common Stock during the period between any Quarterly Dividend Payment Date and the next subsequent Quarterly Dividend Payment Date, a dividend of $100.00 per share on the Series B Incentive Stock shall nevertheless be payable on such subsequent Quarterly Dividend Payment Date.

(C) Dividends shall begin to accrue and be cumulative on outstanding shares of Series B Incentive Stock from the Quarterly Dividend Payment Date next preceding the date of issue of such shares, unless the date of issue of such shares is prior to the record date for the first Quarterly Dividend Payment Date, in which case dividends on such shares shall begin to accrue from the date of issue of such shares, or unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of shares of Series B Incentive Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in either of which events such dividends shall begin to accrue and be cumulative from such Quarterly Dividend Payment Date. Accrued but unpaid dividends shall not bear interest. Dividends paid on the shares of Series B Incentive Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding. The Board of Directors may fix a record date for the determination of holders of shares of Series B Incentive Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be not more than sixty (60) days prior to the date fixed for the payment thereof.

3. **Voting Rights.** Except as otherwise provided by law, the holders of shares of Series B Incentive Stock shall not be entitled to vote on any matter submitted to the vote of stockholders.

4. **Certain Restrictions.**

(A) Whenever quarterly dividends or other dividends or distributions payable on the Series B Incentive Stock as provided in Section 2 are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series B Incentive Stock outstanding shall have been paid in full, the Corporation shall not:

(i) declare or pay dividends, or make any other distributions, on any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series B Incentive Stock;

(ii) declare or pay dividends, or make any other distributions, on any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series B Incentive Stock, except dividends paid ratably on the Series B Incentive Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled;
(iii) redeem or purchase or otherwise acquire for consideration shares of any stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series B Incentive Stock, provided that the Corporation may at any time redeem, purchase or otherwise acquire shares of any such junior stock in exchange for shares of any stock of the Corporation ranking junior (both as to dividends and upon dissolution, liquidation or winding up) to the Series B Incentive Stock, or

(iv) redeem or purchase or otherwise acquire for consideration any shares of Series B Incentive Stock, or any shares of stock ranking on a parity with the Series B Incentive Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of such shares upon such terms as the Board of Directors, after consideration of the respective annual dividend rates and other relative rights and preferences of the respective series and classes, shall determine in good faith will result in fair and equitable treatment among the respective series or classes.

(B) The Corporation shall not permit any subsidiary of the Corporation to purchase or otherwise acquire for consideration any shares of stock of the Corporation unless the Corporation could, under paragraph (A) of this Section 4, purchase or otherwise acquire such shares at such time and in such manner.

5. Reacquired Shares. Any shares of Series B Incentive Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be restored to the status of authorized but unissued shares after the acquisition thereof. All such shares shall upon any such restoration become authorized but unissued shares of Incentive Stock and may be reissued as part of a new series of Incentive Stock subject to the conditions and restrictions on issuance set forth herein, in the Restated Articles of Incorporation, or in any amendment thereto creating a series of Incentive Stock or any similar stock or as otherwise required by law.


(A) Upon any liquidation, dissolution or winding up of the Corporation, voluntary or otherwise no distribution shall be made (i) to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series B Incentive Stock unless, prior thereto, the holders of Series B Incentive Stock shall have received an amount per share (the “Series B Liquidation Preference”) equal to $10,000 per share, plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment, provided that the holders of shares of Series B Incentive Stock shall be entitled to receive an aggregate amount per share, subject to the provision for adjustment hereinafter set forth, equal to 10,000 times the aggregate amount to be distributed per share to holders of Common Stock, or (ii) to the holders of shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series B Incentive Stock, except distributions made ratably on the Series B Incentive Stock and all such parity stock in proportion to the total amounts to which the holders of all such shares are entitled upon such liquidation, dissolution or winding up. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision, combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the aggregate amount to which holders of Series B Incentive Stock were entitled immediately prior to such event under the proviso in clause (i) of the preceding sentence shall be adjusted by multiplying such amount by a fraction the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that are outstanding immediately prior to such event.

(B) In the event, however, that there are not sufficient assets available to permit payment in full of the Series B Liquidation Preference and the liquidation preferences of all other classes and series of stock of the Corporation, if any, that rank on a parity with the Series B Incentive Stock in respect thereof, then the assets available for such distribution shall be distributed ratably to the holders of the Series B Incentive Stock and the holders of such parity shares in proportion to their respective liquidation preferences.
(C) Neither the merger or consolidation of the Corporation into or with another corporation nor the merger or consolidation of any other corporation into or with the Corporation shall be deemed to be a liquidation, dissolution or winding up of the Corporation within the meaning of this Section 6.

7. Consolidation, Merger, etc. In case the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case each share of Series B Incentive Stock shall at the same time be similarly exchanged or changed into an amount per share, subject to the provision for adjustment hereinafter set forth, equal to 10,000 times the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged. In the event the Corporation shall at any time declare or pay any dividend on the Common Stock payable in shares of Common Stock, or effect a subdivision, combination or consolidation of the outstanding shares of Common Stock (by reclassification or otherwise than by payment of a dividend in shares of Common Stock) into a greater or lesser number of shares of Common Stock, then in each such case the amount set forth in the preceding sentence with respect to the exchange or change of shares of Series B Incentive Stock shall be adjusted by multiplying such amount by a fraction, the numerator of which is the number of shares of Common Stock outstanding immediately after such event and the denominator of which is the number of shares of Common Stock that were outstanding immediately prior to such event.

8. No Redemption. The Series B Incentive Stock shall not be redeemable by the Corporation.

9. Rank. The Series B Incentive Stock shall rank, with respect to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up, on a parity with the Series A Junior Participating Incentive Stock and junior to all other series of the Corporation’s Incentive Stock, except to the extent that any such other series specifically provides that it shall rank on a parity with or junior to the Series B Incentive Stock.

10. Amendment. At any time any shares of Series B Incentive Stock are outstanding, the Articles of Incorporation of the Corporation shall not be further amended in any manner which would materially alter or change the powers, preferences or special rights of the Series B Incentive Stock so as to affect them adversely without the affirmative vote of the holders of at least two-thirds of the outstanding shares of Series B Incentive Stock, voting separately as a single class.

11. Fractional Shares. Series B Incentive Stock may be issued in fractions of a share that shall entitle the holder, in proportion to such holder’s fractional shares, to receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series B Incentive Stock.

ARTICLE IV

No holder of shares or securities of the Corporation now or hereafter authorized shall have any preemptive right or be entitled as of right to subscribe for, purchase or receive any unissued or treasury shares of any class, whether now or hereafter authorized, or any notes, bonds, debentures, or other securities convertible into, or carrying options or warrants to purchase, shares of any class. All such unissued or treasury shares of any class, or notes, bonds, debentures or other securities convertible into, or carrying options or warrant to purchase, shares of any class may be issued or disposed of by the Board of Directors to such persons and on such terms as it, in its absolute discretion, may deem advisable.

ARTICLE V

The Corporation may indemnify to the fullest extent permitted by law any person who is made, or threatened to be made, a party to an action, suit or proceeding, whether civil, criminal, administrative, investigative, or otherwise (including an action, suit or proceeding by or in the right of the Corporation) by reason of the fact that the person is or was a director or officer of the Corporation or a fiduciary within the meaning of the Employee Retirement Income Security Act of 1974 with respect to any employee benefit plan of the Corporation, or serves or served at the request of the Corporation as a director or officer, or as a fiduciary of an employee benefit plan, of another corporation, partnership, joint venture, trust or other enterprise. This Article shall not be deemed exclusive of any other provisions
for indemnification of directors, officers and fiduciaries that may be included in any statute, bylaw, agreement, resolution of shareholders or directors or otherwise, both as to action in any official capacity and action in another capacity while holding office.

ARTICLE VI

Any vacancy occurring in the Board of Directors may be filled by the affirmative vote of a majority of the remaining directors, though less than a quorum of the Board of Directors, or by a sole remaining director. Any directorship to be filled by reason of an increase in the number of directors of the Corporation fixed by the bylaws may be filled by the affirmative vote of a majority of the number of directors fixed by the bylaws prior to such increase, provided that not more than two such directorships may be filled by the directors during any one period between annual meetings of the shareholders of the Corporation. Any such directorship not so filled by the directors shall be filled by election at the next annual meeting of shareholders or at a special meeting of shareholders called for that purpose.

ARTICLE VII

No director of the Corporation shall be personally liable to the Corporation or its shareholders for monetary damages for conduct as a director; provided that this Article VII shall not eliminate the liability of a director for any act or omission for which such elimination of liability is not permitted under the Oregon Business Corporation Act. No amendment to the Oregon Business Corporation Act that further limits the acts or omissions for which elimination of liability is permitted shall affect the liability of a director for any act or omission which occurs prior to the effective date of such amendment.

ARTICLE VIII

In any election of directors of the Corporation at a meeting of shareholders at which a quorum is present, each director shall be elected if the number of votes cast “for” the director exceeds the number of votes cast “against” the director; provided, however, that if the number of nominees exceeds the number of directors to be elected, the directors shall be elected by a plurality of the votes cast by the shares entitled to vote in the election of directors.
Article 1. Establishment, Purpose, and Duration

1.1 Establishment. Mentor Graphics Corporation, an Oregon corporation (hereinafter referred to as the “Company”), establishes an incentive compensation plan to be known as the Mentor Graphics Corporation 2010 Omnibus Incentive Plan (hereinafter referred to as the “Plan”), as set forth in this document. This Plan permits the issuance of Nonqualified Stock Options, Incentive Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Deferred Stock Units, Performance Shares, Performance Units, Cash-Based Awards and Other Stock-Based Awards. This Plan shall become effective upon stockholder approval and shall remain in effect as provided in Section 1.3 hereof.

1.2 Purpose of this Plan. The purpose of this Plan is to provide a means whereby Employees, Non-employee Directors, and Third Party Service Providers of the Company develop a sense of proprietorship and personal involvement in the development and financial success of the Company, and to encourage them to devote their best efforts to the business of the Company, thereby advancing the interests of the Company and its stockholders. A further purpose of this Plan is to provide a means through which the Company may attract and retain able individuals to become Employees, Non-employee Directors or Third Party Service Providers of the Company. This Plan is intended to provide a means whereby those individuals upon whom the responsibilities of the successful administration and management of the Company are of importance can acquire and maintain stock ownership, thereby strengthening their concern for the welfare of the Company.

1.3 Duration of this Plan. Unless sooner terminated as provided herein, this Plan shall terminate on March 10, 2020; provided, however, that the term of this Plan shall be extended for ten years following any action by the Board approving an increase in the number of Shares available for issuance under the Plan, which action is subsequently approved within 12 months by the stockholders. After this Plan is terminated, no Awards may be granted but Awards previously granted shall remain outstanding in accordance with their applicable terms and conditions and this Plan’s terms and conditions.

Article 2. Definitions

Whenever used in this Plan, the following terms shall have the meanings set forth below, and when the meaning is intended, the initial letter of the word shall be capitalized.

2.1 “Affiliate” shall mean any corporation or other entity (including, but not limited to, a partnership or a limited liability company) that is affiliated with the Company through an interest of more than fifty percent (50%) by reason of stock or equity ownership or otherwise, and is designated as an Affiliate for purposes of this Plan by the Committee.

2.2 “Annual Award Limit” or “Annual Award Limits” have the meaning set forth in Section 4.3.

2.3 “Award” means, individually or collectively, a grant under this Plan of Nonqualified Stock Options, Incentive Stock Options, Stock Appreciation Rights, Restricted Stock, Restricted Stock Units, Deferred Stock Units, Performance Shares, Performance Units, Cash-Based Awards or Other Stock-Based Awards, in each case subject to the terms of this Plan.

2.4 “Award Agreement” means either (i) a written or electronic agreement entered into by the Company and a Participant setting forth the terms and provisions applicable to an Award granted under this Plan, including any amendment or modification thereof, or (ii) a written or electronic statement issued by the Company to a Participant describing the terms and provisions of such Award, including any amendment or modification thereof. The Committee may modify the Company’s Award process from time to time in its sole discretion, including by providing for the use of electronic, internet or other non-paper Award Agreements, and the use of electronic, internet or other non-paper means for the acceptance thereof and actions thereunder by a Participant.

2.5 “Beneficial Owner” or “Beneficial Ownership” shall have the meaning ascribed to such term in Rule 13d-3 of the General Rules and Regulations under the Exchange Act.
2.6 “Board” or “Board of Directors” means the Board of Directors of the Company.

2.7 “Cash-Based Awards” means an Award, denominated in cash, granted to a Participant as described in Article 10.

2.8 “Change of Control” means a situation where any of the following events occur:

(a) Acquisition of Stock by Third Party. The acquisition by any Person of Beneficial Ownership of 40% or more of either the then-outstanding shares of common stock of the Company or the Outstanding Voting Securities; provided, however, that, for purposes of this Section 2.8(a), the following acquisitions shall not constitute a Change of Control: (i) any acquisition directly from the Company, (ii) any acquisition by the Company, or (iii) any acquisition by any employee benefit plan (or related trust) sponsored or maintained by the Company or any Subsidiary of the Company;

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

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

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

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

2.9 “Code” means the U.S. Internal Revenue Code of 1986, as amended from time to time. For purposes of this Plan, references to sections of the Code shall be deemed to include references to any applicable regulations and any successor or similar provision.

2.10 “Committee” means the Compensation Committee of the Board or another committee appointed by the Board to administer the Plan. Each member of the Compensation Committee or any other such committee must be an “independent director” under NASDAQ rules, an “outside director” for purposes of Code Section 162(m), and a “non-employee director” under Rule 16b-3(b)(3) under the Exchange Act, as such requirements may change from time to time.

2.11 “Company” means Mentor Graphics Corporation, an Oregon corporation, and any successor thereto as provided in Article 19 herein.
2.12 “Covered Employee” means any Employee who is or may become a “Covered Employee,” as defined in Code Section 162(m), and who is designated, either as an individual Employee or class of Employees, by the Committee within the shorter of (i) ninety (90) days after the beginning of the Performance Period, or (ii) twenty-five percent (25%) of the Performance Period has elapsed, as a “Covered Employee” under this Plan for such applicable Performance Period.

2.13 “Deferred Stock Unit” means an Award granted to a Participant pursuant to Article 8 giving the Participant a contractual right to receive a stated number of Shares or, if provided by the Committee on the Grant Date, cash equal to the Fair Market Value of such Shares, under the Plan at the end of a specified period of time or upon the occurrence of a specified event.

2.14 “Director” means any individual who is a member of the Board of Directors of the Company.

2.15 “Employee” means any individual performing services for the Company, an Affiliate, or a Subsidiary and designated as an employee of the Company, the Affiliate, or the Subsidiary on the payroll records. An Employee shall not include any individual during any period he or she is classified or treated by the Company, Affiliate, or Subsidiary as a contingent worker, independent contractor, consultant, or any employee of a franchise, master distributor, employment, consulting, or temporary agency or any other entity other than the Company, Affiliate, or Subsidiary, without regard to whether such individual is subsequently determined to have been, or is subsequently retroactively reclassified as an employee of the Company, Affiliate, or Subsidiary during such period. An individual shall not cease to be an Employee in the case of (i) any leave of absence approved by the Company for purposes protected under law including, without limitation, medical leave, leave to care for a family member, maternity- paternity- or adoptive leave, leave for military service or leave to participate in mandatory legal process or (ii) transfers or Company-initiated relocations between locations of the Company or between the Company, any Affiliates, or any Subsidiaries. For purposes of Incentive Stock Options, no such leave may exceed three (3) months, unless reemployment upon expiration of such leave is guaranteed by statute or contract. If reemployment upon expiration of a leave of absence approved by the Company is not so guaranteed, then three (3) months following the commencement of such leave, any Incentive Stock Option held by a Participant shall cease to be treated as an Incentive Stock Option and shall be treated for tax purposes as a Nonqualified Stock Option. Neither service as a Director nor payment of a director’s fee by the Company shall be sufficient to constitute “employment” by the Company.

2.16 “Exchange Act” means the Securities Exchange Act of 1934, as amended from time to time, or any successor act thereto.

2.17 “Fair Market Value” or “FMV” means

(a) A price of a Share that is based on the opening, closing, actual, high, low, or average selling prices of a Share reported on any established stock exchange or national market system including without limitation the New York Stock Exchange and the National Market System of the National Association of Securities Dealers, Inc. Automated Quotation System on the applicable date, the preceding trading day, the next succeeding trading day, or an average of trading days, as determined by the Committee in its discretion. Unless the Committee determines otherwise, Fair Market Value on any day shall be deemed to be equal to the closing price of a Share of the Company’s common stock on NASDAQ on that day or, if that day is not a trading day, on the prior trading day.

(b) If Shares are regularly quoted by a recognized securities dealer but selling prices are not reported, the mean between the high bid and low asked prices for a Share on the day of determination or, if that day is not a trading day, the last market trading day prior to the day of determination, as reported in The Wall Street Journal or such other source as the Committee deems reliable.

(c) In the event Shares are not publicly traded at the time a determination of their value is required to be made hereunder, the price of a Share as determined by the Committee in such manner as it deems appropriate.

2.18 “Grant Date” means the date an Award is granted to a Participant pursuant to the Plan.

2.19 “Grant Price” means the price established at the time of grant of an SAR pursuant to Article 7, used to determine whether there is any payment due upon exercise of the SAR.
2.20 “Incentive Stock Option” or “ISO” means an Option to purchase Shares granted under Article 6 to an Employee and that is designated as an Incentive Stock Option and that is intended to meet the requirements of Code Section 422, or any successor provision.

2.21 “Non-employee Director” means a Director who is not an Employee.

2.22 “Nonqualified Stock Option” or “NQSO” means an Option that is not intended to meet the requirements of Code Section 422, or that otherwise does not meet such requirements.

2.23 “Option” means an Incentive Stock Option or a Nonqualified Stock Option, as described in Article 6.

2.24 “Option Price” means the price at which a Share may be purchased by a Participant pursuant to an Option.

2.25 “Other Stock-Based Award” means an equity-based or equity-related Award not otherwise described by the terms of this Plan, granted pursuant to Article 10.

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

2.27 “Participant” means any eligible individual as set forth in Article 5 to whom an Award is granted.

2.28 “Performance-Based Compensation” means compensation under an Award that is intended to satisfy the requirements of Code Section 162(m) for certain performance-based compensation paid to Covered Employees. Notwithstanding the foregoing, nothing in this Plan is intended nor shall be construed to mean that an Award which does not satisfy the requirements for performance-based compensation under Code Section 162(m) does not constitute performance-based compensation for other purposes, including Code Section 409A.

2.29 “Performance Measures” means measures, as described in Article 12, on which the performance goals are based and which are approved by the Company’s stockholders pursuant to this Plan in order to qualify Awards as Performance-Based Compensation.

2.30 “Performance Period” means the period of time during which the performance goals must be met in order to determine the degree of payout and/or vesting with respect to an Award.

2.31 “Performance Share” means an Award under Article 9 and subject to the terms of this Plan, denominated in Shares, the value of which at the time it is payable is determined as a function of the extent to which corresponding performance goals, as described in Article 12, have been achieved.

2.32 “Performance Unit” means an Award under Article 9 and subject to the terms of this Plan, denominated in units, the value of which at the time it is payable is determined as a function of the extent to which corresponding performance goals, as described in Article 12, have been achieved.

2.33 “Period of Restriction” means the period, if any, when Restricted Stock, Restricted Stock Units or Deferred Stock Units are subject to a substantial risk of forfeiture (based on the passage of time, the achievement of performance goals, or upon the occurrence of other events as determined by the Committee, in its discretion), as provided in Article 8.

2.34 “Person” shall have the meaning ascribed to such term in Section 3(a) (9) of the Exchange Act and used in Sections 13(d) and 14(d) thereof, including a “group” as defined in Section 13(d) thereof.

2.35 “Plan” means the Mentor Graphics Corporation 2010 Omnibus Incentive Plan.

2.36 “Plan Year” means the Company’s fiscal year that begins February 1 and ends January 31.

2.38 “Restricted Stock” means an Award granted to a Participant pursuant to Article 8 under which Shares are actually issued to the Participant on the Grant Date, subject to forfeiture or repurchase during the Period of Restriction.

2.39 “Restricted Stock Unit” means an Award granted to a Participant pursuant to Article 8, except no Shares are actually issued to the Participant on the Grant Date.

2.40 “Share” means a share of common stock of the Company.

2.41 “Stock Appreciation Right” or “SAR” means an Award, designated as an SAR, pursuant to the terms of Article 7.

2.42 “Subsidiary” means any corporation or other entity, whether domestic or foreign, in which the Company has or obtains, directly or indirectly, an interest of more than fifty percent (50%) by reason of stock ownership or otherwise.

2.43 “Third Party Service Provider” means any consultant, agent, advisor, or independent contractor who is a natural person and who renders services to the Company, a Subsidiary, or an Affiliate that (a) are not in connection with the offer and sale of the Company’s securities in a capital raising transaction, and (b) do not directly or indirectly promote or maintain a market for the Company’s securities.

Article 3. Administration

3.1 General. The Committee shall be responsible for administering this Plan, subject to this Article 3 and the other provisions of this Plan. The Committee may employ attorneys, consultants, accountants, agents, and other individuals, any of whom may be an Employee, and the Committee, the Company, and its officers and Directors shall be entitled to rely upon the advice, opinions, or valuations of any such individuals. All actions taken and all interpretations and determinations made by the Committee shall be final and binding upon the Participants, the Company, and all other interested individuals.

3.2 Authority of the Committee. Subject to any express limitations set forth in the Plan, including, without limitation, the requirements to obtain stockholder approval, the Committee shall have full and exclusive discretionary power and authority to take such actions as it deems necessary and advisable with respect to the administration of the Plan including, but not limited to, the following:

(a) To determine from time to time which of the persons eligible under the Plan shall be granted Awards, when and how each Award shall be granted, what type or combination of types of Awards shall be granted, the provisions of each Award granted (which need not be identical), including the time or times when a person shall be permitted to receive Shares pursuant to an Award;

(b) To construe and interpret the Plan and Awards granted under it, and to establish, amend, and revoke rules and regulations for its administration. The Committee, in the exercise of this power, may correct any defect, omission, or inconsistency in the Plan or in an Award Agreement, in a manner and to the extent it shall deem necessary or expedient to make the Plan fully effective;

(c) To approve forms of Award Agreements for use under the Plan;

(d) To determine Fair Market Value of a Share in accordance with Section 2.17 of the Plan;

(e) To amend the Plan or any Award Agreement as provided in the Plan;

(f) To adopt sub-plans and/or special provisions applicable to Awards regulated by the laws of a jurisdiction other than and outside of the United States. Such sub-plans and/or special provisions may take precedence over other provisions of the Plan, but unless otherwise superseded by the terms of such sub-plans and/or special provisions, the provisions of the Plan shall govern;

(g) To authorize any person to execute on behalf of the Company any instrument required to grant an Award previously granted by the Committee;

(h) To determine whether Awards will be settled in Shares, cash, or in any combination;
(i) To determine whether Awards will be adjusted for dividend equivalents, meaning a credit, made at the discretion of the Committee, to the account of a Participant in an amount equal to the cash dividends paid on one Share for each Share represented by an Award held by such Participant;

(j) To establish a program whereby Participants designated by the Committee may reduce compensation otherwise payable in cash in exchange for Awards under the Plan;

(k) Subject to Section 17.1(b), to authorize a program permitting eligible Participants to surrender outstanding Awards in exchange for newly granted Awards;

(l) To impose such restrictions, conditions, or limitations as it determines appropriate as to the timing and manner of any resales by a Participant or other subsequent transfers by the Participant of any Shares, including, without limitation, (i) restrictions under an insider trading policy and (ii) restrictions as to the use of a specified brokerage firm for such resales or other transfers; and

(m) To provide, either at the time an Award is granted or by subsequent action, that an Award shall contain as a term thereof, a right, either in tandem with the other rights under the Award or as an alternative thereto, of the Participant to receive, without payment to the Company, a number of Shares, cash or a combination thereof, the amount of which is determined by reference to the value of Shares.

Article 4. Shares Subject to this Plan and Maximum Awards

4.1 Number of Shares Authorized and Available for Awards. Subject to adjustment as provided in Section 4.4 of the Plan, the maximum number of Shares authorized and available for issuance under the Plan shall be 13,200,000, plus the number of Shares subject to outstanding stock options or restricted stock units under the Prior Plans as of the date of stockholder approval of this Plan that thereafter expire or terminate without issuance of the Shares. In connection with approving this Plan, the Board of Directors has approved a resolution that, effective upon receipt of stockholder approval of this Plan, any Shares available for issuance under the Prior Plans that are not subject to outstanding awards under the Prior Plans will no longer be available for issuance under the Prior Plans.

4.2 Shares Available for Issuance. Shares covered by an Award shall be counted as used only to the extent they are issued. Any Shares related to Awards under this Plan or under Prior Plans that terminate by expiration, forfeiture (including through repurchase of the Shares at original cost), cancellation, or otherwise without the issuance of the Shares, or are settled in cash in lieu of Shares, or are exchanged with the Committee’s permission, prior to the issuance of Shares, for Awards not involving Shares, shall be available again for grant under this Plan. In addition, any Shares that are not issued or delivered as a result of the net settlement of an outstanding SAR or Option under this Plan or Prior Plans, and any Shares withheld or used to pay the Option Price or withholding taxes related to an outstanding Award under this Plan or Prior Plans, shall be available again for grant under this Plan. Cash-Based Awards, Performance Units and any other Awards that are not settled by issuance of Shares shall not reduce the Shares available for issuance under the Plan.

4.3 Annual Award Limits. No Participant may be granted Options or SARs under the Plan for more than an aggregate of 1,000,000 Shares in an Plan Year, as may be adjusted pursuant to Section 4.4. The maximum dollar amount payable under all Performance Unit Awards and Cash-Based Awards that are intended to qualify as Performance-Based Compensation plus the maximum value of Shares under all Performance Share Awards and Other Stock-Based Awards that are intended to qualify as Performance-Based Compensation, in the aggregate, granted to any one Participant in any one Plan Year shall not exceed $5,000,000; for this purpose, the value of Shares shall be the FMV of the Shares on the Grant Date of the applicable Award.

4.4 Adjustments in Authorized Shares. Adjustment in authorized Shares available for issuance under the Plan or under an outstanding Award and adjustments in Annual Award Limits shall be subject to the following provisions:

(a) In the event of any corporate event or transaction (including, but not limited to, a change in the Shares of the Company or the capitalization of the Company) such as a merger, consolidation, reorganization, recapitalization, separation, partial or complete liquidation, stock dividend, stock split, reverse stock split, split up, spin-off, or other distribution of stock or property of the Company, combination of Shares, exchange of Shares, dividend in kind, or other like change in capital structure, number of outstanding Shares or distribution (other than normal cash
dividends) to stockholders of the Company, or any similar corporate event or transaction, the Committee, in order to 
prevent dilution or enlargement of Participants’ rights under this Plan, shall substitute or adjust, as applicable, the number 
and kind of Shares that may be issued under this Plan or under particular forms of Awards, the number and kind of 
Shares subject to outstanding Awards, the Option Price or Grant Price applicable to outstanding Awards, the Annual 
Award Limits, and other value determinations applicable to outstanding Awards; provided that the Committee, in its 
sole discretion, shall determine the methodology or manner of making such substitution or adjustment. The Committee, 
in its sole discretion, may also make appropriate adjustments in the terms of any Awards under this Plan to reflect such 
changes or distributions and may modify any other terms of outstanding Awards, including modifications of performance 
goals and changes in the length of Performance Periods.

(b) The determination of the Committee as to the foregoing adjustments, if any, shall be 
conclusive and binding on Participants under this Plan.

(c) Subject to the provisions of Article 17 and notwithstanding anything else herein to the 
contrary, without affecting the number of Shares reserved or available hereunder, the Committee may authorize the 
issuance or assumption of benefits either under this Plan or outside of this Plan in connection with any merger, 
consolidation, acquisition of property or stock, or reorganization upon such terms and conditions as it may deem 
appropriate, subject to compliance with the rules under Code Sections 422, 424 and 409A, as and where applicable.

Article 5. Eligibility and Participation

5.1 Eligibility. Individuals eligible to participate in this Plan include all Employees, Non-employee 
Directors, and Third Party Service Providers.

5.2 Actual Participation. Subject to the provisions of this Plan, the Committee may, from time to time, 
select from all eligible individuals, those individuals to whom Awards shall be granted and shall determine, in its sole 
discretion, the nature of, any and all terms permissible by law, and the amount of each Award.

Article 6. Stock Options

6.1 Grant of Options. Subject to the terms and provisions of this Plan, Options may be granted to 
Participants in such number, and upon such terms, and at any time and from time to time as shall be determined by the 
Committee, in its sole discretion.

6.2 Award Agreement. Each Option grant shall be evidenced by an Award Agreement that shall specify 
the Option Price, the maximum duration of the Option, the number of Shares to which the Option pertains, the conditions 
upon which an Option shall become vested and exercisable, and such other provisions as the Committee shall determine 
which are not inconsistent with the terms of this Plan. The Award Agreement also shall specify whether the Option is 
intended to be an ISO or an NQSO.

6.3 Option Price. The Option Price for each grant of an Option under this Plan shall be determined by 
the Committee in its sole discretion and shall be specified in the Award Agreement; provided, however, the Option Price 
must be at least equal to one hundred percent (100%) of the FMV of a Share as of the Option’s Grant Date.

6.4 Term of Options. Each Option granted to a Participant shall expire at such time as the Committee 
shall determine at the time of grant; provided, however, no Option shall be exercisable later than the tenth (10th) 
anniversary date of its grant.

6.5 Exercise of Options. Options granted under this Article 6 shall be exercisable at such times and be 
subject to such restrictions and conditions as the Committee shall in each instance approve, which terms and restrictions 
need not be the same for each grant or for each Participant.

6.6 Payment. Options granted under this Article 6 shall be exercised by the delivery of a notice of exercise 
to the Company or an agent designated by the Company in a form and using a means specified or accepted by the 
Committee, or by complying with any alternative procedures which may be authorized by the Committee, setting forth 
the number of Shares with respect to which the Option is to be exercised, accompanied by full payment for the Shares. 
A condition of the issuance of the Shares as to which an Option shall be exercised shall be the payment of the Option 
Price, as specified in the Award Agreement. The Option Price of any exercised Option shall be payable to the Company 
in accordance with one of the following methods:

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(a) in cash or its equivalent;

(b) by tendering (either by actual delivery or attestation) previously acquired Shares having an aggregate Fair Market Value at the time of exercise equal to the Option Price;

(c) by a cashless (broker-assisted) exercise;

(d) by any combination of (a), (b) and (c); or

(e) any other method approved or accepted by the Committee in its sole discretion.

Subject to any governing rules or regulations, as soon as practicable after receipt of written notification of exercise and full payment (including satisfaction of any applicable tax withholding), the Company shall deliver to the Participant evidence of book entry Shares, or upon the Participant’s request, Share certificates in an appropriate amount based upon the number of Shares purchased under the Option(s). Unless otherwise determined by the Committee, all payments under all of the methods indicated above shall be paid in United States dollars or Shares, as applicable.

6.7 Special Rules Regarding ISOs. Notwithstanding any provision of the Plan to the contrary, an ISO granted to a Participant shall be subject to the following rules:

(a) Special ISO Definitions:

(i) “Parent Corporation” shall mean as of any applicable date a corporation in respect of the Company that is a parent corporation within the meaning of Code Section 424(e).

(ii) “ISO Subsidiary” shall mean as of any applicable date any corporation in respect of the Company that is a subsidiary corporation within the meaning of Code Section 424(f).

(iii) A “10% Owner” is an individual who owns stock possessing more than ten percent (10%) of the total combined voting power of all classes of stock of the Company or its Parent Corporation or any ISO Subsidiary.

(b) Eligible employees. ISos may be granted solely to eligible Employees of the Company, Parent Corporation, or ISO Subsidiary (as permitted under Code Sections 422 and 424).

(c) Specified as an ISO. The Award Agreement evidencing the grant of an ISO shall specify that such grant is intended to be an ISO.

(d) Option price. The Option Price of an ISO granted under the Plan shall be determined by the Committee in its sole discretion and shall be specified in the Award Agreement; provided, however, the Option Price must at least equal one hundred percent (100%) of the Fair Market Value of a Share as of the ISO’s Grant Date (in the case of a 10% owner, the Option Price may not be not less than 110% of such Fair Market Value).

(e) Right to exercise. Any ISO granted to a Participant under the Plan shall be exercisable during his or her lifetime solely by such Participant or, in the event of the Participant’s death, by his estate or heirs (as permitted under Code Section 422(b)(5)).

(f) Exercise period. The period during which a Participant may exercise an ISO shall not exceed ten (10) years (five (5) years in the case of a Participant who is a 10% Owner) from the date on which the ISO was granted.

(g) Dollar limitation. To the extent that the aggregate Fair Market Value of (a) the Shares with respect to which Options designated as Incentive Stock Options plus (b) the shares of stock of the Company, Parent Corporation, and any ISO Subsidiary with respect to which other Incentive Stock Options are exercisable for the first time by a holder of an ISO during any calendar year under all plans of the Company and any Affiliate and Subsidiary exceeds $100,000, such Options shall be treated as Nonqualified Stock Options. For purposes of the preceding sentence, (a) Options shall be taken into account in the order in which they were granted, and (b) the Fair Market Value of the Shares shall be determined as of the time the Incentive Stock Options were granted.
(h) **Notification of disqualifying disposition.** If any Participant shall make any disposition of Shares issued pursuant to the exercise of an ISO, such Participant shall notify the Company of such disposition within thirty (30) days thereof. The Company shall use such information to determine whether a disqualifying disposition as described in Code Section 421(b) has occurred.

(i) **Transferability.** No ISO granted under this Plan may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than by will or by the laws of descent and distribution (as permitted under Code Section 422(b) (5)); provided, however, at the discretion of the Committee, an ISO may be transferred to a grantor trust under which the Participant making the transfer is the sole beneficiary.

**Article 7. Stock Appreciation Rights**

7.1 **Grant of SARs.** Subject to the terms and conditions of this Plan, SARs may be awarded to Participants at any time and from time to time as shall be determined by the Committee. Subject to the terms and conditions of this Plan, the Committee shall have complete discretion in determining the number of SARs granted to each Participant and, consistent with the provisions of this Plan, in determining the terms and conditions pertaining to such SARs.

7.2 **Grant Price.** The Grant Price for each grant of an SAR shall be determined by the Committee and shall be specified in the Award Agreement; provided, however, the Grant Price must be at least equal to one hundred percent (100%) of the FMV of a Share as of the Grant Date.

7.3 **SAR Agreement.** Each SAR Award shall be evidenced by an Award Agreement that shall specify the Grant Price, the term of the SAR, and such other provisions as the Committee shall determine.

7.4 **Term of SAR.** The term of an SAR granted under this Plan shall be determined by the Committee, in its sole discretion, and except as determined otherwise by the Committee and specified in the SAR Award Agreement, no SAR shall be exercisable later than the tenth (10th) anniversary date of its grant.

7.5 **Exercise of SARs.** SARs may be exercised upon whatever terms and conditions the Committee, in its sole discretion, imposes.

7.6 **Settlement of SARs.** Upon the exercise of an SAR, a Participant shall be entitled to receive payment from the Company in an amount determined by multiplying:

(a) the excess of the Fair Market Value of a Share on the date of exercise over the Grant Price; by

(b) the number of Shares with respect to which the SAR is exercised.

7.7 **Form of Payment.** Payment, if any, with respect to an SAR settled in accordance with Section 7.6 of the Plan shall be made in accordance with the terms of the applicable Award Agreement, in cash, Shares, or a combination thereof, as the Committee determines.

7.8 **Other Restrictions.** The Committee shall impose such other conditions or restrictions on any Shares received upon exercise of an SAR granted pursuant to this Plan as it may deem advisable or desirable. These restrictions may include, but shall not be limited to, a requirement that the Participant hold the Shares received upon exercise of an SAR for a specified period of time.

**Article 8. Restricted Stock, Restricted Stock Units and Deferred Stock Units**

8.1 **Grant of Restricted Stock, Restricted Stock Units or Deferred Stock Units.** Subject to the terms and provisions of this Plan, the Committee, at any time and from time to time, may award Shares of Restricted Stock, Restricted Stock Units and/or Deferred Stock Units to Participants in such amounts as the Committee shall determine. Restricted Stock Units shall be similar to Restricted Stock except that no Shares are actually issued to the Participant until the Period of Restriction has expired and any other performance-based or other vesting conditions have been satisfied. Deferred Stock Units shall be similar to Restricted Stock Units except that the issuance of Shares shall be further delayed after vesting as specified under the terms of the Award.

Updated: 6/11/2014
8.2 **Restricted Stock, Restricted Stock Unit or Deferred Stock Unit Agreement.** Each Restricted Stock, Restricted Stock Unit and/or Deferred Stock Unit award shall be evidenced by an Award Agreement that shall specify the Period(s) of Restriction, the number of Shares of Restricted Stock or the number of Restricted Stock Units or Deferred Stock Units granted, and such other provisions as the Committee shall determine.

8.3 **Other Restrictions.** The Committee shall impose such other conditions and/or restrictions on any Shares of Restricted Stock, Restricted Stock Units or Deferred Stock Units awarded pursuant to this Plan as it may deem advisable including, without limitation, a requirement that Participants pay a stipulated purchase price for each Share of Restricted Stock or each Restricted Stock Unit or Deferred Stock Unit, restrictions based upon the achievement of specific performance goals, as provided for in Article 12, time-based restrictions on vesting following the attainment of the performance goals, time-based restrictions, and/or restrictions under applicable laws or under the requirements of any stock exchange or market upon which such Shares are listed or traded, or holding requirements or sale restrictions placed on the Shares by the Company upon vesting of such Restricted Stock, Restricted Stock Units or Deferred Stock Units. To the extent deemed appropriate by the Committee, the Company may retain the certificates representing Shares of Restricted Stock in the Company’s possession until such time as all conditions and/or restrictions applicable to such Shares have been satisfied or lapse. Except as otherwise provided in this Article 8, Shares of Restricted Stock covered by each Restricted Stock Award shall become freely transferable by the Participant after all conditions and restrictions applicable to such Shares have been satisfied or lapse (including satisfaction of any applicable tax withholding obligations), and Restricted Stock Units and Deferred Stock Units shall be paid in cash, Shares, or a combination of cash and Shares as the Committee, in its sole discretion, shall determine.

8.4 **Certificate Legend.** In addition to any legends placed on certificates pursuant to Section 8.3, each certificate representing Shares of Restricted Stock granted pursuant to this Plan may bear a legend such as the following or as otherwise determined by the Committee in its sole discretion:

> The sale or transfer of Shares of stock represented by this certificate, whether voluntary, involuntary, or by operation of law, is subject to certain restrictions on transfer as set forth in the Mentor Graphics Corporation 2010 Omnibus Incentive Plan, and in the associated Award Agreement. A copy of the Plan and such Award Agreement may be obtained from Mentor Graphics Corporation.

8.5 **Voting Rights.** Unless otherwise determined by the Committee and set forth in a Participant’s Award Agreement, to the extent permitted or required by law, as determined by the Committee, Participants holding Shares of Restricted Stock awarded hereunder shall have the right to exercise full voting rights with respect to those Shares during the Period of Restriction. A Participant shall have no voting rights with respect to any Restricted Stock Units or Deferred Stock Units awarded hereunder until Shares are issued.

**Article 9. Performance Units/Performance Shares**

9.1 **Award of Performance Units/Performance Shares.** Subject to the terms and provisions of this Plan, the Committee, at any time and from time to time, may award Performance Units and/or Performance Shares to Participants in such amounts and upon such terms as the Committee shall determine.

9.2 **Value of Performance Units/Performance Shares.** Each Performance Unit shall have an initial value that is established by the Committee at the time of grant. Each Performance Share shall have an initial value equal to the Fair Market Value of a Share on the Grant Date. The Committee shall, in its sole discretion, set performance goals, as provided for in Article 12. The extent to which the performance goals are met will determine the value and/or number of Performance Units/Performance Shares that will be paid out to the Participant.

9.3 **Earning of Performance Units/Performance Shares.** Subject to the terms of this Plan, after the applicable Performance Period has ended, the holder of Performance Units/Performance Shares shall be entitled to receive payout on the value and number of Performance Units/Performance Shares earned by the Participant over the Performance Period, to be determined as a function of the extent to which the corresponding performance goals have been achieved.

9.4 **Form and Timing of Payment of Performance Units/Performance Shares.** Payment of earned Performance Units/Performance Shares shall be as determined by the Committee and as evidenced in the Award Agreement. Subject to the terms of this Plan, the Committee, in its sole discretion, may pay earned Performance Units/Performance Shares in the form of cash or in Shares (or in a combination thereof) equal to the value of the earned
Performance Units/Performance Shares at the close of the applicable Performance Period, or as soon as practicable after the end of the Performance Period. Any Shares may be granted subject to any restrictions deemed appropriate by the Committee. The determination of the Committee with respect to the form of payout of such Awards shall be set forth in the Award Agreement pertaining to the grant of the Award.

**Article 10. Cash-Based Awards and Other Stock-Based Awards**

10.1 **Grant of Cash-Based Awards.** Subject to the terms and provisions of the Plan, the Committee, at any time and from time to time, may grant Cash-Based Awards to Participants in such amounts and upon such terms as the Committee may determine.

10.2 **Other Stock-Based Awards.** The Committee may grant other types of equity-based or equity-related Awards not otherwise described by the terms of this Plan (including the grant or offer for sale of unrestricted Shares) in such amounts and subject to such terms and conditions, as the Committee shall determine. Such Awards may involve the transfer of actual Shares to Participants, or payment in cash of amounts based on the value of Shares and may include, without limitation, Awards designed to comply with or take advantage of the applicable local laws of jurisdictions other than the United States.

10.3 **Value of Cash-Based Awards or Other Stock-Based Awards.** Each Cash-Based Award shall specify a payment amount or payment range as determined by the Committee. Each Other Stock-Based Award shall be expressed in terms of Shares or units based on Shares, as determined by the Committee. The Committee may, in its sole discretion, establish performance goals, as provided for in Article 12. If the Committee exercises its discretion to establish performance goals, the number and/or value of Other Stock-Based Awards and/or the amount of the Cash-Based Awards that will be paid out to the Participant will depend on the extent to which the performance goals are met.

10.4 **Payment of Cash-Based Awards or Other Stock-Based Awards.** Payment, if any, with respect to a Cash-Based Award or an Other Stock-Based Award shall be made in accordance with the terms of the Award, in cash or Shares as the Committee determines.

**Article 11. Transferability of Awards and Shares**

11.1 **Transferability of Awards.** Except as provided in Section 11.2, during a Participant’s lifetime, his or her Awards shall be exercisable only by the Participant. Awards shall not be transferable other than by will or the laws of descent and distribution or, subject to the consent of the Committee, pursuant to a domestic relations order entered into by a court of competent jurisdiction. No Awards shall be subject, in whole or in part, to attachment, execution or levy of any kind. Any purported transfer in violation of this Section 11.1 shall be null and void. The Committee may establish such procedures as it deems appropriate for a Participant to designate a beneficiary to whom any amounts payable or Shares deliverable in the event of, or following, the Participant’s death may be provided.

11.2 **Committee Action.** Except as provided in Section 6.7(i), the Committee may, in its discretion, determine that notwithstanding Section 11.1, any or all Awards shall be transferable to and exercisable by such transferees, and subject to such terms and conditions, as the Committee may deem appropriate; provided, however, no Award may be transferred for value without stockholder approval.

11.3 **Restrictions on Share Transferability.** The Committee may impose such restrictions on any Shares acquired by a Participant under the Plan as it may deem advisable, including, without limitation, minimum holding period requirements, restrictions under applicable federal securities laws, under the requirements of any stock exchange or market upon which such Shares are then listed or traded, or under any blue sky or state securities laws applicable to such Shares.

**Article 12. Performance Measures**

12.1 **Performance Measures.** The performance goals upon which the payment or vesting of an Award to a Covered Employee that is intended to qualify as Performance-Based Compensation shall be limited to the following Performance Measures:

- (a) revenue;
- (b) bookings;
- (c) gross profit or margin;
(d) operating income or margin;
(e) exit rate operating income margin (derived by annualizing the cost of sales and operating expense structure in place at fiscal year-end compared to the actual revenues generated in that fiscal year);
(f) earnings before or after taxes, interest, depreciation, and/or amortization;
(g) net earnings or net income (before or after taxes);
(h) earnings per share;
(i) share price (including, but not limited to, growth measures and total stockholder return);
(j) operating expenses (including cost reductions);
(k) return measures (including return on assets, capital, invested capital, equity, sales, or revenue);
(l) cash flow (including operating cash flow, free cash flow, cash flow return on equity, and cash flow return on investment);
(m) asset turnover (including days sales outstanding);
(n) reduction in leverage;
(o) market share;
(p) working capital; and
(q) economic value added or EVA\(^\circ\) (net operating profit after tax minus the sum of capital multiplied by the cost of capital).

Any of the above Performance Measure(s), or any combination thereof, may be used to measure the performance of the Company, Subsidiary, and/or Affiliate as a whole or any business unit of the Company, Subsidiary, and/or Affiliate, as the Committee may deem appropriate. Performance Measures may be compared to (i) the performance of a group of comparator companies, (ii) a published or special index that the Committee, in its sole discretion, deems appropriate, and/or (iii) other benchmarks approved by the Committee. The Committee also has the authority to provide for accelerated vesting of any Award based on the achievement of performance goals.

12.2 Evaluation of Performance. The Committee may provide in any such Award that any evaluation of performance may include or exclude any of the following events or income or expense items that occur during a Performance Period: (a) asset write-downs, (b) litigation or claim judgments or settlements, (c) the effect of changes in tax laws, accounting principles, or other laws or provisions affecting reported results, (d) any reorganization and restructuring programs, executive termination costs or other special charges, (e) extraordinary items as defined by generally accepted accounting principles or any successor there to, (f) acquisitions or divestitures, including asset sales, (g) the positive or negative impact of foreign exchange movements, (h) stock-based compensation expense, (i) in-process research and development expenses, (j) intangible asset amortization, (k) integration and other one-time expenditures or other adjustments related to acquisitions, (l) acquisition costs, (m) merger costs, including severance, lease and other facility costs of the acquired company, (n) gains or losses associated with either the repurchase or potential settlement of any or all of the Company’s outstanding debt or convertible debt instruments issued by the Company from time to time, and (o) the positive or negative impacts associated with the implementation of International Financial Reporting Standards (“IFRS”). To the extent such inclusions or exclusions affect Awards to Covered Employees that are intended to qualify as Performance-Based Compensation, they shall be prescribed in a form that meets the requirements of Code Section 162(m) for deductibility.

12.3 Adjustment of Performance-Based Compensation. Subject to Section 12.4, Awards that are intended to qualify as Performance-Based Compensation may not be adjusted upward. The Committee shall retain the discretion to adjust such Awards downward, either on a formula or discretionary basis or any combination, as the Committee determines.

12.4 Committee Discretion. In the event that applicable tax or securities laws or regulations or court or regulatory decisions change to permit Committee discretion to alter the governing Performance Measures without obtaining stockholder approval of such changes, the Committee shall have sole discretion to make such changes without obtaining stockholder approval. In addition, in the event that the Committee determines that it is advisable to grant Awards that shall not qualify as Performance-Based Compensation, the Committee may make such grants without satisfying the requirements of Code Section 162(m) and base vesting on Performance Measures other than those set forth in Section 12.1.

**Article 13. Dividend Equivalents**

Any Participant selected by the Committee may be granted dividend equivalents based on the dividends declared on Shares that are subject to any Award, to be credited as of dividend payment dates, during the period between the date the Award is granted and the date the Award is exercised, vests, or expires, as determined by the Committee. Such
dividend equivalents shall be converted to cash or additional Shares by such formula and at such time and subject to such limitations as may be determined by the Committee. Notwithstanding the foregoing, the Committee may not grant dividend equivalents based on the dividends declared on Shares that are subject to a NQSO, ISO, or SAR Award, and if any Award for which dividend equivalents have been granted has its vesting dependent upon the achievement of one or more Performance Measures, then the dividend equivalents shall accrue and only be paid to the extent the Award becomes vested.

Article 14. Beneficiary Designation

Each Participant under this Plan may, from time to time, name any beneficiary or beneficiaries (who may be named contingently or successively) to whom any benefit under this Plan is to be paid in case of his death before he receives any or all of such benefit. Each such designation shall revoke all prior designations by the same Participant, shall be in a form prescribed by the Committee, and will be effective only when filed by the Participant in writing with the Company during the Participant’s lifetime. In the absence of any such beneficiary designation, benefits remaining unpaid or rights remaining unexercised at the Participant’s death shall be paid to or exercised by the Participant’s executor, administrator, or legal representative.

Article 15. Rights of Participants

15.1 Employment. Nothing in this Plan or an Award Agreement shall (a) interfere with or limit in any way the right of the Company, its Affiliates, and/or its Subsidiaries, to terminate any Participant’s employment or service on the Board or to the Company, its Affiliates, and/or its Subsidiaries at any time or for any reason not prohibited by law, or (b) confer upon any Participant any right to continue his employment or service as a Non-employee Director for any specified period of time. Neither an Award nor any benefits arising under this Plan shall constitute an employment contract with the Company or any Affiliate or Subsidiary and, accordingly, subject to Articles 3 and 17, this Plan and the benefits hereunder may be terminated at any time in the sole and exclusive discretion of the Committee without giving rise to any liability on the part of the Company, its Affiliates, and/or its Subsidiaries.

15.2 Participation. No individual shall have the right to be selected to receive an Award under this Plan, or, having been so selected, to be selected to receive a future Award.

15.3 Rights as a Stockholder. Except as otherwise provided herein, a Participant shall have none of the rights of a stockholder with respect to Shares covered by any Award until the Participant becomes the record holder of such Shares.

Article 16. Change of Control

16.1 Change of Control of the Company. Notwithstanding any other provision of this Plan to the contrary, the provisions of this Article 16 shall apply in the event of a Change of Control, unless otherwise determined by the Committee in connection with the grant of an Award as reflected in the applicable Award Agreement.

(a) Outstanding Options and SARs exchanged for Replacement Awards. Upon a Change of Control, if an award meeting the requirements of Section 16.2 (a “Replacement Award”) is provided to a Participant to replace the Participant’s then outstanding Options or Stock Appreciation Rights (the “Replaced Award”), then the Replaced Award shall be deemed cancelled and shall have no further force or effect and the Company shall have no further obligation with respect to the Replaced Award.

(b) Outstanding Options and SARs not exchanged for Replacement Awards. Upon a Change of Control, to the extent a Participant’s then-outstanding Options and Stock Appreciation Rights are not exchanged for Replacement Awards as provided for in paragraph (a) above, then such Options and Stock Appreciation Rights may become fully vested and exercisable if approved by the Committee or provided for in the Award Agreement.

(c) Service-Based Outstanding Awards other than Options and SARs. Upon a Change of Control, all then-outstanding Awards, other than Options and SARs, that are not vested and as to which vesting depends solely on the satisfaction of a service obligation by a Participant to the Company, Subsidiary, or Affiliate may vest in full and be free of restrictions related to the vesting or transferability of such Awards if approved by the Committee or provided for in the Award Agreement.
(d) **Other Awards.** Upon a Change of Control, the treatment of then-outstanding Awards not subject to subparagraphs (a), (b) or (c) above shall be determined by the terms and conditions set forth in the applicable Award Agreement.

(c) **Committee discretion regarding treatment of Awards not exchanged for Replacement Awards.** Except to the extent that a Replacement Award is provided to the Participant, the Committee may, in its sole discretion, (i) determine that any or all outstanding Awards granted under the Plan, whether or not exercisable, will be canceled and terminated and that in connection with such cancellation and termination the holder of such Award may receive for each Share subject to such Awards a cash payment (or the delivery of shares of stock, other securities or a combination of cash, stock and securities equivalent to such cash payment) equal to the difference, if any, between the consideration received by stockholders of the Company in respect of a Share in connection with such transaction and the purchase price per Share, if any, under the Award multiplied by the number of Shares subject to such Award; provided that if such product is zero or less or to the extent that the Award is not then exercisable, the Awards will be canceled and terminated without payment therefore or (ii) provide that the period to exercise Options or Stock Appreciation Rights granted under the Plan shall be extended (but not beyond the expiration date of such Option or Stock Appreciation Right).

16.2 **Replacement Awards.** An award shall qualify as a Replacement Award if: (i) it has a value in the aggregate at least equal to the value of the Replaced Award as determined by the Committee in its sole discretion; (ii) it relates to publicly traded equity securities of the Company or its successor in the Change of Control or of another entity that is affiliated with the Company or of its successor following the Change of Control; and (iii) its other terms and conditions are in the aggregate not less favorable to the Participant than the terms and conditions of the Replaced Award (including the provisions that would apply in the event of a subsequent Change of Control). Without limiting the generality of the foregoing, the Replacement Award may take the form of a continuation of the Replaced Award if the requirements of the preceding sentence are satisfied. The determination of whether the conditions of this Section 16.2 are satisfied shall be made by the Committee, as constituted immediately before the Change of Control, in its sole discretion.

**Article 17. Amendment and Termination**

17.1 **Amendment and Termination of the Plan and Award Agreements.**

(a) Subject to subparagraphs (b) and (c) of this Section 17.1 and Section 17.3 of the Plan, the Board may at any time terminate the Plan or an outstanding Award Agreement and the Committee may, at any time and from time to time, amend the Plan or an outstanding Award Agreement.

(b) Except in connection with a corporate transaction involving the Company (including, without limitation, any stock dividend, stock split, extraordinary cash dividend, recapitalization, reorganization, merger, consolidation, split-up, spin-off, combination, or exchange of shares), the terms of an outstanding Award may not be amended to reduce the Option Price of outstanding Options or to reduce the Grant Price of outstanding SARs or cancel outstanding Options or SARs in exchange for cash, other awards or options or SARs with an Option Price or Grant Price, as applicable, that is less than the Option Price of the cancelled Options or the Grant Price of the cancelled SARs without stockholder approval.

(c) Notwithstanding the foregoing, no amendment of this Plan shall be made without stockholder approval if stockholder approval is required pursuant to rules promulgated by any stock exchange or quotation system on which Shares are listed or quoted or by applicable U.S. state corporate laws or regulations, applicable U.S. federal laws or regulations or the applicable laws of any foreign country or jurisdiction where Awards are, or will be, granted under the Plan.

17.2 **Adjustment of Awards Upon the Occurrence of Certain Unusual or Nonrecurring Events.** Subject to Section 12.3, the Committee may make adjustments in the terms and conditions of, and the criteria included in, Awards in recognition of unusual or nonrecurring events (including, without limitation, the events described in Section 4.4 hereof) affecting the Company or the financial statements of the Company or of changes in applicable laws, regulations, or accounting principles, whenever the Committee determines that such adjustments are appropriate in order to prevent unintended dilution or enlargement of the benefits or potential benefits intended to be made available under this Plan. The determination of the Committee as to the foregoing adjustments, if any, shall be conclusive and binding on Participants under this Plan. By accepting an Award under this Plan, a Participant agrees to any adjustment to the Award made pursuant to this Section 17.2 without further consideration or action.
17.3 **Awards Previously Granted.** Notwithstanding any other provision of this Plan to the contrary, other than Sections 17.2, 17.4, or 20.14, no termination or amendment of this Plan or an Award Agreement shall adversely affect in any material way any Award previously granted under this Plan, without the written consent of the Participant holding such Award.

17.4 **Amendment to Conform to Law.** Notwithstanding any other provision of this Plan to the contrary, the Committee may amend the Plan or an Award Agreement, to take effect retroactively or otherwise, as deemed necessary or advisable for the purpose of conforming the Plan or an Award Agreement to any present or future law relating to plans of this or similar nature, and to the administrative regulations and rulings. By accepting an Award under this Plan, a Participant agrees to any amendment made pursuant to this Section 17.4 to any Award granted under the Plan without further consideration or action.

**Article 18. Withholding**

18.1 **Tax Withholding.** The Company shall have the power and the right to deduct or withhold, or require a Participant to remit to the Company, the minimum statutory amount to satisfy federal, state, and local taxes, domestic or foreign, required by law or regulation to be withheld with respect to any taxable event arising as a result of this Plan.

18.2 **Share Withholding.** With respect to withholding required upon the exercise of Options or SARs, upon the lapse of restrictions on Restricted Stock and Restricted Stock Units, or upon the achievement of performance goals related to Performance Shares, or any other taxable event arising as a result of an Award (collectively and individually referred to as “Share Payment”), Participants may elect, subject to the approval of the Committee, to satisfy the withholding requirement, in whole or in part, by having the Company withhold from a Share Payment the number of Shares having a Fair Market Value on the date the withholding is to be determined equal to the minimum statutory withholding requirement but in no event shall such withholding exceed the minimum statutory withholding requirement. All such elections shall be irrevocable, made in writing, and signed by the Participant, and shall be subject to any restrictions or limitations that the Committee, in its sole discretion, deems appropriate.

**Article 19. Successors**

All obligations of the Company under this Plan with respect to Awards granted hereunder shall be binding on any successor to the Company, whether the existence of such successor is the result of a direct or indirect purchase, merger, consolidation, or otherwise, of all or substantially all of the business and/or assets of the Company.

**Article 20. General Provisions**

20.1 **Forfeiture Events.**

(a) The Committee may specify in an Award Agreement that the Participant’s rights, payments, and benefits with respect to an Award shall be subject to reduction, cancellation, forfeiture, or recoupment upon the occurrence of certain specified events, in addition to any otherwise applicable vesting or performance conditions of an Award. Such events may include, but shall not be limited to, termination of employment for cause, termination of the Participant’s provision of services to the Company, Affiliate, or Subsidiary, violation of material Company, Affiliate, or Subsidiary policies, breach of non-competition, confidentiality, or other restrictive covenants that may apply to the Participant, or other conduct by the Participant that is detrimental to the business or reputation of the Company, any Affiliate, or Subsidiary.

(b) The Committee may specify in an Award Agreement that, if any of the Company’s financial statements are required to be restated resulting from errors, omissions, or fraud, the Company may recover all or a portion of any Award granted or paid to a Participant with respect to any fiscal year of the Company the financial results of which are negatively affected by such restatement. Unless otherwise specified in the Award Agreement, the amount to be recovered from the Participant shall be the amount by which the Award exceeded the amount that would have been payable to the Participant had the financial statements been initially filed as restated, or any greater or lesser amount (including, but not limited to, the entire Award) that the Committee shall determine. In no event shall the amount to be recovered by the Company be less than the amount required to be repaid or recovered as a matter of law (including but not limited to amounts that are required to be recovered or forfeited under Section 304 of the Sarbanes-Oxley Act of 2002). The Committee shall determine whether the Company shall effect any such recovery: (i) by seeking repayment from the Participant, (ii) by reducing (subject to applicable law and the terms and conditions of the applicable plan, program or arrangement) the amount that would otherwise be payable to the Participant under any compensatory plan,
program, or arrangement maintained by the Company, an Affiliate, or any Subsidiary, (iii) by withholding payment of future increases in compensation (including the payment of any discretionary bonus amount) or grants of compensatory awards that would otherwise have been made in accordance with the company’s otherwise applicable compensation practices, or (iv) by any combination of the foregoing.

20.2 **Legend.** The certificates for Shares may include any legend which the Committee deems appropriate to reflect any restrictions on transfer of such Shares.

20.3 **Gender and Number.** Except where otherwise indicated by the context, any masculine term used herein also shall include the feminine, the plural shall include the singular, and the singular shall include the plural.

20.4 **Severability.** In the event any provision of this Plan shall be held illegal or invalid for any reason, the illegality or invalidity shall not affect the remaining parts of this Plan, and this Plan shall be construed and enforced as if the illegal or invalid provision had not been included.

20.5 **Requirements of Law.** The granting of Awards and the issuance of Shares under this Plan shall be subject to all applicable laws, rules, and regulations, and to such approvals by any governmental agencies or national securities exchanges as may be required. The Company, in its discretion, may postpone the granting and exercising of Awards, the issuance or delivery of Shares under any Award or any other action permitted under the Plan to permit the Company, with reasonable diligence, to complete such national securities exchange listing or registration or qualification of such Shares or other required action under any federal or state law, rule, or regulation and may require any Participant to make such representations and furnish such information as it may consider appropriate in connection with the issuance or delivery of Shares in compliance with applicable laws, rules, and regulations. The Company shall not be obligated by virtue of any provision of the Plan to recognize the exercise of any Award or to otherwise sell or issue Shares in violation of any such laws, rules, or regulations, and any postponement of the exercise or settlement of any Award under this provision shall not extend the term of such Awards. Neither the Company nor its directors or officers shall have any obligation or liability to a Participant with respect to any Award (or Shares issuable thereunder) that shall lapse because of such postponement.

20.6 **Delivery of Title.** The Company shall have no obligation to issue or deliver evidence of title for Shares issued under this Plan prior to:

(a) obtaining any approvals from governmental agencies that the Company determines are necessary or advisable; and

(b) completion of any registration or other qualification of the Shares under any applicable national or foreign law or ruling of any governmental body that the Company determines to be necessary or advisable.

20.7 **Inability to Obtain Authority.** The inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company’s counsel to be necessary to the lawful issuance and sale of any Shares, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

20.8 **Investment Representations.** The Committee may require any individual receiving Shares pursuant to an Award under this Plan to represent and warrant in writing that the individual is acquiring the Shares for investment and without any present intention to sell or distribute such Shares.

20.9 **Participants Based Outside of the United States.** Notwithstanding any provision of this Plan to the contrary, in order to comply with the laws in other countries in which the Company, its Affiliates, and/or its Subsidiaries operate or have Employees, Non-employee Directors or Third Party Service Providers, the Committee, in its sole discretion, shall have the power and authority to:

(a) determine which Affiliates and Subsidiaries shall be covered by this Plan;

(b) determine which Employees, Non-employee Directors or Third Party Service Providers outside the United States are eligible to participate in this Plan;

(c) modify the terms and conditions of any Award granted to Employees, Non-employee Directors or Third Party Service Providers outside the United States to comply with applicable foreign laws;
(d) establish subplans and modify exercise procedures and other terms and procedures, to the extent such actions may be necessary or advisable, and any such subplans and modifications to Plan terms and procedures established under this Section 20.9 by the Committee shall be attached to this Plan document as appendices; and

(e) take any action, before or after an Award is made, that it deems advisable to obtain approval or comply with any necessary local government regulatory exemptions or approvals.

Notwithstanding the above, the Committee may not take any actions hereunder, and no Awards shall be granted, that would violate applicable law.

20.10 Uncertificated Shares. To the extent that this Plan provides for issuance of certificates to reflect the transfer of Shares, the transfer of such Shares may be effected on a noncertificated basis, to the extent not prohibited by applicable law or the rules of any stock exchange.

20.11 Unfunded Plan. Participants shall have no right, title, or interest whatsoever in or to any investments that the Company, its Subsidiaries, or its Affiliates may make to aid them in meeting their obligations under this Plan. Nothing contained in this Plan, and no action taken pursuant to its provisions, shall create or be construed to create a trust of any kind, or a fiduciary relationship between the Company and any Participant, beneficiary, legal representative, or any other individual. To the extent that any individual acquires a right to receive payments from the Company or any Affiliate or Subsidiary under this Plan, such right shall be no greater than the right of an unsecured general creditor of the Company or the Subsidiary or Affiliate, as the case may be. All payments to be made hereunder shall be paid from the general funds of the Company, or the Subsidiary or Affiliate, as the case may be and no special or separate fund shall be established and no segregation of assets shall be made to assure payment of such amounts except as expressly set forth in this Plan.

20.12 No Fractional Shares. No fractional Shares shall be issued or delivered pursuant to this Plan or any Award. The Committee shall determine whether cash, Awards, or other property shall be issued or paid in lieu of fractional Shares or whether such fractional Shares or any rights thereto shall be forfeited or otherwise eliminated.

20.13 Retirement and Welfare Plans. Neither Awards made under this Plan nor Shares or cash paid pursuant to such Awards may be included as “compensation” for purposes of computing the benefits payable to any Participant under the Company’s or any Subsidiary’s or Affiliate’s retirement plans (both qualified and nonqualified) or welfare benefit plans unless such other plan expressly provides that such compensation shall be taken into account in computing a Participant’s benefit.

20.14 Deferred Compensation.

(a) The Committee may grant Awards under the Plan that provide for the deferral of compensation within the meaning of Code Section 409A. It is intended that such Awards comply with the requirements of Code Section 409A so that amounts deferred thereunder are not includible in income and are not subject to an additional tax of twenty percent (20%) at the time the deferred amounts are no longer subject to a substantial risk of forfeiture.

(b) Notwithstanding any provision of the Plan or Award Agreement to the contrary, if one or more of the payments or benefits to be received by a Participant pursuant to an Award would constitute deferred compensation subject to Code Section 409A and would cause the Participant to incur any penalty tax or interest under Code Section 409A or any regulations or Treasury guidance promulgated thereunder, the Committee may reform the Plan and Award Agreement to comply with the requirements of Code Section 409A and to the extent practicable maintain the original intent of the Plan and Award Agreement. By accepting an Award under this Plan, a Participant agrees to any amendments to the Award made pursuant to this Section 20.14(b) without further consideration or action.

20.15 Nonexclusivity of this Plan. The adoption of this Plan shall not be construed as creating any limitations on the power of the Board or Committee to adopt such other compensation arrangements as it may deem desirable for any Participant.

20.16 No Constraint on Corporate Action. Nothing in this Plan shall be construed to: (i) limit, impair, or otherwise affect the Company’s or a Subsidiary’s or an Affiliate’s right or power to make adjustments, reclassifications, reorganizations, or changes of its capital or business structure, or to merge or consolidate, or dissolve, liquidate, sell, or
transfer all or any part of its business or assets; or (ii) limit the right or power of the Company or a Subsidiary or an Affiliate to take any action which such entity deems to be necessary or appropriate.

20.17 **Governing Law.** The Plan and each Award Agreement shall be governed by the laws of the State of Oregon, excluding any conflicts or choice of law rule or principle that might otherwise refer construction or interpretation of this Plan to the substantive law of another jurisdiction. Unless otherwise provided in the Award Agreement, recipients of an Award under this Plan are deemed to submit to the exclusive jurisdiction and venue of the federal or state courts of Oregon to resolve any and all issues that may arise out of or relate to this Plan or any related Award Agreement.

20.18 **Delivery and Execution of Electronic Documents.** To the extent permitted by applicable law, the Company may (i) deliver by email or other electronic means (including posting on a web site maintained by the Company or by a third party under contract with the Company) all documents relating to the Plan or any Award thereunder (including without limitation, prospectuses) and all other documents that the Company is required to deliver to its security holders (including without limitation, annual reports and proxy statements) and (ii) permit Participants to electronically execute applicable Plan documents (including, but not limited to, Award Agreements) in a manner prescribed by the Committee.

20.19 **No Representations or Warranties Regarding Tax Effect.** Notwithstanding any provision of the Plan to the contrary, the Company, its Affiliates and Subsidiaries, the Board and the Committee neither represent nor warrant the tax treatment under any federal, state, local or foreign laws and regulations thereunder (individually and collectively referred to as the “Tax Laws”) of any Award granted or any amounts paid to any Participant under the Plan including, but not limited to, when and to what extent such Awards or amounts may be subject to tax, penalties and interest under the Tax Laws.
RESTRICTED STOCK UNIT AGREEMENT

This Agreement is entered into as of _____, ____ between Mentor Graphics Corporation, an Oregon corporation (“Company”), and __________ (“Recipient”).

On the date of this Agreement (“Grant Date”), Recipient has been granted an award of Restricted Stock Units (“RSUs”) pursuant to Section 8 of the Company’s 2010 Omnibus Incentive Plan, and Recipient desires to accept the award subject to the terms and conditions of this Agreement.

1. Grant of Restricted Stock Units.

The Company hereby grants to Recipient _____ RSUs subject to the terms and conditions of this Agreement. The grant of RSUs obligates the Company, upon vesting in accordance with this Agreement, to issue to the Recipient one share of Common Stock of the Company for each RSU.

2. Vesting of RSUs.

   2.1 RSUs shall become vested, and the underlying shares of Common Stock shall be issued, on the first anniversary of the Grant Date.

   2.2 If Recipient has a separation from service as a director (as defined for purposes of Section 409A of the Internal Revenue Code (“Section 409A”)) for any reason, all RSUs shall become vested and the underlying shares of Common Stock shall be issued to Recipient.

3. Acceleration upon Change in Control.

Notwithstanding any provision in this Agreement, all RSUs shall immediately become vested upon the occurrence of a “change in control event” as defined in Treas. Reg. §1.409A-3(i)(5) (or successor provisions).

4. No Voting or Dividend Rights.

The Recipient shall have no voting, dividend or any other rights as a shareholder with respect to the RSUs or the Common Stock underlying the RSUs until the underlying Common Stock is issued to the Recipient.

5. Non-Assignability of RSUs.

The RSUs may not be assigned or transferred except on death, by will or operation of law.

6. Delivery of Shares.

As soon as practicable on or after the date on which the RSUs become vested, the Company will issue in the name of the Recipient the number of shares of Common Stock underlying the RSUs that vested, and will deliver such shares to the Recipient in accordance with instructions from the Recipient or in such other manner as may be determined by the Company. In accordance with Treas. Reg. § 1.409A-3(d) (or successor provisions), payment shall be made by the end of the calendar year containing such vesting date or, if later, by the 15th day of the third calendar month following such vesting date.


If, prior to the vesting of the RSUs awarded under this Agreement, the outstanding shares of Common Stock of the Company are increased or decreased or changed into or exchanged for a different number or kind of shares or other securities of the Company by reason of any recapitalization, reclassification, stock split, combination
of shares, or dividend payable in shares, appropriate adjustment shall be made by the Compensation Committee of
the Company's Board of Directors (the “Administrator”) in the number and kind of shares subject to the unvested
RSUs under this Agreement so that the Recipient’s proportionate interest before and after the occurrence of the event
is maintained. Fractional shares will be disregarded. Any such adjustment made by the Administrator shall be
conclusive.

8. Successorship.

Subject to the limits in Section 5, this Agreement will be binding upon and benefit the parties, their
successors and assigns.


9.1 Subject to Section 9.4, this Agreement constitutes the entire agreement of the parties with regard
to the subjects hereof and may be amended only by written agreement between the Company and Recipient.

9.2 The parties agree to execute such further instruments and to take such further action as may
reasonably be necessary to carry out the intent of this Agreement.

9.3 The terms and conditions of this Agreement shall be governed by the laws of the State of Oregon.

9.4 The terms and conditions of this Agreement shall be interpreted and administered in such a way as
to comply with the applicable provisions of Section 409A to the maximum extent possible. In addition, if the
Recipient must be treated as a “specified employee” within the meaning of Section 409A, any payments made on
account of the Recipient’s separation from service as a director (as defined for purposes of Section 409A) shall be
made on the date that is six (6) months and one (1) day following the date of the Recipient’s separation from service
as a director. To the extent that the Company determines that the RSUs fail to comply with the applicable
requirements of Section 409A, the Company reserves the right (without any obligation to do so) to amend,
restructure, terminate or replace the RSUs in order to cause the RSUs to either not be subject to Section 409A or to
comply with the applicable provisions of Section 409A.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of the day and year first
above written.

MENTOR GRAPHICS CORPORATION

By
Dean Freed
Vice President and General Counsel

RECIPIENT

____________________________
NAME
CERTIFICATIONS

I, Walden C. Rhines, certify that:

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

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

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

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
   
   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Dated: September 4, 2014

/S/ WALDEN C. RHINES

Walden C. Rhines
Chief Executive Officer
CERTIFICATIONS

I, Gregory K. Hinckley, certify that:

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

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

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

4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Dated: September 4, 2014

/S/ GREGORY K. HINCKLEY

Gregory K. Hinckley
President, Chief Financial Officer

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

(i) the Quarterly Report on Form 10-Q of the Company for the quarter ended July 31, 2014 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

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

Dated: September 4, 2014

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

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


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

(i) the Quarterly Report on Form 10-Q of the Company for the quarter ended July 31, 2014 (the “Report”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

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

Dated: September 4, 2014

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

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