LOGICVISION INC
Form 10-Q
November 12, 2004

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2004

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.: 0-31773

LOGICVISION, INC.

(Exact name of registrant as specified in its charter)

Delaware	**94-3166964**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

25 Metro Drive, Third Floor
San Jose, California 95110
(Address of principal executive offices)

Telephone: (408) 453-0146
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes |_| No |X|

At October 29, 2004, 16,105,452 shares of Registrant s Common Stock, $0.0001 par value were outstanding.

LOGICVISION, INC.

FORM 10-Q

QUARTERLY PERIOD ENDED SEPTEMBER 30, 2004

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PART I: FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

LOGICVISION, INC.
UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	September 30, 2004	December 31, 2003
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 7,539	$15,475
Short-term investments	12,818	3,782
Accounts receivable, net	2,560	2,756
Prepaid expenses and other current assets	1,321	1,251
Total current assets	24,238	23,264
Property and equipment, net	986	922
Marketable securities	7,365	11,801
Other long-term assets, net	2,007	508
Total assets	$34,596	$36,495
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 2,360	$ 754
Accrued liabilities	2,238	1,389
Deferred revenue	5,496	5,482
Total current liabilities	10,094	7,625
Non-current deferred revenue	2,818	1,719
Total liabilities	12,912	9,344
Commitments and contingencies (Note 5)		
Stockholders Equity:		
Preferred stock, $0.0001 par value:		
Authorized: 5,000,000 shares;		
Issued and outstanding: no shares issued and outstanding		
Common stock, $0.0001 par value:		
Authorized: 125,000,000 shares;		
Issued and outstanding: 16,094,087 shares at September 30, 2004 and 15,775,779 shares at December 31, 2003	2	2
Additional paid-in capital	98,315	97,759
Deferred stock-based compensation	(10)	(132)
Accumulated other comprehensive income	108	135
Accumulated deficit	(76,731)	(70,613)
Total stockholders equity	21,684	27,151
Total liabilities and stockholders equity	$34,596	$36,495

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

LOGICVISION, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Revenues:				
License	$1,662	$466	$ 4,111	$2,046
Service	962	950	2,977	3,115
Product	69	65	278	129
Total revenues	2,693	1,481	7,366	5,290
Cost of revenues:				
License	42	58	136	144
Service	691	524	1,977	2,013
Product	99	32	266	53
Total cost of revenues	832	614	2,379	2,210
Gross profit	1,861	867	4,987	3,080
Operating expenses:				
Research and development	1,220	1,089	3,659	3,526
Sales and marketing	1,530	2,149	4,368	7,118
General and administrative	980	1,082	3,366	3,167
Total operating expenses	3,730	4,320	11,393	13,811
Loss from operations	(1,869)	(3,453)	(6,406)	(10,731)
Interest and other income, net	106	152	324	523
Loss before provision for income taxes	(1,763)	(3,301)	(6,082)	(10,208)
Provision for income taxes	4	41	36	123

Net loss	$ (1,767)	$ (3,342)	$ (6,118)	$(10,331)
Net loss per common share, basic and diluted	$ (0.11)	$ (0.21)	$ (0.38)	$ (0.67)
Weighted average number of shares outstanding, basic and diluted	16,065	15,618	15,990	15,435

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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LOGICVISION, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(in thousands)

	Nine Months Ended September 30,	
	2004	**2003**
Cash flows from operating activities:		
Net loss	$ (6,118)	$ (10,331)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	468	1,342
Amortization of deferred stock-based compensation	39	601
Changes in operating assets and liabilities:		
Accounts receivable, net	195	(2,206)
Prepaid expenses and other current assets	(69)	220
Other long-term assets	(1,499)	(57)
Accounts payable	1,606	(862)
Deferred revenue	1,114	1,836
Accrued liabilities	849	(41)
Net cash used in operating activities	(3,415)	(9,498)
Cash flows from investing activities:		
Purchase of marketable securities	(3,283)	(4,301)
Purchase of short-term investments	(6,984)	(2,004)
Purchase of property and equipment	(528)	(395)
Proceeds from sales of marketable securities and short-term investments	5,667	8,490
Net cash provided by (used in) investing activities	(5,128)	1,790
Cash flows from financing activities:		
Proceeds from issuance of common stock	639	698
Repayment of short-term debt		(1,500)

Net cash provided by (used in) financing activities	639	(802)
Effect of exchange rate on cash	(32)	17
Net decrease in cash and cash equivalents	(7,936)	(8,493)
Cash and cash equivalents, beginning of period	15,475	16,179
Cash and cash equivalents, end of period	$ 7,539	$ 7,686

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

LOGICVISION, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of LogicVision, Inc. (LogicVision or the Company) and its wholly-owned subsidiaries after elimination of all inter-company transactions. The Company s fiscal year ends on December 31.

The accompanying unaudited condensed consolidated financial statements of LogicVision have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial information and in accordance with the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, they do not include all of the information and footnotes necessary for a fair presentation of financial position, results of operations and cash flows in conformity with GAAP. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The December 31, 2003 fiscal year end balance sheet data was derived from the audited financial statements and does not include all disclosures required by GAAP. Operating results for the three months and nine months ended September 30, 2004 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2004 or any other future period. The unaudited condensed consolidated interim financial statements contained herein should be read in conjunction with the audited financial statements and footnotes for the year ended December 31, 2003 included in the Company s Annual Report on Form 10-K as filed with the SEC.

Certain items previously presented in specific financial statement captions have been reclassified to conform with the current presentation for 2004.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and to disclose contingent liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates.

Note 2. Recently Issued Accounting Standards

In June 2004, the Financial Accounting Standards Board (FASB) issued EITF Issue 03-01 The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments (EITF 03-01). EITF 03-01 establishes a common approach to evaluating other-than-temporary impairment to investments in an effort to reduce the ambiguity in impairment methodology found in APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock and Statement of Financial Accounting Standards (SFAS) No. 115, Accounting for Certain Investments in Debt and Equity Securities, which has resulted in inconsistent application. In September 2004, the FASB issued FASB Staff Position (FSP) No. EITF Issue 03-01-1, which deferred the effective date for the measurement and recognition guidance clarified in EITF 03-01; however, disclosure requirements have not been deferred. Disclosure requirements are effective for the Company s next annual financial statements. While the effective date for certain elements of EITF 03-01 have been deferred, the adoption of EITF 03-01 when finalized is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

On December 17, 2003, the Staff of the Securities and Exchange Commission issued Staff Accounting Bulletin No. 104 (SAB 104), Revenue Recognition, which supersedes SAB 101, Revenue Recognition in Financial Statements. SAB 104 s primary purpose is to rescind the accounting guidance contained in SAB 101 related to multiple-element revenue arrangements that was superseded as a result of the issuance of EITF 00-21, Accounting for Revenue Arrangements with Multiple Deliverables. Additionally, SAB 104 rescinds the SEC s related Revenue Recognition in Financial Statements Frequently Asked Questions and Answers issued with SAB 101 that had been codified in SEC Topic 13, Revenue Recognition. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104, which was effective upon issuance. The Company s adoption of SAB 104 did not have a material effect on its financial position or results of operations.

Note 3. Cash and Cash Equivalents, Short-Term Investments and Marketable Securities

The Company considers all highly liquid investment instruments with original maturities of three months or less at the acquisition date to be cash equivalents, and investment instruments with original maturities of more than three months but less than twelve months to be short-term investments. All short-term investments and marketable securities are classified as held-to-maturity. Interest and realized gains and losses are included in interest income. Realized gains and losses are recognized based on

the specific identification method. Cash and cash equivalents, short-term investments and marketable securities consist of the following (in thousands):

	September 30, 2004	December 31, 2003
Cash and cash equivalents:		
Cash	$ 641	$ 1,942
Money market funds	3,800	203
Commercial paper	1,298	-
U.S. government agency notes	1,800	13,330
Total cash and cash equivalents	7,539	15,475
Short-term investments:		
U.S. government agency notes	11,069	3,782
Certificates of deposit	1,500	-
Commercial paper	249	-
Total short-term investments	12,818	3,782
Marketable securities:		
U.S. government agency notes	7,365	11,801
	$ 27,722	$ 31,058

Cash and Cash Equivalents, Short-Term Investments and Marketable Securities		

Note 4. Loan Agreement

The Company has a Loan Agreement with a bank under which it may borrow, on a revolving basis, up to $5.0 million at an interest rate equal to prime rate, which was equal to an annual rate of 4.75% at September 30, 2004. The agreement is unsecured and is not collateralized by the Company s assets. Under the agreement, the Company must comply with certain operating and reporting covenants and is not permitted to pay dividends, or make material investments or dispositions without the prior written consent of the bank. If the Company fails to comply with its covenants under the agreement, the bank can declare any outstanding amounts immediately due and payable and cease advancing money or extending credit to or for the Company. The agreement expires on January 31, 2005. There were no borrowings outstanding at September 30, 2004, and the Company was in compliance with all the operating and reporting covenants under the Agreement.

Note 5. Commitments and Contingencies

Lease obligations

At September 30, 2004, total future obligations under contractual obligations and commercial commitments, primarily leasing arrangements, were as follows (in thousands):

	Operating Leases
Year ending December 31,	
2004	$ 146
2005	494
2006	414
2007	325
2008	302
Thereafter	389
	$2,070

Rent expense for the three months and nine months ended September 30, 2004 was $208,000 and $686,000, respectively. Rent expense for the three months and nine months ended September 30, 2003 was $280,000 and $876,000, respectively.

The Company and its subsidiaries in Canada, India and Japan rent office facilities under non-cancelable operating leases which expire through March 2010. The Company and its subsidiaries are responsible for certain maintenance costs, taxes and insurance under the respective leases.

Off-balance Sheet Arrangements

The Company s off-balance sheet arrangements consist solely of operating leases as described above.

Indemnification Obligations

The Company enters into standard license agreements in the ordinary course of business. Pursuant to these agreements, the Company agrees to indemnify its customers for losses suffered or incurred by them as a result of any patent, copyright, or other intellectual property infringement claim by any third party with respect to the Company s products. These indemnification obligations have perpetual terms. The Company estimates the fair value of its indemnification obligations as insignificant, based upon its historical experience concerning product and patent infringement claims. Accordingly, the Company has no liabilities recorded for indemnification under these agreements as of September

30, 2004.

The Company has agreements whereby its officers and directors are indemnified for certain events or occurrences while the officer or director is, or was, serving at the Company s request in such capacity. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a directors and officers insurance policy that reduces its exposure and enables the Company to recover a portion of future amounts paid. As a result of the Company s insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal. Accordingly, no liabilities have been recorded for these agreements as of September 30, 2004.

Warranties

The Company offers its customers a warranty that its products will conform to the documentation provided with the products. To date, there have been no payments or material costs incurred related to fulfilling these warranty obligations. Accordingly, the Company has no liabilities recorded for these warranties as of September 30, 2004. The Company assesses the need for a warranty reserve on a quarterly basis, and there can be no guarantee that a warranty reserve will not become necessary in the future.

Note 6. Concentration of Credit Risk

The Company has been dependent on a relatively small number of customers for a substantial portion of its revenue, although the customers comprising this group have changed from time to time. Three customers accounted for 19%, 16% and 13% of its revenues in the three months ended September 30, 2004 and two customers accounted for 20% and 18% of its revenues in the nine months ended September 30, 2004. In the three and nine months ended September 30, 2003, no customer accounted for more than 10% of its revenues.

At September 30, 2004, two customers accounted for 67%, and 28% of net accounts receivable, respectively. At December 31, 2003, two customers accounted for approximately 64% and 24% of net accounts receivable, respectively.

Note 7. Net Loss Per Share

SFAS No. 128, Earnings Per Share, requires a dual presentation of basic and diluted earnings per share (EPS). Basic EPS excludes dilution and is computed by dividing net income or loss by the weighted average number of shares of common stock outstanding during the period. Diluted EPS reflects the potential dilution that would occur if outstanding securities to issue common stock were exercised or converted to common stock. Diluted net loss per share for the three months and nine months ended September 30, 2004 and 2003 does not differ from basic net loss per share since potential shares of common stock issuable upon exercise of stock options and warrants are anti-dilutive under the treasury stock method.

The following table presents the calculation of basic and diluted net loss per share (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Numerator - Basic and Diluted				
Net loss	$ (1,767)	$ (3,342)	$ (6,118)	$ (10,331)
Denominator - Basic and Diluted				
Weighted average common stock outstanding	16,065	15,618	15,990	15,435
Basic and diluted net loss per share	$ (0.11)	$ (0.21)	$ (0.38)	$ (0.67)

Options and warrants to purchase an aggregate of 4.6 million shares of common stock were outstanding at September 30, 2004, and were excluded from the computation of diluted shares because of their antidilutive effect on loss per share for the three months and nine months then ended.

Note 8. Comprehensive Loss

SFAS No. 130, Reporting Comprehensive Income, requires companies to classify items of other comprehensive income by their nature in the financial statements and display the accumulated balance of other comprehensive income separately from retained earnings and additional paid-in capital in the stockholders equity section of the balance sheet.

LogicVision s other comprehensive income consists primarily of adjustments to translate the financial statements of the Company s foreign subsidiaries into U.S. dollars for consolidation. The functional currency of the Company s foreign subsidiaries is the local currency and therefore, the translation adjustments of those statements into U.S. dollars are recorded in accumulated other comprehensive income, which is reported as a separate component of stockholders equity.

For the three months and nine months ended September 30, 2004 and 2003, comprehensive loss, which was comprised of the Company s net loss for the periods and changes in foreign currency translation adjustments, was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Net loss	$ (1,767)	$ (3,342)	$ (6,118)	$ (10,331)
Other comprehensive income - Cumulative translation adjustment	10	10	(27)	41
Comprehensive loss	$ (1,757)	$ (3,332)	$ (6,145)	$ (10,290)

Note 9. Deferred Stock-Based Compensation

The Company accounts for employee stock-based compensation plans using the intrinsic value method. Accordingly, deferred compensation is only recorded if the current market price of the underlying stock exceeds the exercise price on the date of grant.

Had compensation cost for the Company s stock-based compensation plan been determined based on the minimum value at the grant date for awards consistent with the provisions of SFAS No. 123 and SFAS No. 148, the Company s net loss would have been increased to the pro forma amounts indicated below (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Net loss, as reported	$(1,767)	$(3,342)	$(6,118)	$(10,331)
Add: Stock-based compensation				

	Three Months Ended September 30,		Nine Months Ended September 30,	
net loss expense included in reported	(46)	164	39	601
Deduct: Total stock-based compensation expense determined under fair value based method for all awards granted	(787)	(499)	(2,589)	(2,212)
Pro forma net loss	$(2,600)	$(3,677)	$(8,668)	$(11,942)
Loss per share:				
Basic and diluted as reported	$ (0.11)	$ (0.21)	$ (0.38)	$ (0.67)
Basic and diluted pro forma	$ (0.16)	$ (0.24)	$ (0.54)	$ (0.77)

The value of the option grants has been calculated on the date of grant using the Black-Scholes options pricing model with the following weighted-average assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Expected average life of option	4.4years	4 years	3.6years	4 years
Risk-free interest rate	3.55%	3.72%	2.78%	2.64%
Expected dividends				
Expected volatility	2.88	2.09	2.85	2.07

These pro forma amounts may not be representative of the effects for future years as options vest over several years and additional awards are generally made each year.

Stock-based compensation expense related to stock options granted to consultants is recognized as earned using the multiple option method. At each reporting date, the Company re-values the unvested portion of the option using the Black-Scholes option pricing model. As a result, the stock-based compensation expense will fluctuate as the fair market value of the Company s common stock fluctuates. For the three months and nine months ended September 30, 2004, the Company did not have any stock-based compensation expenses related to stock options granted to consultants. For the three months and nine months ended September 30, 2003, the stock-based compensation expenses related to stock options granted to consultants were $87,000 and $140,000, respectively.

Note 10. Segment Reporting

SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information, requires the presentation of segment information in a manner consistent with that of chief operating decision makers. Although the Company offers various design and manufacturing embedded test software products and services to its customers, the Company does not manage its operations by these products and services, but instead views the Company as one operating segment when making business decisions. The Company does not manage its operations on a geographical basis. Revenues attributed to the United States and to all foreign countries are based on the geographical location of the customers. The Company uses one measurement of profitability for its business.

The following is a summary of the Company s revenues by geographic operations (in thousands):

	Three Months Ended September 30,	Nine Months Ended September 30,
Net revenues:		

	2004	2003	2004	2003
United States	$ 2,080	$ 1,041	$ 5,601	$ 4,037
Japan	555	324	1,562	928
Other	58	116	203	325
	$ 2,693	$ 1,481	$ 7,366	$ 5,290

The following is a summary of the Company s long-lived assets (in thousands):

	September 30, 2004	December 31, 2003
United States	$ 644	$ 515
India	156	210
Canada	111	87
Japan	74	106
Others	1	4
	$ 986	$ 922

Note 11. Subsequent Event

In November 2004, the Company completed the acquisition of SiVerion, Inc. (SiVerion) for a total purchase price of $7.4 million. At the closing, the Company paid $1.4 million in cash and issued 2 million shares of the Company s common stock valued at $3.4 million to SiVerion s stockholders and paid $600,000 to certain debtholders. The purchase price also includes a contingent payment of up to $2 million in cash payable on November 5, 2006 if the average closing price of the Company s common stock for the 10 trading days immediately prior thereto is less than $3.00, in exchange for all of SiVerion s outstanding capital stock. SiVerion s software products aggregate and analyze data from various semiconductor fabrication and test sources to identify whether silicon behavior meets design criteria across varying manufacturing and operating conditions.

Upon closing, SiVerion became a business unit of the Company, retained all of its employees, and continued its operations in Arizona. One of SiVerion s directors, who was also a beneficial owner of approximately 34% of SiVerion s capital stock, has joined the Company s board of directors.

ITEM 2: MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the unaudited condensed consolidated financial statements and notes thereto set forth in Item 1 of this report and the section entitled Management s Discussion and Analysis of Financial Condition and Results of Operations in the Company s Annual Report on Form 10-K for the year ended December 31, 2003.

When used in this discussion, the words expects, anticipates, estimates, and similar expressions are intended to identify forward-looking statements. These statements, which include statements as to our critical accounting policies, our expectations regarding expenses, our estimates regarding our cash resources, the adequacy of our capital resources, our capital requirements and our needs for additional financing, planned capital expenditures, use of our working capital, sources of revenue and anticipated revenues, the features and *benefits of our products, customer demand, our growth strategy, our reliance on a limited number of customers, our business development efforts, expansion of our technologies and products, including by investment or acquisition, our ability to attract customers and establish license agreements, expectations regarding competition, our ability to attract and retain qualified personnel and our foreign currency risk strategy, are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, those risks discussed below, as well as the seasonality of the buying patterns of our customers, the concentration of sales to a limited number of customers, dependence upon and trends in capital spending budgets in the semiconductor industry and fluctuations in general economic conditions, our ability to rapidly develop new technology and introduce new products, our ability to safeguard our intellectual property and the matters discussed in Factors That May Affect Future Operating Results. These forward-looking statements speak only as of the date hereof. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company s expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.*

Critical Accounting Policies

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue Recognition

We account for our revenue under the provisions of Statement of Position 97-2, Software Revenue Recognition, as amended by Statement of Position 98-9 Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions and Statement of Position 81-1 Accounting for Performance of Construction-Type and Certain Production-Type Contracts.

We derive our revenues from three primary sources: license revenues, comprised of fees associated with the licensing of software; service revenues, from maintenance, consulting and training services; and product revenues, from the sale of hardware products. Revenue is recognized when persuasive evidence of an arrangement exists, all obligations have been performed pursuant to the terms of such an arrangement, the product has been delivered, the fee is fixed or determinable and the collection of the resulting receivable is reasonably assured. If any of these criteria are not met, we defer revenue recognition until such time as all criteria are met. Payments received in advance of revenues being recognized are presented as deferred revenue.

License revenues. We have three license types:

Subscription licenses - subscription licenses include software licenses and maintenance for a specific time period, generally three years or less. Maintenance is bundled into the license agreement for the term of the license and is not charged separately. Since vendor-specific objective evidence, or VSOE, of fair value does not exist for each element of the arrangement, revenues from subscription licenses are recognized ratably over the license term commencing upon the effective date of the license, if delivery and other revenue recognition criteria are met.

Term licenses - term licenses include software licenses for a specific time period, generally three to five years. Revenues associated with term licenses are recognized on the effective date of the license, if delivery and other revenue recognition criteria are met. Maintenance agreements for term licenses are sold separately for a specified period and may continue to be renewed for the balance of the license term.

Perpetual licenses - perpetual licenses consist of software licensed on a perpetual basis. Revenues associated with perpetual licenses are recognized on the effective date of the license, if delivery has occurred and other revenue recognition criteria are met. We no longer offer this type of license.

The timing of revenue recognition for licenses will differ depending on the license type and on the individual terms and conditions associated with each particular license agreement. We use VSOE of fair value to allocate the total fee among all delivered and undelivered elements in those arrangements which contain multiple elements. If the arrangement includes the future delivery of a specified product or upgrade, all revenues under the arrangement are deferred until the specified product or upgrade has been delivered. If VSOE does not exist for one or more delivered elements, we apply the residual method of accounting to the delivered elements. Under the residual method, we defer the VSOE of the fair value of the undelivered elements and recognize revenue on the remaining portion of the arrangement. VSOE for maintenance is generally based upon the customer s annual renewal rates as set forth in the license agreement. When VSOE for maintenance cannot be established, we recognize all related revenues ratably over the term of our maintenance obligation. VSOE for services is generally based on the price charged when the services are sold separately. The timing of revenue recognition for both delivered and undelivered elements is in accordance with the relevant provisions of SOP 97-2.

On occasion we offer extended payment terms beyond our normal business practice of between 30 and 60 days to certain customers. We do not have sufficient experience collecting under these extended payment term arrangements. As a result, when payment terms are extended, the fee is not considered fixed or determinable and we recognize revenue when the payment is due.

Service revenues. We recognize maintenance revenue ratably over the maintenance period. Customers generally renew maintenance agreements for term and perpetual licenses annually. We allocate a portion of the subscription license revenue to maintenance revenue using the estimated fair value of the maintenance, which is based on maintenance renewals sold separately for similar products.

We generally recognize consulting service revenues on a percentage of completion basis as the services are performed. Training revenues are recognized when the training is performed.

Product revenues. The terms of our hardware product sales include annual maintenance. Product revenues are recognized ratably over the term of our maintenance obligation as we do not have a history of selling maintenance for this product separately. Once we have established VSOE for the maintenance of this product, we will recognize revenues upon delivery of the product if other revenue recognition criteria are met.

Deferred revenue. Deferred revenue consists primarily of maintenance and support services under maintenance contracts and unearned license revenues. Deferred revenue represents the excess of amounts invoiced or received over the revenue recognized. Deferred revenue fluctuates at each period end in accordance with the mix of contracts.

Use of Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, allowance for doubtful accounts, investments, inventory, income taxes, long-term service contracts, and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Allowance for Doubtful Accounts

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Valuation of Investments

We record an investment impairment charge when we believe an investment has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in

losses or an inability to recover the carrying value of the investments that may not be reflected in an investment s current carrying value, thereby possibly requiring an impairment charge in the future.

Inventory

We record inventory reserves when conditions exist that suggest our inventory may be in excess of anticipated demand or is obsolete based upon our assumptions about future demand of our products or market conditions. We regularly evaluate the ability to realize the value of our inventory based on a combination of factors including sales forecasts, estimated product end of life dates and estimated current and future market value. When recorded, our reserves are intended to reduce the carrying value of our inventory to its net realizable value.

Accounting for Income Taxes

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we were to determine that we would be able to realize our deferred tax assets in the future in excess of our net recorded amount, an adjustment to the deferred tax asset would increase net income in the period such determination was made.

Results of Operations

Cost of Revenues

Cost of license revenues consists of shipping, product packaging, software license and maintenance costs, materials and labor costs, and royalties paid to third party vendors. Cost of product revenues consists of product material and labor costs and inventory reserves. Cost of service revenues consists of compensation and related costs and third party consultant costs associated with providing postcontract customer support and consulting services.

Operating Expenses

Research and development expenses consist primarily of compensation and related costs for personnel and consulting expenses. All research and development costs are expensed as incurred.

Sales and marketing expenses consist primarily of compensation and related costs for sales and marketing personnel, marketing programs, public relations, promotional materials, amortization of non-competition agreement, travel and related trade show expenses.

General and administrative expenses consist primarily of compensation and related costs for general management, information technology, finance and accounting personnel, insurance, professional services and related fees and expenses.

The following table sets forth, for the periods indicated, certain financial data as a percentage of revenues:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Revenues:				
License	61.7%	31.5%	55.8%	38.7%
Service	35.7	64.1	40.4	58.9
Product	2.6	4.4	3.8	2.4
Total revenues	100.0	100.0	100.0	100.0
Cost of revenues:				
License	1.6	3.9	1.8	2.7
Service	25.7	35.4	26.8	38.1

Product	3.7	2.2	3.6	1.0
Total cost of revenues	31.0	41.5	32.2	41.8
Gross profit	69.0	58.5.	67.8	58.2
Operating expenses:				
Research and development	45.3	73.5	49.7	66.7
Sales and marketing	56.8	145.1	59.3	134.6
General and administrative	36.4	73.1	45.7	59.9
Total operating expenses	138.5	291.7	154.7	261.2
Loss from operations	(69.5)	(233.2)	(86.9)	(203.0)
Interest and other income, net	3.9	10.3	4.4	9.9
Loss before provision for income taxes	(65.6)	(222.9)	(82.5)	(193.1)
Provision for income taxes	0.1	2.8	0.5	2.3
Net loss	(65.7)%	(225.7)%	(83.0)%	(195.4)%

Three Months Ended September 30, 2004 Compared with the Three Months Ended September 30, 2003

Revenues

Total revenues were $2.7 million in the third quarter of 2004, a $1.2 million or 81.8% increase from $1.5 million in the third quarter of 2003. The increase in total revenues was primarily attributable to an increase in license revenues resulting from new subscription license orders received from customers.

Cost of revenues

Total cost of revenues increased 35.5% in the third quarter of 2004, as compared to the third quarter of 2003. Total cost of revenues was $0.8 million in the third quarter of 2004, compared to $0.6 million in the third quarter of 2003. The increase was primarily due to increased cost of professional services, primarily post-sales customer support, and an increase in product costs resulting from an inventory reserve.

Research and development

Research and development expenses were $1.2 million or 45.3% of revenues for the third quarter of 2004, a slight increase as compared to $1.1 million or 73.5% of revenue for the same period in the prior year. The increase was due to higher costs of licensed software. The decrease in research and development expenses as a percentage of total revenue was due to the increase in revenue. Research and development expenses are expected to increase in absolute terms as we continue to invest in the automation and enhancement of our product offering.

Sales and marketing

Sales and marketing expenses decreased $0.6 million or 28.8% in the third quarter of 2004, as compared to the third quarter of 2003. Sales and marketing expenses were $1.5 million in the third quarter of 2004, compared to $2.1 million for the same period in the prior year. The decrease was due to lower compensation and other personnel expenses resulting from reductions in headcount, office expenses, amortization of covenant not to compete, trade show expense and stock-based compensation expense.

General and administrative

General and administrative expenses decreased $0.1 million or 9.4% in the third quarter of 2004, as compared to the third quarter of 2003. General and administrative expenses were $1.0 million in the third quarter of 2004, compared to $1.1 million for the same period in the prior year. The decrease was primarily due to lower office expenses.

Interest and other income

Interest income of $0.1 million decreased 30.3% in the third quarter of 2004, as compared to the third quarter of 2003. The decrease was primarily due to lower investment balances and lower interest rates.

Income taxes

Our net operating losses are generated domestically, and amounts attributed to our foreign operations have been insignificant for all periods presented. For the third quarter of 2004 and 2003, we recorded income tax provisions of $4,000 and $41,000, respectively, primarily related to state and foreign taxes. No benefit for income taxes has been recorded due to the uncertainty of the realization of deferred tax assets. From inception through December 31, 2003, we incurred net losses for federal and state tax purposes. As of December 31, 2003, we had federal and California net operating loss carryforwards of approximately $53.5 million and $22 million available to reduce future federal and California taxable income, respectively. These federal and California carryforwards begin to expire in 2006 and 2004, respectively, if not utilized. The extent to which these carryforwards can be used to offset future taxable income may be limited under Section 382 of the Internal Revenue Code and applicable state tax law.

Nine Months Ended September 30, 2004 Compared with the Nine Months Ended September 30, 2003

Revenues

Total revenues were $7.4 million in the first nine months of 2004, a $2.1 million or 39.2% increase from $5.3 million in the first nine months of 2003. The increase in total revenues was primarily attributable to an increase in license revenues resulting from subscription orders and an increase in revenues from product sales.

Cost of revenues

Total cost of revenues increased $0.2 million or 7.6% in the first nine months of 2004, as compared to the first nine months of 2003. Total cost of revenues was $2.4 million in the first nine months of 2004, compared to $2.2 million in the first nine months of 2003. The increase was primarily due to increases in product costs and the establishment of an inventory reserve.

Research and development

Research and development expenses increased $0.2 million or 3.8% in the first nine months of 2004, as compared to the first nine months of 2003. Research and development expenses were $3.7 million in the first nine months of 2004, compared to $3.5 million for the same period in the prior year. The increase was primarily due to an increase in compensation and personnel expenses.

Sales and marketing

Sales and marketing expenses decreased $2.7 million or 38.6% in the first nine months of 2004, as compared to the first nine months of 2003. Sales and marketing expenses were $4.4 million in the first nine months of 2004, compared to $7.1 million for the same period in the prior year. The decrease was primarily due to lower compensation and other personnel expenses of $1.0 million resulting from reductions in headcount, lower amortization of a covenant not to compete of $0.7 million, lower stock-based compensation expense of $0.3 million, lower office expenses of $0.3 million, lower depreciation expense of $0.2 million, and lower trade show expenses of $0.2 million.

General and administrative

General and administrative expenses increased $0.2 million or 6.3% in the first nine months of 2004, as compared to the first nine months of 2003. General and administrative expenses were $3.4 million in the first nine months of 2004, compared to $3.2 million for the same period in the prior year. The increase was primarily due to higher personnel costs of $0.4 million resulting from increased headcount and higher business consulting expense of $0.2 million, partially offset by decreases in office expenses of $0.3 million and stock-based compensation expense of $0.1 million.

Interest and other income

Interest and other income decreased $0.2 million or 38.0% in the first nine months of 2004, as compared to the first nine months of 2003. Interest and other income was $0.3 million in the first nine months of 2004, compared to $0.5 million for the same period in the prior year. The decrease was primarily due to lower investment balances and lower interest rates.

Income taxes

Our net operating losses are generated domestically, and amounts attributed to our foreign operations have been insignificant for all periods presented. For the first nine months of 2004 and 2003, we recorded income tax provisions of $36,000 and $123,000, respectively, primarily related to state and foreign taxes.

Liquidity and Capital Resources

At September 30, 2004, we had cash and cash equivalents, short-term investments and marketable securities of $27.7 million and working capital of $14.1 million.

Net cash used in operating activities was $3.4 million and $9.5 million in the first nine months of 2004 and 2003, respectively. Net cash used in operating activities for the nine months ended September 30, 2004 was primarily due to a net loss of $6.1 million; an increase in other long-term assets of $1.5 million resulting from a prepaid license fee for technology incorporated in our LV 2004(TM) product and an increase in prepaid expenses of $0.1 million; partly offset by an increase in accounts payable of $1.6 million; an increase in deferred revenue of $1.1 million, an increase in other accrued liabilities of $0.9 million; an increase in non-cash charges relating to depreciation and amortization of $0.5 million and a decrease in accounts receivable of $0.2 million. Net cash used in operating activities for the nine months ended September 30, 2003 was primarily due to a net loss of $10.3 million; an increase in accounts receivable of $2.2 million; a decrease in accounts payable of $0.9 million due to timing of payments to suppliers in order to optimize discounts and payment periods, partly offset by non-cash charges relating to depreciation and amortization and amortization of deferred stock-based compensation of $1.3 million and $0.6 million, respectively; and a decrease in prepaid and other current expenses of $0.2 million and an increase in deferred revenue of $1.8 million.

Net cash used in investing activities was $5.1 million for the nine months ended September 30, 2004 and net cash provided by investing activities was $1.8 million for the nine months ended September 30, 2003. Net cash used in investing activities for the nine months ended September 30, 2004 was due to the purchase of marketable securities and short-term investments of $3.3 million and $7.0 million, respectively, and the purchase of property and equipment of $0.5 million, partly offset by proceeds from the maturity of marketable securities of $5.7 million. Net cash provided by investing activities for the nine months ended September 30, 2003 was primarily due to the proceeds from sales and maturity of marketable securities of $8.5 million, partly offset by purchases of short-term investments and marketable securities of $4.3 million and $2.0 million, respectively, and the purchase of property and equipment of $0.4 million.

Net cash provided by financing activities was $0.6 million for the nine months ended September 30, 2004 and net cash used in financing activities was $0.8 million for the nine months ended September 30, 2003. Net cash provided by financing activities for the nine months ended September 30, 2004 was primarily due to the proceeds from the issuance of common stock pursuant to the employee stock purchase plan and exercises of employee stock options. Net cash used in financing activities for the nine months ended September 30, 2003 was primarily due to repayments of a bank loan of $1.5 million, offset by net proceeds of $0.7 million received from the issuance of common stock pursuant to the employee stock purchase plan and exercises of employee stock options.

We have a loan agreement with a bank under which we may borrow, on a revolving basis, up to $5.0 million at an interest rate equal to prime rate, which was equal to an annual rate of 4.75% at September 30, 2004. Under the agreement, we must comply with certain operating and reporting covenants and are not permitted to pay dividends, or make material investments or dispositions without the prior written consent of the bank. If we fail to comply with its covenants under the agreement, the bank can declare any outstanding amounts immediately due and payable and cease advancing money or extending credit to or for us.

No amount was outstanding under this agreement at September 30, 2004, and the agreement expires on January 31, 2005. At September 30, 2004, we were in compliance with all the operating and reporting covenants under the loan agreement; however, because it is probable that we will not be in compliance with an operating covenant at the end of 2004, we will be required to renegotiate the loan or request a waiver of the operating covenant as of December 31, 2004 in order to continue to have the ability to borrow under the agreement.

We expect to finance our future commitments using existing cash resources. We currently anticipate that our available cash resources will be sufficient to meet our anticipated operating and capital requirements for at least the next 12 months. We expect our cash resources before any borrowings to decrease in the short term due to cash resources required for working capital, cash paid in connection with our November 2004 acquisition of SiVerion, Inc., and to fund operating cash flows.

We intend to continue to invest in the development of new products and enhancements to our existing products. Our future liquidity and capital requirements will depend upon numerous factors, including the costs and timing of consulting and software services to facilitate the automation and enhancement of our product offering and expansion of our product development efforts, the costs and timing of expansion of sales and marketing and customer support activities, the extent to which our existing and new products gain market acceptance, competing technological and market developments, the costs involved in maintaining and enforcing patent claims and other intellectual property rights, the level and timing of license and service revenues, available borrowings under line of credit arrangements and other factors. In addition, we may utilize cash resources to fund acquisitions of, or investments in, complementary businesses, technologies or product lines. From time to time, we may be required to raise additional funds through public or private financing, strategic relationships or other arrangements. There can be no assurance that such funding, if needed, will be available on terms attractive to us, or at all. Furthermore, any additional equity financing may be dilutive to stockholders, and debt financing, if available, may involve restrictive covenants. Strategic arrangements, if necessary to raise additional funds, may require us to relinquish our rights to certain of our technologies or products. Our failure to raise capital when needed could have a material adverse effect on our business, operating results and financial condition.

Contractual Obligations and Other Commercial Commitments

At September 30, 2004, our obligations under contractual obligations and commercial commitments, primarily leasing arrangements, were as follows (in thousands):

	Operating Leases
Year ending December 31,	
2004	$ 146
2005	494
2006	414
2007	325
2008	302
Thereafter	389
	$2,070

We rent office facilities under noncancelable operating leases which expire through March 2010. We are responsible for certain maintenance costs, taxes and insurance under the respective leases.

Off-balance Sheet Arrangements

The Company s off-balance sheet arrangements consist solely of operating leases as described above.

Indemnification Obligations

We enter into standard license agreements in the ordinary course of business. Pursuant to these agreements, we agree to indemnify our customers for losses suffered or incurred by them as a result of any patent, copyright, or other intellectual property infringement claim by any third party with respect to our products. These indemnification obligations have perpetual terms. We estimate the fair value of our indemnification obligations as insignificant, based upon our historical experience concerning product and patent infringement claims. Accordingly, we have not recorded any liabilities for indemnification under these agreements as of September 30, 2004.

We have agreements whereby our officers and directors are indemnified for certain events or occurrences while the officer or director is, or was, serving at our request in such capacity. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited; however, we have a directors and officers insurance policy that reduces our exposure and enables us to recover a portion of future amounts paid. As a result of our insurance policy coverage,

we believe the estimated fair value of these indemnification agreements is minimal. Accordingly, we have no liabilities recorded for these agreements as of September 30, 2004.

Warranties

We offer our customers a warranty that our products will conform to the documentation provided with the products. To date, there have been no payments or material costs incurred related to fulfilling these warranty obligations. Accordingly, we have no liabilities recorded for these warranties as of September 30, 2004. We assess the need for a warranty reserve on a quarterly basis, and there can be no guarantee that a warranty reserve will not become necessary in the future.

FACTORS THAT MAY AFFECT FUTURE OPERATING RESULTS

If the semiconductor industry does not adopt embedded test technology on a widespread basis, our revenues could decline and our stock price could fall.

To date, the semiconductor industry has not adopted embedded test technology as an alternative to current testing methods on a widespread basis. If the semiconductor industry does not adopt embedded test technology widely and in the near future, our growth will be limited, our revenues could decline, and our stock price could fall. We cannot assure you that integrated circuit designers and design companies customers will accept embedded test technology as an alternative to current testing methods in the time frame we anticipate, or at all. The industry may fail to adopt embedded test technology for many reasons, including the following:

- potential customers may determine that existing solutions adequately address their testing needs, or the industry may develop alternative technologies to address their testing needs;
- our existing and potential customers may react to declines in demand for semiconductors by curtailing or delaying new initiatives for new complex semiconductors or by extending the approval process for new projects, thereby lengthening our sales cycles;
- potential customers may not be willing to accept the perceived delays in the early design stages associated with implementing embedded test technology in order to achieve potential time and cost savings at later stages of silicon debugging and production testing;
- potential customers may have concerns over the reliability of embedded testing methods relative to existing test methods;
- our current and potential customers may not accept or embrace our recently released LV2004TM integrated family of products; and
- designers may be reluctant to take on the added responsibility of incorporating embedded test technology as part of their design process, or to learn how to implement embedded test technology.

If the industries into which we sell our products experience recession or other cyclical effects impacting our customers research and development budgets, our operating results could be negatively impacted.

Our sales are dependent upon capital spending trends and new design projects, and a substantial portion of our costs is fixed in the near term. The demand from our customers is uncertain and difficult to predict. Slower growth in the semiconductor and systems markets such as postponed or canceled capital expenditures for previously planned expansions or new fabrication facility construction projects, a reduced number of design starts, reduction of design and test budgets or continued consolidation among our customers would harm our business and financial condition.

The primary customers for semiconductors that incorporate our embedded test technology are companies in the communications, networking, server and high-end consumer products industries. Any significant downturn in these particular markets or in general economic conditions which result in the cutback of research and development budgets or capital expenditures would likely result in a reduction in demand for our products and services and could harm our business. If the economy declines as a result of economic, political or social turmoil, existing and prospective customers may further reduce their design budgets or delay implementation of our products, which could harm our business and operating results.

In addition, the markets for semiconductor products are cyclical. In recent years, most countries have experienced significant economic difficulties. These difficulties triggered a significant downturn in the semiconductor market, resulting in reduced budgets for chip design tools. In addition, the electronics industry has historically been subject to seasonal and cyclical fluctuations in demand for its products, and this trend may continue in the future. These industry downturns have been, and may continue to be, characterized by diminished product demand, excess manufacturing capacity and subsequent erosion of average selling prices. As a result, our future operating results may reflect substantial fluctuations from period to period as a consequence of these industry patterns, general economic conditions affecting the timing of orders from customers and other factors. Any negative factors affecting the semiconductor industry, including the downturns described here, could significantly harm our business, financial condition and results of operations.

We have a history of losses and an accumulated deficit of approximately $76.7 million as of September 30, 2004. If we do not generate sufficient net revenue in the future to achieve or sustain profitability, our stock price could decline.

We have incurred significant net losses since our inception, including losses of $6.1 million for the nine months ended September 30, 2004, $12.0 million for the year ended December 31, 2003 and $8.5 million for the year ended December 31, 2002. At September 30, 2004, we had an accumulated deficit of approximately $76.7 million. We expect our future revenues to be impacted by our long sales cycle and our revenue recognition policies, and we expect to continue to invest in our research and development projects as well as service operations required to support our business development activities. Because we expect to continue to invest in product and business development, our expenditures could continue to outpace growth in our revenues, if any, thus preventing us from achieving and maintaining profitability. To achieve and maintain profitability, we will need to generate and sustain substantially higher revenues while maintaining reasonable cost and expense levels. If we fail to achieve profitability within the time frame expected by securities analysts or investors and our cash balances continue to decline, the market price of our common stock will likely decline. We may not achieve profitability if our revenues do not increase or if they increase more slowly than we expect. In addition, our operating expenses are largely fixed, and any shortfall in anticipated revenues in any given period could harm our operating results.

The sales and implementation cycles for our products are typically long and unpredictable, taking from six months to two years for sales and an additional six to twelve months for implementation. As a result, we may have difficulty predicting future revenues and our revenues and operating results may fluctuate significantly, which could cause our stock price to fluctuate.

Our sales cycle has ranged from six months to two years and our customers implementation cycle has been approximately an additional six to twelve months. We believe that convincing a potential customer to integrate our technology into an integrated circuit at the design stage, which we refer to as a design win, is critical to retaining existing customers and to obtaining new customers. However, acceptance of our embedded test technology generally involves a significant commitment of resources by prospective customers and a fundamental change in their method of designing and testing integrated circuits. Many of our potential customers are large enterprises that generally do not adopt new design methodologies quickly. Also, we may have limited access to the key decision-makers of potential customers who can authorize the adoption of our technology. As a result, the period between our initial contact with a potential customer and the sale of our products to that customer, if any, is often lengthy and may include delays associated with our customers budgeting and approval processes, as well as a substantial investment of our time and resources. We have incurred high customer engagement and support costs, including sales commissions, and the failure to manage these costs could harm our operating results.

If we fail to achieve a design win with a potential customer early in a given product cycle, it is unlikely that the potential customer will become a customer before its next product cycle, if at all. Because of the length of our sales cycle, our failure to achieve design wins could have a material and prolonged adverse effect on our sales and revenue growth. Our revenue streams may fluctuate significantly due to the length of our sales cycle, which may make our future revenues difficult to project and may cause our stock price to fluctuate.

Fluctuations in our revenues and operating results could cause the market price of our common stock to decline.

Our revenues and operating results have fluctuated significantly from quarter to quarter in the past and may do so in the future, which could cause the market price of our common stock to decline. Accordingly, quarter-to-quarter comparisons of our results of operations may not be an indication of our future performance. In future periods, our revenues and results of operations may be below the estimates of public market analysts and investors. This discrepancy could cause the market price of our common stock to decline.

Fluctuations in our revenues and operating results may be caused by:

- timing, terms and conditions of customer agreements;
- customers placing orders at the end of the quarter;
- the mix of our license and services revenues;
- timing of sales commission expenses and the recognition of license revenues from related customer agreements;
- changes in our and our customers development schedules and levels of expenditures on research and development;
- industry patterns and changes or cyclical and seasonal fluctuations in the markets we target;
- timing and completion of milestones under customer agreements;

- timing and acceptance of new technologies, product releases or enhancements by us, our competitors or our customers; and
- market and general economic conditions.

Delays or deferrals in purchasing decisions by our customers may increase as we develop new or enhanced products. Our current dependence on a small number of customers increases the revenue impact of each customer s actions relative to these factors. Our expense levels are based, in large part, on our expectations regarding future revenues, and as a result net income for any quarterly period in which material customer agreements are delayed could vary significantly from our budget projections.

The accounting rules regarding revenue recognition may cause fluctuations in our revenues independent of our order position.

The accounting rules we are required to follow require us to recognize revenues only when certain criteria are met. As a result, for a given quarter it is possible for us to fall short in our revenues and/or earnings estimates even though total orders are according to our plan or, conversely, to meet our revenue and/or earnings estimates even though total orders fall short of our plan, due to revenues produced by deferred revenues. Orders for software support and consulting services yield revenues over multiple quarters, often rather than at the time of sale. The specific terms agreed to with a customer and/or any changes to the rules interpreting such terms may have the effect of requiring deferral of product revenues in whole or in part or, alternatively, of requiring us to accelerate the recognition of such revenues for products to be used over multiple years.

Intense competition in the semiconductor and systems industries, particularly in the design and test of semiconductors, could prevent us from increasing or sustaining our revenues and prevent us from achieving or sustaining profitability.

The semiconductor and systems industries are extremely competitive and characterized by rapidly changing technology. The market for embedded test solutions is still evolving, and we expect competition to become more intense in the future. Our current principal competitors in the design phase of product development include:

- electronic design automation providers such as Cadence Design Systems, Inc., Magma Design Automation, Inc., Mentor Graphics Corporation and Synopsys, Inc., all of which offer basic built-in self-test capability;
- smaller test tool providers;
- potential customers that develop test solutions internally; and
- integrated device manufacturers, such as International Business Machines Corporation, that use their own test solutions in chips manufactured for and sold to others.

Our embedded test technology also has the potential to impact the automated test equipment market, which may place us in competition with traditional hardware tester manufacturers such as Advantest Corporation, Agilent Technologies, Inc., Credence Systems Corporation, LTX Corporation, and Teradyne, Inc. As embedded test becomes adopted more widely in the market, any of these automated test equipment companies, or others, may offer their own embedded test solutions. Some of our competitors in electronic design automation and external test equipment businesses are significantly larger than we are and have greater financial resources, greater name recognition and longer operating histories than we have. Some of our competitors offer a more comprehensive range of products covering the entire design flow and complete external test flow, and they may be able to respond more quickly or adjust prices more effectively to take advantage of new opportunities or customer requirements. In addition, all of the tester manufacturers above participate in our LVReady partner program through which our embedded test access software is integrated into their test platform, which may provide them with additional insight into our business and technology. Increased competition in the semiconductor industry could result in pricing pressures, reduced sales, reduced margins or failure to achieve or maintain widespread market acceptance, any of which could prevent us from increasing or sustaining our revenues and achieving or sustaining profitability.

Our target markets are comprised of a limited number of customers. If we fail to obtain or retain customer relationships, our revenues could decline.

We derive a significant portion of our revenues from a relatively small number of customers. Two customers accounted for 20% and 18%, respectively, of total revenues for the nine months ended September 30, 2004. Five customers accounted for approximately 39% of total revenues in 2003, of which two customers accounted for 15% and 11%, respectively. We anticipate that we will continue to rely on a limited number of customers for a substantial portion of our future revenues and we must obtain additional large orders from customers on an ongoing basis to increase our revenues and grow our business. In addition, the loss of any significant or well-known customer could harm our operating results or our reputation. In particular, a loss of a significant

customer could cause fluctuations in our results of operations because our expenses are fixed in the short term, it takes us a long time to replace customers and, because of required methods of revenue recognition, any offsetting license revenues may need to be recognized over a period of time.

Our products incorporate technology licensed from third parties, including Nortel Networks. If any of these licenses are terminated, our ability to develop and license our products could be delayed or reduced.

We use technology, including software, which we license from third parties. In particular, we license technology from Nortel Networks under two patents for testing embedded memories and digital systems, and we use the Nortel technology in our embedded test technology. Our license agreement with Nortel may be terminated if we materially violate the terms of the agreement, if a competitor of Nortel acquires a significant percentage of our common stock without first obtaining Nortel s consent or if we bring patent infringement proceedings against Nortel under any patent embodied in, or acquired as a result of access to, the technology we license from Nortel. If we do not maintain our existing third party technology licenses or enter into licenses for alternative technologies, we could be required to cease or delay product shipments while we seek to develop alternative technologies.

We depend on third parties to provide electronic design automation software that is compatible with our solution. If these third parties do not continue to provide compatible design products, we would need to develop alternatives, which could delay product introductions and cause our revenues and operating results to decline.

Our customers depend on electronic design automation software to design their products using our solution. We depend on the same software to develop our products. Although we have established relationships with a variety of electronic design automation vendors to gain access to this software and to assure compatibility, these relationships may be terminated with limited notice. If any of these relationships were terminated and we were unable to obtain alternative software in a timely manner, our customers could be unable to use our solution. In addition, we could experience a significant increase in development costs, our development process could take longer, product introductions could be delayed and our revenues and operating results could decline.

If automated test equipment companies are unwilling to work with us to make our technology compatible with theirs, we may need to pursue alternatives, which could increase the time it takes us to bring our solution to market and decrease customer acceptance of our technology.

Although we are presently working with a number of automated test equipment companies to achieve optimal compatibility of our technologies, these companies may elect not to work with us in the future. If automated test equipment companies are unwilling to incorporate modifications into their equipment and operating systems to allow them to work with our technology, we may need to seek alternatives. These alternatives might not provide optimal levels of test function, and pursuing these alternatives could increase the time and expense it takes us to bring our technology to market, either of which could decrease customer acceptance of our technology and cause our revenues and margins to decline.

Our future success will depend on our ability to keep pace with rapid technological advancements in the semiconductor industry. If we fail to develop and introduce new products and enhancements on a timely basis, our ability to attract and retain customers could be impaired, which would cause our operating results to decline.

The semiconductor industry is characterized by rapidly changing technology, evolving industry standards, rapid changes in customer requirements, frequent product introductions and ongoing demands for greater speed and functionality. We must continually design, develop and introduce new products with improved features to be competitive. Our products may not achieve market acceptance or adequately address the changing needs of the marketplace, and we may not be successful in developing and marketing new products or enhancements to our existing products on a timely basis. The introduction of products embodying new technologies, the emergence of new industry standards or changes in customer requirements could render our existing products obsolete and unmarketable. We may not have the financial resources necessary to fund future innovations. If we are unable, for technical, legal, financial or other reasons, to respond in a timely manner to changing market conditions or customer requirements, our business and operating results could be seriously harmed.

Future changes in financial accounting standards, including pronouncements and interpretations of accounting pronouncements on software revenue recognition and stock-based compensation, may cause adverse unexpected revenue fluctuations and affect our reported results of operations.

A change in accounting policies can have a significant effect on our reported results and may even affect our reporting of transactions completed before a change is announced. In particular, new pronouncements and varying interpretations of pronouncements on software revenue recognition have occurred with frequency, may occur in the future and could impact our

revenues. Required changes in our methods of revenue recognition could result in deferral of revenues recognized in current periods to subsequent periods or accelerated recognition of deferred revenues to current periods, each of which could cause shortfalls in meeting the expectations of investors and securities analysts. Our stock price could decline as a result of any shortfall.

For example, any changes requiring that we record an expense for employee stock options using the fair value method or changes in existing taxation rules relating to stock options could have a significant negative effect on our reported results. The Financial Accounting Standards Board, or FASB, has announced, and several agencies and entities are considering, proposals to change generally accepted accounting principles in the United States that, if implemented, would require us to record charges to earnings for employee stock option grants. Such a requirement would negatively impact our earnings. In addition, the FASB has proposed a choice of valuation models to estimate the fair value of employee stock options. These models, including the Black-Scholes option-pricing model, use varying methods and inputs and may yield significantly different results.

Accounting policies affecting many other aspects of our business, including rules relating to revenue recognition, purchase accounting for business combinations and employee stock option grants have recently been revised or are under review. Changes to those rules or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

Compliance with changing regulation of corporate governance and public disclosure may result in additional costs.

Changes in the laws and regulations affecting public companies, including the provisions of the Sarbanes-Oxley Act of 2002 and new SEC and NASDAQ rules and regulations are creating new duties and requirements for us and our executives, directors, attorneys and independent accountants. In order to comply with these new rules, we may have to incur additional costs for personnel and use additional outside legal, accounting and advisory services, which are likely to increase our operating expenses. Management time associated with these compliance efforts necessarily reduces time available for other operating activities, which could adversely affect operating results. To date, our costs to comply with these rules have not been significant; however, we cannot predict or estimate the amount of future additional costs we may incur or the timing of such costs.

Our embedded test products may have errors or defects that users identify after deployment, which could harm our reputation and our business.

Our products may contain undetected errors when first introduced or when new versions or enhancements are released. We have from time to time found errors in versions of our embedded test products, and we may find errors in our products in the future. The occurrence of errors could cause sales of our products to decline, divert the attention of management and engineering personnel from our product development efforts and cause significant customer relations problems. Customer relations problems could damage our reputation, hinder market acceptance of our products and result in loss of future revenues.

If we are unable to successfully manage the service support for our hardware product, our reputation and our operating results could be harmed.

The LogicVision Validator is our hardware product. Because our other products are delivered in the form of software, our customer support service personnel may experience difficulties in responding to customer needs, and we may be required to obtain third-party assistance, either directly or in the form of further training for our existing support personnel. Delays in customer service could result in rejection of our product and loss of customer confidence. Third-party assistance could be costly and divert attention of our personnel from primary support of our other products. Loss of sales, damaged reputation or increased costs could harm our revenues and profitability.

We must continually attract and retain engineering personnel, or we will be unable to execute our business strategy.

Our strategy for encouraging the adoption of our technology requires that we employ highly skilled engineers to develop our products and work with our customers. In the past, we have experienced difficulty in hiring and retaining highly skilled engineers with appropriate qualifications to support our business. As a result, our future success depends in part on our ability to identify, attract, retain and motivate qualified engineering personnel. Competition for qualified engineers is intense, especially in the Silicon Valley where our headquarters are located. If we lose the services of a significant number of our engineers and we cannot hire and integrate additional engineers, it could disrupt our ability to develop our products and implement our business strategy.

We may be unable to replace the technical, sales, marketing and managerial contributions of key individuals.

We depend on our senior executives, and our research and development, sales and marketing personnel, who are critical to our business. We do not have long-term employment agreements with our key employees, and we only maintain a key person life insurance policy on our Chairman. If we lose the services of any of these key executives, our product development processes and sales efforts could be slowed. We may also incur increased operating expenses and be required to divert the attention of other senior executives to search for their replacements. The integration of any executives or new personnel could disrupt our ongoing operations.

If we fail to protect our intellectual property rights, competitors may be able to use our technologies, which could weaken our competitive position, reduce our revenues or increase our costs.

Our success and ability to compete depend largely upon the protection of our proprietary technology. We rely on a combination of patent, copyright, trademark and trade secret laws, confidentiality procedures and licensing arrangements to establish and protect our proprietary rights. Our pending patent applications may not result in issued patents, and our existing and future patents may not be sufficiently broad to protect our proprietary technologies. Policing unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent the misappropriation or unauthorized use of our technologies, particularly in foreign countries where the laws may not protect our proprietary rights as fully as U.S. laws. Any patents we obtain or license may not be adequate to protect our proprietary rights. Our competitors may independently develop similar technology, duplicate our products or design around any patents issued to us or our other intellectual property rights.

Litigation may be necessary to enforce our intellectual property rights or to determine the validity or scope of the proprietary rights of others. As a result of any such litigation, we could lose our proprietary rights and incur substantial unexpected operating costs. We may need to take legal action to enforce our proprietary rights in the future. Any action we take to protect our intellectual property rights could be costly and could absorb significant management time and attention. In addition, failure to adequately protect our trademark rights could impair our brand identity and our ability to compete effectively

Any dispute involving our patents or other intellectual property could include our industry partners and customers, which could trigger our indemnification obligations to them and result in substantial expense to us.

In any dispute involving our patents or other intellectual property, our licensees could also become the target of litigation. This could trigger technical support and indemnification obligations in some of our license agreements which could result in substantial expenses. In addition to the time and expense required for us to support or indemnify our licensees, any such litigation could severely disrupt or shut down the business of our licensees, which in turn could hurt our relations with our customers and cause our revenues to decrease.

Failure to obtain export licenses could harm our business.

We must comply with U.S. Department of Commerce regulations in shipping our software and hardware products and other technologies outside the United States. Although we have not had any significant difficulty complying with these regulations to date, any significant future difficulty in complying could harm our business, operating results and financial condition.

We have limited control over third-party representatives who market, sell and support our products in foreign markets. Loss of these relationships could decrease our revenues and harm our business.

We offer our products and services for sale through distributors and sales representatives in India, Korea, Taiwan and Germany. We anticipate that sales in these markets will account for a portion of our total revenues in future periods. During 2004, we appointed a new distributor in Germany. Our third-party representatives are not obligated to continue selling our products, and they may terminate their arrangements with limited prior notice. Growing our relationship with these new distributors or establishing alternative distribution channels in these markets could consume substantial management time and resources, decrease our revenues and increase our expenses.

We face business, political and economic risks because a portion of our revenues and operations are outside of the United States.

International revenues accounted for 24% of our total revenues for the nine months ended September 30, 2004 and 19% of our total revenues for the year ended December 31, 2003. In addition to our international sales, we have operations in Canada, Japan, UK and India. Our success depends upon continued expansion of our international operations, and we expect that international revenues will continue to be an important component of our total future revenues. Our international business involves a number of risks, including:

- our ability to adapt our products to foreign design methods and practices;

- the uncertainty of international orders due to typically lengthy international selling cycles;
- cultural differences in the conduct of business;
- difficulty in attracting qualified personnel;
- managing foreign branch offices and subsidiaries;
- longer payment cycles for and greater difficulty collecting accounts receivable;
- unexpected changes in regulatory requirements, royalties and withholding taxes that restrict the repatriation of earnings;
- tariffs and other trade barriers;
- the burden of complying with a wide variety of foreign laws; and
- political, economic, health or military conditions associated with worldwide conflicts and events.

As we increase our direct selling activities in Japan, a portion of our international revenues is denominated in Japanese yen, which is subject to exposure from movements in foreign currency exchange rates. In addition, some of our international revenues are denominated in U.S. dollars, creating a risk that fluctuation in currency exchange rates will make our prices uncompetitive. To the extent that profit is generated or losses are incurred in foreign countries, our effective income tax rate may be significantly affected. Any of these factors could significantly harm our future international sales and, consequently, our revenues and overall results of operations and business and financial condition.

We may be unable to consummate future potential acquisitions or investments or successfully integrate acquired businesses or investments or foreign operations with our business, which may disrupt our business, divert management s attention and slow our ability to expand the range of our proprietary technologies and products.

We intend to continue to expand the range of our proprietary technologies and products, and we may acquire or make investments in additional complementary businesses, technologies or products, if appropriate opportunities arise. For example, we recently completed the acquisition of SiVerion, Inc. We may be unable to identify suitable acquisition or investment candidates at reasonable prices or on reasonable terms, or consummate future acquisitions or investments, each of which could slow our growth strategy. Our recent acquisition of SiVerion, Inc. and any future acquisitions may involve risks such as the following:

- we may be unable to complete the development and application of the acquired technology or products or integrate the technology or products with our own;
- we may not achieve the anticipated benefits of the acquisitions;
- our acquisition and integration costs may be higher than we anticipated and may cause our quarterly and annual operating results to fluctuate;
- we may be unable to retain key employees, such as management, technical or sales personnel, of the acquired businesses;
- we may experience difficulty and expense in assimilating the operations and personnel of the acquired businesses, which could be further affected by the acquired businesses not being located near our existing sites, such as SiVerion in Arizona;
- we may be exposed to unknown liabilities of acquired companies;
- we may experience difficulties in establishing and maintaining uniform standards, controls, procedures and policies;
- our relationships with key customers of acquired businesses may be impaired, due to changes in management and ownership of the acquired businesses;
- we may incur amortization or impairment expenses if an acquisition results in significant goodwill or other intangible assets; or
- our stockholders may be diluted if we pay for the acquisition with equity securities.

These factors could disrupt our ongoing business, distract our management and employees and increase our expenses or otherwise harm our operating results.

Intellectual property litigation, which is common in our industry, could be costly, harm our reputation, limit our ability to license or sell our proprietary technologies or products and divert the attention of management and technical personnel.

The semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. While we have not received formal notice of any infringement of the rights of any third party, questions of infringement in the semiconductor field involve highly technical and subjective analyses. Litigation may be necessary in the future to enforce any patents we may receive and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity, and we may not prevail in any future litigation. Any such litigation, whether or not determined in our favor or settled, could be costly, could harm our reputation and could divert the efforts and attention of our management and technical personnel from normal business operations. Adverse determinations in litigation could result in the loss of our proprietary rights, subject us to significant liabilities, require us to seek licenses from third parties or prevent us from licensing our technology or selling our products, any of which could harm our business.

Our stock price may decline significantly because of stock market fluctuations that affect the prices of technology stocks. A decline in our stock price could result in securities class action litigation against us that could divert management s attention and harm our business.

The stock market has experienced significant price and trading volume fluctuations that have adversely affected the market prices of common stock of technology companies. These broad market fluctuations may reduce the market price of our common stock. In the past, securities class action litigation has often been brought against a company after periods of volatility in the market price of securities. In the future, we may be a target of similar litigation. Securities litigation could result in substantial costs and divert our management s attention and resources, which in turn could harm our ability to execute our business plan.

If investors price our common stock below $1.00 per share, our stock may fail to meet the requirements for continued listing on The Nasdaq National Market, in which case the price and liquidity of our common stock may decline.

The Nasdaq Stock Market has quantitative maintenance criteria for the continued listing of common stock on The Nasdaq National Market, including maintaining a minimum closing bid of $1.00 per share. As of September 30, 2004, we were in compliance with all Nasdaq National Market listing requirements. However, our stock price has declined significantly over the past year and experienced volatility. If the closing bid price of our common stock price falls and remains below $1.00 per share for 30 consecutive days, our common stock may not remain listed on The Nasdaq National Market. If we fail to maintain continued listing on The Nasdaq National Market and must move to a market with less liquidity, our financial condition could be harmed and our stock price would likely decline. If we are delisted, it could have a material adverse effect on the market price of, and the liquidity of the trading market for, our common stock.

Our ability to raise capital in the future may be limited and our failure to raise capital when needed could prevent us from growing.

We believe that our existing cash resources and available debt financing will be sufficient to meet our anticipated cash needs for at least the next 12 months. However, the timing and amount of our working capital and capital expenditure requirements may vary significantly depending on numerous factors, including:

- the level and timing of license and service revenues;
- the costs and timing of expansion of product development efforts and the success of these development efforts;
- the extent to which our existing and new products gain market acceptance;
- the costs and timing of expansion of sales and marketing activities;
- competing technological and marketing developments;
- the extent of international operations;
- the need to adapt to changing technologies and technical requirements;
- the costs involved in maintaining and enforcing patent claims and other intellectual property rights;
- the existence of opportunities for expansion and for acquisitions of, investments in, complementary businesses, technologies or product lines; and
- access to and availability of sufficient management, technical, marketing and financial personnel.

If our capital resources are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity securities or debt securities or obtain debt financing. The sale of additional equity securities or debt securities would result in additional dilution to our stockholders. Additional debt would result in increased expenses and could result in covenants that would restrict our operations. If adequate funds are not available or are not available on acceptable terms, this would significantly limit our ability to hire, train or retain employees, support our expansion, take advantage of unanticipated opportunities such as acquisitions of businesses or technologies, develop or enhance products, or respond to competitive pressures.

ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Fluctuations

In the normal course of business, we are exposed to market risk from the effect of foreign exchange rate fluctuations on the U.S. dollar value from our foreign operations. A significant portion of our revenues has been denominated in U.S. dollars; however, as we increase our direct sales activities in Japan, an increasing portion of our revenues may be denominated in the Japanese yen. In addition, the operating expenses incurred by our foreign subsidiaries are denominated in local currencies. Accordingly, we are subject to exposure from movements in foreign currency exchange rates. To date, the effect of changes in foreign currency exchange rates on our financial position and operating results has not been material. We currently do not use financial instruments to hedge foreign currency risks. We intend to assess the use of financial instruments to hedge currency exposures on an ongoing basis.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relate primarily to our investment portfolio. We have not used derivative financial instruments in our investment portfolio. We invest our excess cash in high-quality corporate issuers and in debt instruments of the U.S. Government and, by policy, limit the amount of credit exposure to any one issuer. As stated in our investment policy, we are averse to principal loss and seek to preserve our invested funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in high credit quality securities and by positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. The portfolio includes only marketable securities with active secondary or resale markets to ensure portfolio liquidity.

Investments in both fixed and floating rate interest-earning instruments carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to rising interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities which have declined in market value due to changes in interest rates.

Short-term investments and long-term investments are classified as held-to-maturity and the cost of securities sold is based on the specific identification method. At September 30, 2004, we had short-term U.S. government securities and long-term U.S. government securities of $11.1 million and $7.4 million, respectively and short-term commercial paper and certificates of deposits of $1.7 million.

ITEM 4: CONTROLS AND PROCEDURES

(a) **Evaluation of disclosure controls and procedures.** We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the Exchange Act), that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Our disclosure controls and procedures have been designed to meet, and management believes that they meet, reasonable assurance standards. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that, subject to the limitations noted above, our disclosure controls and procedures were effective to ensure that material information relating to us, including our consolidated subsidiaries, is made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

(b) **Changes in internal controls.** There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) identified in connection with the evaluation described in Item 4(a) above that occurred during our 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: 6 EXHIBITS

Exhibits.

31.1 Rule 13a-14(a) Certification of Chief Executive Officer.

31.2 Rule 13a-14(a) Certification of Chief Financial Officer.

32.1** Statement of Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. §1350).

32.2** Statement of Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. §1350).

** In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release Nos. 33-8238 and 34-47986, Final Rule: Management s Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed filed for purpose of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

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: November 12, 2004

LOGICVISION, INC.
(Registrant)

By: /s/ JAMES T. HEALY

James T. Healy
President, Chief Executive Officer and Director
(Principal Executive Officer)

By: /s/ BRUCE M. JAFFE

Bruce M. Jaffe
Vice President of Finance and Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

Exhibit Number	Description of Exhibit
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