

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

FORM 10-Q

(Mark One)

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended May 4, 2002

or

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from _____ to _____

Commission file number: 0-30877

Marvell Technology Group Ltd.

(Exact name of registrant as specified in its charter)

Bermuda
(State or other jurisdiction of
incorporation or organization)

77-0481679
(I.R.S. Employer
Identification No.)

4th Floor, Windsor Place, 22 Queen Street, P.O. Box HM 1179, Hamilton, HM EX, Bermuda
(Address, including Zip Code, of Principal Executive Offices)

(441) 296-6395
(Registrant’s telephone number, including area code)

N/A
(Former name, former address, and former fiscal year, if changed since last report)

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

Shares Outstanding of the Registrant’s Common Stock	
Class	Outstanding at May 4, 2002
Common stock, \$0.002 par value	119,401,013

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

MARVELL TECHNOLOGY GROUP LTD. **CONDENSED CONSOLIDATED BALANCE SHEETS** (Unaudited) (In thousands, except par value)

ASSETS		
	April 30, 2002	January 31, 2002
Current assets:		
Cash and cash equivalents	\$ 114,254	\$ 114,483
Short-term investments	142,767	135,761
Accounts receivable, net of allowances of \$1,223 and \$1,232	56,387	42,150
Inventory	22,117	23,600
Prepaid expenses and other current assets	12,636	14,135
Deferred income taxes	9,287	9,287
Total current assets	357,448	339,416
Property and equipment, net	59,836	52,924
Goodwill and acquired intangible assets	1,659,417	1,680,740
Other noncurrent assets	18,233	17,975
Total assets	\$2,094,934	\$2,091,055
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 36,885	\$ 30,990
Accrued liabilities	11,692	14,083
Accrued employee compensation	10,878	11,755
Accrued facility consolidation charge	16,623	—
Income taxes payable	19,689	17,744
Deferred income	11,750	8,907
Current portion of capital lease obligations	1,201	1,039
Total current liabilities	108,718	84,518
Capital lease obligations	9,636	10,017
Other long-term liabilities	7,136	6,793
Total liabilities	125,490	101,328
Shareholders' equity:		
Common stock, \$0.002 par value; 242,000 shares authorized; 119,401 and 118,577 shares issued and outstanding	239	238
Additional paid-in capital	2,655,683	2,646,757
Deferred stock-based compensation	(7,817)	(10,099)
Accumulated other comprehensive income	388	946
Accumulated deficit	(679,049)	(648,115)
Total shareholders' equity	1,969,444	1,989,727
Total liabilities and shareholders' equity	\$2,094,934	\$2,091,055

See accompanying notes to condensed consolidated financial statements.

MARVELL TECHNOLOGY GROUP LTD.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended April 30,	
	2002	2001
Net revenue	\$ 98,800	\$ 64,230
Operating costs and expenses:		
Cost of goods sold (1)	43,780	30,161
Research and development (1)	30,609	20,066
Selling and marketing (1)	11,012	9,545
General and administrative (1)	3,642	2,985
Amortization of stock-based compensation	2,282	4,113
Amortization of goodwill and acquired intangible assets	21,323	104,508
Facilities consolidation charge	17,799	—
Total operating costs and expenses	130,447	171,378
Operating loss	(31,647)	(107,148)
Interest and other income, net	2,139	2,967
Loss before income taxes	(29,508)	(104,181)
Provision for income taxes	1,426	785
Net loss	\$ (30,934)	\$(104,966)
Net loss per share:		
Basic	\$ (0.26)	\$ (0.93)
Diluted	\$ (0.26)	\$ (0.93)
Weighted average shares:		
Basic	118,089	112,517
Diluted	118,089	112,517

(1) Excludes amortization of stock-based compensation as follows:

Cost of goods sold	\$ 45	\$ 82
Research and development	1,494	2,693
Selling and marketing	403	727
General and administrative	340	611
	\$ 2,282	\$ 4,113

See accompanying notes to condensed consolidated financial statements.

MARVELL TECHNOLOGY GROUP LTD.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Three Months Ended April 30,	
	2002	2001
Cash flows from operating activities:		
Net loss	\$ (30,934)	\$(104,966)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	3,860	3,474
Amortization of stock-based compensation	2,282	4,113
Amortization of goodwill and acquired intangible assets	21,323	104,508
Changes in assets and liabilities:		
Accounts receivable	(14,237)	(648)
Inventory	1,483	6,668
Prepaid expenses and other assets	1,240	(1,298)
Accounts payable	5,895	(2,323)
Accrued liabilities and other	(2,047)	(2,466)
Accrued employee compensation	(877)	1,782
Accrued facility consolidation charge	16,623	—
Income taxes payable	2,367	821
Deferred revenue	2,843	417
Net cash provided by operating activities	9,821	10,082
Cash flows from investing activities:		
Purchases of short-term investments	(20,473)	(8,003)
Sales and maturities of short-term investments	12,487	11,020
Purchases of investments	—	(667)
Acquisition costs	—	(29,086)
Purchases of property and equipment	(10,772)	(7,117)
Net cash used in investing activities	(18,758)	(33,853)
Cash flows from financing activities:		
Proceeds from the issuance of common stock	8,929	1,037
Repurchases of common stock	(2)	(109)
Principal payments on capital lease obligations	(219)	(15)
Net cash provided by financing activities	8,708	913
Net decrease in cash and cash equivalents	(229)	(22,858)
Cash and cash equivalents at beginning of period	114,483	184,128
Cash and cash equivalents at end of period	\$114,254	\$ 161,270

See accompanying notes to condensed consolidated financial statements.

MARVELL TECHNOLOGY GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. The Company and its Significant Accounting Policies

The Company

Marvell Technology Group Ltd. (the “Company”), a Bermuda company, was incorporated on January 11, 1995. The Company designs, develops and markets integrated circuits utilizing proprietary communications mixed-signal processing, or CMSP, and digital signal processing technologies for the communications and storage markets. On January 21, 2001, the Company acquired Galileo Technology Ltd. (“Galileo”), an Israeli corporation. Galileo develops high-performance communications internetworking and switching products for the broadband communications market.

Basis of presentation

The Company’s fiscal year is the 52- or 53-week period ending on the Saturday closest to January 31. In a 52-week year, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal year 2003 will be comprised of 52 weeks. For presentation purposes, the financial statements and notes refer to January 31 as the Company’s year-end and April 30, July 31 and October 31 as the Company’s quarter-ends.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to present fairly the Company’s financial position as of April 30, 2002, the results of its operations for the three months ended April 30, 2002 and 2001, and its cash flows for the three months ended April 30, 2002 and 2001. These condensed consolidated financial statements and related notes are unaudited and should be read in conjunction with the Company’s audited financial statements and related notes included in the Company’s 2002 Annual Report on Form 10-K. The results of operations for the three months ended April 30, 2002 are not necessarily indicative of the results that may be expected for any other interim period or for the full fiscal year.

Revenue recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable and collection is reasonably assured. Under these criteria, product revenue is generally recognized upon shipment of product to customers, net of accruals for estimated sales returns and allowances. However, some of the Company’s sales are made through distributors under agreements allowing for price protection and rights of return on product unsold by the distributors. Product revenue on sales made through distributors with rights of return is deferred until the distributors sell the product to end customers. Additionally, collection is not deemed to be “reasonably assured” if customers receive extended payment terms. As a result, revenue on sales to customers with payment terms substantially greater than the Company’s normal payment terms is deferred and is recognized as revenue as the payments become due. Deferred revenue less the related cost of the inventories is reported as deferred income.

The provision for estimated sales returns and allowances on product sales is recorded in the same period the related revenues are recorded. These estimates are based on historical sales returns, analysis of credit memo data and other known factors. Actual returns could differ from these estimates.

The Company also enters into development agreements with some of its customers. Development revenue is recognized under the percentage-of-completion method, with the associated costs included in research and development expense. The Company estimates the percentage-of-completion of its development contracts based on an analysis of progress toward completion, which is measured using input measures such as percentage of completion.

MARVELL TECHNOLOGY GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Available-for-sale investments

The amortized cost and fair value of available-for-sale investments are presented in the following tables (in thousands):

As of April 30, 2002	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate debt securities	\$114,536	\$ 445	\$(606)	\$114,375
U.S., state, county and municipal debt securities	27,215	19	(88)	27,146
Foreign government securities	13,110	20	(19)	13,111
Equity securities	1,600	950	—	2,550
	156,461	1,434	(713)	157,182
Less amounts classified as cash equivalents	(14,415)	—	—	(14,415)
Short-term investments	\$142,046	\$1,434	\$(713)	\$142,767
As of January 31, 2002	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Corporate debt securities	\$100,232	\$ 461	\$(738)	\$ 99,955
State, county and municipal debt securities	25,870	10	(97)	25,783
Foreign government securities	13,163	—	(92)	13,071
Equity securities	2,400	2,157	—	4,557
	141,665	2,628	(927)	143,366
Less amounts classified as cash equivalents	(7,605)	—	—	(7,605)
Short-term investments	\$134,060	\$2,628	\$(927)	\$135,761

Inventory

Inventory is stated at the lower of cost or market, cost being determined under the first-in, first-out method. Appropriate consideration is given to obsolescence, excessive levels, deterioration and other factors in evaluating net realizable value. The components of inventory are presented in the following table (in thousands):

	April 30, 2002	January 31, 2002
Work-in-process	\$18,017	\$16,727
Finished goods	4,100	6,873
	\$22,117	\$23,600

MARVELL TECHNOLOGY GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Goodwill and purchased intangible assets

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), Goodwill and Other Intangible Assets, which is effective for fiscal years beginning after December 15, 2001. SFAS requires, among other things, the discontinuance of goodwill amortization, the reclassification of certain existing recognized intangibles into goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the testing for impairment of existing goodwill and other intangibles. The Company adopted SFAS 142 in February 2002.

As required by SFAS 142, the Company ceased amortizing goodwill of \$1.3 billion beginning February 1, 2002 and has reclassified the carrying value at January 31, 2002 of the acquired workforce of \$10.4 million into goodwill because this intangible asset did not arise from contractual or other legal rights and cannot be separated from the acquired entity and sold, transferred, licensed, rented or exchanged. Also as part of the adoption of SFAS 142, the Company reassessed the useful lives of its two remaining acquisition-related intangible assets, developed technology and trade name, and determined that the useful life of the Galileo trade name should be five years from the date of acquisition instead of its previously estimated useful life of ten years. This change in useful life, which was based on the Company's expected future use of the Galileo trade name in its selling and marketing activities as well as its expected contribution to future cash flows, will increase the Company's trade name amortization expense to \$7.5 million per year in fiscal 2003 compared to the \$3.3 million it recorded in fiscal 2002. The Company has begun performing the first step of the two-step goodwill impairment test prescribed by SFAS 142. The Company has not yet completed this analysis and expects to complete it within the required time frame of the first six months of fiscal 2003.

The following table presents the impact of SFAS 142 on net loss and net loss per share had SFAS 142 been in effect for the three months ended April 30, 2001:

	Three months ended April 30,	
	2002	2001
Net loss — as reported	\$(30,934)	\$(104,966)
Adjustments:		
Amortization of goodwill	—	83,707
Amortization of acquired workforce previously classified as a purchased intangible asset	—	522
Change in amortization life of trade name	—	(831)
Net adjustments	—	83,398
Net loss — as adjusted	\$(30,934)	\$ (21,568)
Basic and diluted net loss per share — as reported	\$ (0.26)	\$ (0.93)
Amortization of goodwill	—	0.74
Amortization of acquired workforce previously classified as a purchased intangible asset	—	0.01
Change in amortization life of trade name	—	(0.01)
Basic and diluted net loss per share — as adjusted	\$ (0.26)	\$ (0.19)

MARVELL TECHNOLOGY GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

The changes in the carrying amount of the goodwill and intangible assets are as follows (in thousands):

	As of April 30, 2002		As of January 31, 2002	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Purchased technology	\$ 388,955	\$ (98,736)	\$ 388,955	\$ (79,288)
Trade name	33,241	(5,263)	33,241	(3,388)
Assembled workforce	—	—	12,532	(2,128)
Total identified intangible assets	422,196	(103,399)	434,728	(84,804)
Goodwill	1,686,674	(345,454)	1,674,142	(343,326)
Total intangible assets	\$2,108,870	\$(449,453)	\$2,108,870	\$(428,130)

The aggregate amortization expense of identified intangible assets was \$21.3 million and \$20.8 million in the first quarter of 2003 and 2002, respectively. The estimated total amortization expenses of acquired intangible assets is \$85.3 million for fiscal years 2003, 2004, and 2005, respectively and \$83.6 million for fiscal year 2006.

MARVELL TECHNOLOGY GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Net loss per share

The Company reports both basic net loss per share, which is based upon the weighted average number of common shares outstanding excluding contingently issuable or returnable shares, and diluted net loss per share, which is based on the weighted average number of common shares outstanding and dilutive potential common shares. The computations of basic and diluted net loss per share are presented in the following table (in thousands, except per share amounts):

	Three Months Ended April 30,	
	2002	2001
Numerator:		
Net loss	\$ (30,934)	\$(104,966)
Denominator:		
Weighted average shares of common stock outstanding	119,040	115,342
Less: unvested common shares subject to repurchase	(951)	(2,825)
Weighted average shares — basic	118,089	112,517
Effect of dilutive securities-		
Unvested common shares subject to repurchase	—	—
Common stock options	—	—
Weighted average shares — diluted	118,089	112,517
Basic net loss per share	\$ (0.26)	\$ (0.93)
Diluted net loss per share	\$ (0.26)	\$ (0.93)

Options to purchase 13,410,429 common shares at a weighted average exercise price of \$14.52 per share have been excluded from the computations of diluted net loss per share for the three months ended April 30, 2002, and options to purchase 9,813,972 common shares at a weighted average exercise price of \$6.36 per share have been excluded from the computations of diluted net loss per shares for the three months ended April 30, 2001, as their effect would have been anti-dilutive. Additionally, 950,660 and 2,824,882 common shares subject to repurchase by the Company have been excluded from the computations of diluted net loss per share for the three months ended April 30, 2002 and 2001, respectively, as their effect would have been anti-dilutive.

MARVELL TECHNOLOGY GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Comprehensive loss

The components of comprehensive loss, net of tax, are presented in the following table (in thousands):

	Three Months Ended April 30,	
	2002	2001
Net loss	\$(30,934)	\$(104,966)
Other comprehensive income:		
Unrealized gains (losses) on available-for-sale investments	(558)	21
Total comprehensive loss	<u>\$(31,492)</u>	<u>\$(104,945)</u>

Accumulated other comprehensive income (loss), as presented on the accompanying condensed consolidated balance sheets, consists of the unrealized gains and losses on available-for-sale investments, net of tax.

2. Facilities Consolidation Charge

During the three months ended April 30, 2002, the Company recorded a \$17.8 million charge associated with costs of consolidation of its facilities. This charge included \$10.8 million in lease abandonment charges relating to the consolidation of the Company's three facilities in the Silicon Valley into one single corporate location. This charge includes the remaining lease commitments of these facilities reduced by the estimated sublease income throughout the duration of the lease term. Facilities consolidation charge also includes \$6.0 million consisting of the write-down of certain property and leasehold improvements associated with the abandoned facilities. Additionally, the Company incurred charges of \$1.0 million through April 30, 2002 as a result of duplicate lease and other costs associated with the dual occupation of its current and abandoned facilities. The facilities consolidation charge is an estimate as of April 30, 2002 and may change as the Company obtains subleases for the abandoned facilities and sublease income is known. At April 30, 2002, payments of \$1.2 million had been made in connection with this charge, and \$16.6 million had been accrued and is payable through 2010.

A summary of the facilities consolidation charge is as follows (in thousands):

Accrued losses on abandoned leased facilities:	
Non-cancelable lease commitments	\$10,847
Property and leasehold improvements	5,999
Duplicate facility lease costs and other	953
	<u>\$17,799</u>

3. Net Revenue

The following table presents net revenues for groups of similar products (in thousands):

Net Revenue:	Three Months Ended April 30,	
	2003	2002
Storage products	\$63,768	\$28,588
Communications products	35,032	35,642
	<u>\$98,800</u>	<u>\$64,230</u>

MARVELL TECHNOLOGY GROUP LTD.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

4. Recent Accounting Pronouncements

In October 2001, the FASB issued Statement of Financial Accounting Standards No. 144 ("SFAS 144"), Accounting for the Impairment or Disposal of Long-Lived Assets, which is effective for fiscal years beginning after December 15, 2001. SFAS 144 supercedes SFAS 121, Accounting for the Impairment of Long-lived Assets and Assets to be Disposed Of, and certain provisions of Accounting Principles Board Opinion No. 30, Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. SFAS 144 requires that long-lived assets to be disposed of by sale, including discontinued operations, be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. SFAS 144 also broadens the reporting requirements of discontinued operations to include all components of an entity that have operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. The Company adopted SFAS 144 on February 1, 2002, and the adoption did not have a significant impact on its financial position and results of operations.

5. Legal Proceedings

On July 31, 2001, a putative class action suit was filed against two investment banks that participated in the underwriting of the Company's initial public offering, or IPO, on June 29, 2000. That lawsuit, which did not name the Company or any of its officers or directors as defendants, was filed in the United States District Court for the Southern District of New York. Plaintiffs allege that the underwriters received "excessive" and undisclosed commissions and entered into unlawful "tie-in" agreements with certain of their clients in violation of Section 10(b) of the Securities Exchange Act of 1934. Thereafter, on September 5, 2001, a second putative class action was filed in the Southern District of New York relating to the Company's IPO. In this second action, plaintiffs named three underwriters as defendants and also named as defendants the Company and two of its officers, one of who is also a director. Relying on many of the same allegations contained in the initial complaint in which the Company was not named as a defendant, plaintiffs allege that the defendants violated various provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. In both actions, plaintiffs seek, among other items, unspecified damages, pre-judgment interest and reimbursement of attorneys' and experts' fees. These two actions relating to the Company's IPO have been consolidated with hundreds of other lawsuits filed by plaintiffs against approximately 40 underwriters and approximately 300 issuers across the United States. To date, there have been no significant developments in the consolidated litigation. It is expected that a small number of cases will be designated as "test cases" for purposes of initial challenges to the pleadings, which are not expected to be briefed, argued and decided before mid-2002. The Company believes that the claims asserted against it and its officers are without merit and intends to defend these claims vigorously. Based on currently available information, the Company does not believe that the ultimate disposition of the lawsuit naming the Company and its officers will have a material adverse impact on its business or financial condition.

On September 12, 2001, Jasmine Networks, Inc. ("Jasmine") filed a lawsuit in the Santa Clara County Superior Court asserting claims against Company personnel and the Company for improperly obtaining and using information and technologies during the course of the negotiations with Company personnel regarding the potential acquisition of Jasmine by the Company. The lawsuit claims that Company officers improperly obtained and used such information and technologies after the Company signed a non-disclosure agreement with Jasmine. The Company believes the claims asserted against its officers and it are without merit and intends to defend all claims vigorously. Based on currently available information, the Company does not believe that the ultimate disposition of this lawsuit will have a material adverse impact on its business or financial condition.

The Company is also party to other claims and litigation proceedings arising in the normal course of business. Although the legal responsibility and financial impact with respect to such claims and litigation cannot currently be ascertained, the Company does not believe that these matters will result in the payment of monetary damages, net of any applicable insurance proceeds, that, in the aggregate, would be material in relation to the Company's consolidated financial position or results of operations.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Form 10-Q contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. These forward-looking statements involve a number of risks and uncertainties, including those identified in the section of this Form 10-Q titled "Additional Factors That May Affect Future Results," which could cause actual results to differ from those discussed in the forward-looking statements. Forward-looking statements in this Form 10-Q are identified by words such as "believes," "expects," "anticipates," "intends," "estimates," "should," "will," "may" and similar expressions. In addition, any statements which refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. We undertake no obligation to release publicly the results of any revisions to these forward-looking statements that could occur after the filing of this Form 10-Q. You are urged to review carefully our various disclosures in this Form 10-Q and our other reports filed with the SEC, including our 2002 Annual Report on Form 10-K, that attempt to advise you of the risks and factors that may affect our business.

Overview

We design, develop and market integrated circuits utilizing proprietary communications mixed-signal and digital signal processing technology for communications-related markets. Our products provide the critical interface between analog signals and the digital information used in computing and communications systems and enable our customers to store and transmit digital information reliably and at high speeds. We were founded in 1995, and our business has grown rapidly since inception. We are a fabless integrated circuit company, which means that we rely on independent, third-party contractors to perform manufacturing, assembly and test functions. This approach allows us to focus on designing, developing and marketing our products and significantly reduces the amount of capital we need to invest in manufacturing products. In January 2001, we acquired Galileo Technology Ltd. in a stock-for-stock transaction for aggregate consideration of approximately \$2.5 billion. Galileo develops high-performance internetworking and switching products for the broadband communications market. The acquisition was accounted for using the purchase method of accounting, and the operating results of Galileo have been included in our consolidated financial statements from the date of acquisition.

In the communications market, we offer transceiver products, switching products, internetworking products and wireless local area network products. Our primary customers for our communications products are leading manufacturers of high speed networking equipment.

In the storage market, our products include read channel devices, System-On-Chip or SOC's, and preamplifiers. Our customers for our storage products are manufacturers of hard disk drives for the enterprise, desktop and mobile computer markets and the emerging consumer applications market. The storage market is highly competitive and is comprised of a small number of large companies. These companies have historically experienced marginal profit levels from sales of their storage products and are under enormous pricing pressure from their customers, which they typically pass through to their integrated circuit suppliers.

Historically, a relatively small number of customers have accounted for a significant portion of our revenue. For the three months ended April 30, 2002, approximately 60% of our net revenue was derived from sales to four significant customers, each of whom individually accounted for 10% or more of our net revenue during this period. We expect to continue to experience significant customer concentration in future periods. In addition, a significant portion of our sales is made to customers located outside of the United States, primarily in Asia. Sales to customers in Asia represented approximately 86% of our net revenue for the three months ended April 30, 2002. Because many manufacturers and manufacturing subcontractors of communications and storage devices are located in Asia, we expect that a significant portion of our revenue will continue to be represented by sales to customers in that region. All of our sales to date have been denominated in United States dollars.

Our sales have historically been made on the basis of purchase orders rather than long-term agreements. In addition, the sales cycle for our products is long, which may cause us to experience a delay between the time we incur expenses and the time revenue is generated from these expenditures. We expect to increase our research and development, selling and marketing, and general and administrative expenditures as we seek to expand our

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operations. We anticipate that the rate of new orders may vary significantly from quarter to quarter. Consequently, if anticipated sales and shipments in any quarter do not occur when expected, expenses and inventory levels could be disproportionately high, and our operating results for that quarter and future quarters may be adversely affected.

Our fiscal year is the 52- or 53-week period ending on the Saturday closest to January 31. In a 52-week year, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal year 2003 will be comprised of 52 weeks. For presentation purposes, our financial statements and notes and this “Management’s Discussion and Analysis of Financial Condition and Results of Operations” refer to January 31 as our year-end and April 30, July 31 and October 31 as our quarter-ends.

Results of Operations

The following table sets forth information derived from our condensed consolidated statements of operations expressed as a percentage of net revenue:

	Three Months Ended April 30,	
	2002	2001
Net revenue	100.0%	100.0%
Operating costs and expenses:		
Cost of goods sold	44.3	47.0
Research and development	31.0	31.2
Selling and marketing	11.1	14.9
General and administrative	3.7	4.6
Amortization of stock-based compensation	2.3	6.4
Amortization of goodwill and acquired intangible assets	21.6	162.7
Facilities consolidation charge	18.0	—
Total operating costs and expenses	132.0	266.8
Operating loss	(32.0)	(166.8)
Interest and other income, net	2.2	4.6
Loss before income taxes	(29.8)	(162.2)
Provision for income taxes	(1.4)	(1.2)
Net loss	(31.2)%	(163.4)%

Three Months Ended April 30, 2002 and 2001

Net Revenue. Net revenue consists primarily of product revenue from sales of our semiconductor devices, and to a much lesser extent, development revenue derived from development contracts with our customers. Net revenue was \$98.8 million for the three months ended April 30, 2002 compared to \$64.2 million for the three months ended April 30, 2001. The increases in net revenue reflect a significant increase in volume shipments of our storage products during the three months ended April 30, 2002, primarily due to increased acceptance of our SOC storage products which began shipping in volume in the second half of fiscal 2002. Revenue from storage products totaled \$63.8 million in the first quarter of fiscal 2003 compared to \$28.6 million in the first quarter of fiscal 2002. Revenue from communications products was \$35.0 million in the first quarter of fiscal 2003 compared to \$35.6 million in the first quarter of fiscal 2002. Revenue derived from development contracts increased in absolute dollars during the first quarter of fiscal 2003 compared to the first quarter of fiscal 2002, but represented less than 10% of net revenues for each quarter. We expect that revenue from storage products for fiscal 2003 will increase from the level of revenue from storage products we reported in fiscal 2002 due in part to increases in shipments of our storage SOCs, which have been widely adopted by the mobile computer sector and which we expect to be adopted by the desktop computer sector during this fiscal year. In addition, we expect growth in revenue from communications products in fiscal 2003 compared to fiscal 2002 primarily due to increases in shipments of our Gigabit Ethernet products, which we expect will continue to be adopted as the replacement for Fast Ethernet products.

Cost of Goods Sold. Cost of goods sold consists primarily of the costs of manufacturing, assembly and test of integrated circuit devices and related overhead costs, and compensation and associated costs relating to manufacturing support, logistics and quality assurance personnel. Gross margin, which is calculated as net revenue less cost of goods sold, as a percentage of net revenue, increased to 55.7% in the three months ended April 30, 2002 from 53.0% in the three months ended April 30, 2001. The increase in gross margin was primarily due to higher margins on our storage products which resulted from a shift in product mix to newer, higher-margin products, and to a lesser extent due to an increase in the amount of development revenue recognized in the first quarter of fiscal 2003 compared to the first quarter of fiscal 2002. The costs associated with contracted development work are included in research and development expense. Our gross margins are primarily driven by product mix; however, our margins may fluctuate in future periods due to, among other things, changes in the mix of products sold, increased pricing pressures from our customers and competitors, and changes in the amount development revenue recognized. We expect that our gross margin as a percentage of net revenue will decrease during fiscal 2003 due to the anticipated production ramps of large volume design wins in lower margin businesses such as the desktop computer sector.

Research and Development. Research and development expense consists primarily of compensation and associated costs relating to development personnel, prototype costs, depreciation and amortization expense, and allocated occupancy costs for these operations. Research and development expense was \$30.6 million, or 31.0% of net revenue, for the three months ended April 30, 2002 compared to \$20.1 million, or 31.2% of net revenue, for the three months ended April 30, 2001. The increase in research and development expense in absolute dollars in the first quarter of fiscal 2003 compared to the first quarter of fiscal 2002 was primarily due to the hiring of additional development personnel which resulted in an increase in salary and related costs of \$4.2 million, increased costs of \$1.6 million for prototype and related product tape-out costs for new product initiatives, increased depreciation and amortization expense of \$1.0 million arising from purchases of property, equipment and technology licenses, and increased facility and other allocated expenses of \$2.2 million related to our expanding operations. We expect that research and development expense will increase in absolute dollars in future periods as we develop new products, expand into new markets and technologies, and hire additional personnel.

Selling and Marketing. Selling and marketing expense consists primarily of compensation and associated costs relating to sales and marketing personnel, sales commissions, promotional and other marketing expenses, and allocated occupancy costs for these operations. Selling and marketing expense was \$11.0 million, or 11.1% of net revenue, for the three months ended April 30, 2002 compared to \$9.5 million, or 14.9% of net revenue, for the three months ended April 30, 2001. The increase in selling and marketing expense in absolute dollars in the first quarter of fiscal 2003 compared to the first quarter of fiscal 2002 was primarily due to the hiring of additional sales and marketing personnel which resulted in an increase in salary and related costs of \$1.3 million, and increased facility and other allocated expenses of \$0.5 million related to our expanding operations, offset by a reduction in commission expense of \$0.5 million. The reduction in commission expense was because we have transitioned all of our storage customers to a direct selling basis as of the end of the first quarter of fiscal 2003 instead of using outside sales representatives. We expect that selling and marketing expense will increase in absolute dollars in future periods as we hire additional sales and marketing personnel and expand our sales and marketing efforts.

General and Administrative. General and administrative expense consists primarily of compensation and associated costs relating to general and administrative personnel, fees for professional services and allocated occupancy costs for these operations. General and administrative expense was \$3.6 million, or 3.7% of net revenue, for the three months ended April 30, 2002 compared to \$3.0 million, or 4.6% of net revenue, for the three months ended April 30, 2001. The increase in general and administrative expense in absolute dollars in the first quarter of fiscal 2003 compared to the first quarter of fiscal 2002 was primarily due to the hiring of additional administrative personnel which resulted in an increase in salary and related costs of \$0.1 million and increased legal and other professional fees of \$0.6 million due to our expanding operations and attorney fees associated with our on-going legal proceedings. We expect that general and administrative expense will remain relatively constant in absolute dollars in future quarters this year compared to the first quarter of fiscal 2003 as we continue to focus on cost saving measures.

Amortization of Stock-Based Compensation. We have recorded deferred stock-based compensation in connection with the grant of stock options to our employees and directors prior to our initial public offering of common stock and in connection with the assumption of stock options as a result of our acquisition of Galileo. Deferred stock-based compensation is being amortized using an accelerated method over the remaining option vesting period. Amortization of stock-based compensation was \$2.3 million, or 2.3% of net revenue, for the three months ended April 30, 2002 compared to \$4.1 million, or 6.4% of net revenue, for the three months ended April 30, 2001. The decrease in amortization expense in absolute dollars in the first quarter of fiscal 2003 compared to the first quarter of fiscal 2002 primarily resulted from a reduced balance of deferred stock-based compensation being amortized in the first quarter of fiscal 2003 compared to the first quarter of fiscal 2002.

Amortization of Goodwill and Acquired Intangible Assets. In connection with the acquisition of Galileo in the fourth quarter of fiscal 2001, we recorded \$1.7 billion of goodwill and \$434.7 million of acquired intangible assets. Goodwill was being amortized over its estimated economic life of five years through January 31, 2002, and acquired intangible assets are being amortized over their estimated economic lives of five to ten years. Goodwill and acquired intangible asset amortization expense was \$21.3 million, or 21.6% of net revenue, for the three months ended April 30, 2002 compared to \$104.5 million, or 162.7% of net revenue, for the three months ended April 30, 2001.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), Goodwill and Other Intangible Assets. SFAS 142 requires, among other things, a goodwill impairment test within six months of adoption and annual impairment tests thereafter. We adopted SFAS 142 in February 2002. As required by SFAS 142, we ceased amortizing goodwill of \$1.3 billion beginning February 1, 2002 and have reclassified the carrying value at January 31, 2002 of the acquired workforce of \$10.4 million into goodwill because this intangible asset did not arise from contractual or other legal rights and cannot be separated from the acquired entity and sold, transferred, licensed, rented or exchanged. Also as part of the adoption of SFAS 142, we reassessed the useful lives of our two remaining acquisition-related intangible assets, developed technology and trade name, and determined that the useful life of the Galileo trade name should be five years from the date of acquisition instead of its previously estimated useful life of ten years. This change in useful life, which was based on our expected future use of the Galileo trade name in our selling and marketing activities as well as our expected contribution to future cash flows, will increase our trade name amortization expense to \$7.5 million per year in fiscal 2003 compared to the \$3.3 million it recorded in fiscal 2002. We have begun performing the first step of the two-step goodwill impairment test prescribed by SFAS 142. We have not yet completed this analysis and expect to complete it within the required time frame of the first six months of fiscal 2003.

Facilities Consolidation Charge. During the three months ended April 30, 2002, we recorded a \$17.8 million charge associated with costs of consolidation of our facilities. This charge included \$10.8 million in lease abandonment charges relating to the consolidation of our three facilities in the Silicon Valley into one single corporate location. This charge includes the remaining lease commitments of these facilities reduced by the estimated sublease income throughout the duration of the lease term. Facilities consolidation charge also includes \$6.0 million consisting of the write-down of certain property and leasehold improvements associated with the abandoned facilities. We also incurred charges of \$1.0 million through April 30, 2002 as a result of duplicate lease and other costs associated with the dual occupation of our current and abandoned facilities. The facilities consolidation charge is an estimate as of April 30, 2002 and may change as we obtain subleases for the abandoned facilities and sublease income is known. At April 30, 2002, payments of \$1.2 million had been made in connection with this charge, and \$16.6 million had been accrued and is payable through 2010.

Interest and Other Income, Net. Interest and other income, net consists primarily of interest earned on cash, cash equivalent and short-term investment balances, offset by interest paid on capital lease obligations. Interest and other income, net was \$2.1 million for the three months ended April 30, 2002 compared to \$3.0 million for the three months ended April 30, 2001. The decrease in interest and other income, net in the first quarter of fiscal 2003 compared to the first quarter of fiscal 2002 was due to an overall decline in interest rates on comparable invested cash balances and an increase in interest expense on capital lease obligations, partially offset by realized gains of \$0.7 million in the first quarter of fiscal 2003.

Provision for Income Taxes. Our effective tax rate was (5)% for the three months ended April 30, 2002 compared to (1)% for the three months ended April 30, 2001. Our effective rates for the first quarter of fiscal

2003 and 2002 were affected by stock-based compensation expense as well as non-deductible expenses relating to our acquisition of Galileo in the fourth quarter of fiscal 2001, which was recorded using the purchase method of accounting. Excluding the effect of stock-based compensation expense, non-deductible, acquisition-related expenses, and costs associated with facilities consolidation, our adjusted effective tax rate for the first quarter of fiscal 2003 was 12%, compared to 15% for the first quarter of fiscal 2002. Our adjusted effective tax rate has decreased to 12% in the first quarter of fiscal 2003 from 15% in the first quarter of fiscal 2002 as a result of a relative increase in pretax profits in jurisdictions with lower tax rates.

Liquidity and Capital Resources

Our principal source of liquidity as of April 30, 2002 consisted of \$257.0 million of cash, cash equivalents and short-term investments. We raised net proceeds of \$94.0 million through our initial public offering in June 2000. In addition, we received \$70.0 million of cash and cash equivalents and \$39.9 million of short-term investments, before acquisition costs, as a result of our acquisition of Galileo in January 2001.

Net cash provided by operating activities was \$9.5 million for the three months ended April 30, 2002 and \$10.1 million for the three months ended April 30, 2001. The cash inflow from operations in the first three months of fiscal 2003 was primarily a result of our generation of income during the period (excluding the non-cash impact of depreciation and amortization expenses), a decrease in inventory and increases in accounts payable and accrued facility consolidation charge, partially offset by an increase in accounts receivable and a decrease in accrued liabilities. The cash inflow from operations in the first three months of fiscal 2002 was primarily due to our generation of income during the period (excluding the non-cash impact of depreciation and amortization expenses) and a decrease in inventory, partially offset by decreases in accounts payable and accrued liabilities. Due to the nature of our business, we experience working capital needs for accounts receivable and inventory. We typically bill customers on an open account basis with net 30-day payment terms. If our sales levels were to increase, it is likely that our levels of accounts receivable would also increase. Our levels of accounts receivable would also increase if customers delayed their payments or if we offered extended payment terms to our customers. Additionally, in order to maintain an adequate supply of product for our customers, we must carry a certain level of inventory. Our inventory level may vary based primarily upon orders received from our customers and our forecast of demand for these products. Other considerations in determining inventory levels may include the product life cycle stage of our products and competitive situations in the marketplace. Such considerations are balanced against risk of obsolescence or potentially excess inventory levels.

Net cash used in investing activities was \$18.4 million for the three months ended April 30, 2002 and \$33.9 million for the three months ended April 30, 2002. The net cash used in investing activities in the first three months of fiscal 2003 was due to purchases of property and equipment of \$10.8 million and purchases of short-term investments of \$20.5 million, partially offset by the proceeds from maturities of short-term investments of \$12.5 million. The net cash used in investing activities in the first three months of fiscal 2002 was primarily due to the payment of \$29.1 million of accrued acquisition costs relating to our acquisition of Galileo, purchases of property and equipment of \$7.1 million, and purchases of short-term investments of \$8.0 million, partially offset by the proceeds from maturities of short-term investments of \$11.0 million.

Net cash provided by financing activities was \$8.7 million for the three months ended April 30, 2002 and \$0.9 million for the three months ended April 30, 2002. In the first three months of fiscal 2003 and 2002, net cash provided by financing activities was attributable to proceeds from the issuance of common stock under our stock option plans and our employee stock purchase plan, partially offset by principal payments on capital lease obligations.

Our relationships with the foundries we utilize allow us to cancel all outstanding purchase orders, provided we pay the foundries for all expenses they have incurred in connection with our purchase orders through the date of cancellation. As of April 30, 2002, our foundries had incurred approximately \$46.2 million of manufacturing expenses on our outstanding purchase orders.

In October 2001, we entered into a lease agreement with Yahoo! Inc. to lease a building in California consisting of approximately 213,000 square feet. The lease commenced on January 1, 2002 and continues through March 16, 2006. Total rent payments over the term of the lease will be approximately \$19.4 million. In

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February 2002, we consolidated our three existing facilities in California into this new building. The lease on one of our former facilities expired in February 2002, but we have ongoing, non-cancelable leases for the two other facilities. We are currently attempting to secure subtenants for the remainder of our lease terms for these two facilities. Since we have been unable to sublease these two facilities, we will continue to be required to pay the full amount of our contracted lease payments while the facilities are vacant or if they are subleased at a future date at lesser rates. In the first quarter of fiscal 2003, we recorded a \$17.8 million charge associated with costs of consolidation of our facilities. This charge includes the remaining lease commitments of these facilities reduced by the estimated sublease income throughout the duration of the lease term. The facilities consolidation charge is an estimate as of April 30, 2002 and may change as we obtain subleases for the abandoned facilities and sublease income is known. At April 20, 2002, payments of \$1.2 million had been made in connection with this charge, and \$16.6 million had been accrued and is payable through 2010.

We intend to fund our capital requirements, as well as our liquidity needs, with existing cash, cash equivalent and short-term investment balances as well as cash generated by operations. However, our capital requirements will depend on many factors, including our rate of sales growth, market acceptance of our products, costs of securing access to adequate manufacturing capacity, the timing and extent of research and development projects and increases in operating expenses, which are all subject to uncertainty. To the extent that our existing cash, cash equivalent and investment balances and cash generated by operations are insufficient to fund our future activities, we may need to raise additional funds through public or private debt or equity financing. Although we are not a party to any definitive agreement regarding an acquisition or other strategic arrangement, we may thereafter enter into an acquisition or other strategic arrangement that could require us to seek additional debt or equity financing. Additional funds may not be available on terms favorable to us or at all.

The following table summarizes our contractual obligations as of April 30, 2002 and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

	Payments Due by Period			
	Less than 1 Year	1 - 3 Years	After 3 Years	Total
	(remaining nine months)			
Contractual obligations:				
Operating leases	\$ 6,453	\$18,935	\$15,508	\$40,896
Capital lease obligations	1,200	4,500	6,800	12,500
Purchase commitments to foundries	46,229	—	—	46,229
Total contractual cash obligations	\$53,882	\$23,435	\$22,308	\$99,625

Recent Accounting Pronouncements

In October 2001, the FASB issued Statement of Financial Accounting Standards No. 144 ("SFAS 144"), Accounting for the Impairment or Disposal of Long-Lived Assets, which is effective for fiscal years beginning after December 15, 2001. SFAS 144 supercedes SFAS 121, Accounting for the Impairment of Long-lived Assets and Assets to be Disposed Of, and certain provisions of Accounting Principles Board Opinion No. 30, Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. SFAS 144 requires that long-lived assets to be disposed of by sale, including discontinued operations, be measured at the lower of carrying amount or fair value less cost to sell, whether reported in continuing operations or in discontinued operations. SFAS 144 also broadens the reporting requirements of discontinued operations to include all components of an entity that have operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. We adopted SFAS 144 on February 1, 2002, and the adoption did not have a significant impact on our financial position and results of operations.

Additional Factors That May Affect Future Results

In addition to the factors discussed in the “Overview” and “Liquidity and Capital Resources” sections of this “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” the following additional factors may affect our future results. Many of these factors are beyond our control, including business cycles and seasonal trends of the computing, semiconductor and related industries.

We have experienced a recent slowdown in the worldwide economy, which has negatively affected our revenues and results of operations in fiscal 2002. If economic conditions worsen, our revenues and results of operations in fiscal 2003 and beyond will be materially and adversely affected.

Over the last year there has been a slowdown in worldwide economies, including the United States, that has resulted in delays of new orders for our products as well as reschedules of existing orders. This slowdown has been brought about by a number of factors, including concerns about inflation, decreased consumer confidence and reports of reduced corporate profits. If economic conditions worsen, our revenues and results of operations in fiscal 2003 and beyond will be materially and adversely affected.

We are dependent upon the hard disk drive industry, which is highly cyclical and experiences rapid technological change.

Sales to customers in the hard disk drive industry represented approximately 65% of our net revenue in the first quarter of fiscal 2003 and represented approximately 57% and 85% of our net revenue in fiscal 2002 and 2001, respectively. The hard disk drive industry is intensely competitive, and the technology changes rapidly. As a result, this industry is highly cyclical, with periods of increased demand and rapid growth followed by periods of oversupply and subsequent contraction. These cycles may affect us as our customers are suppliers to this industry. Hard disk drive manufacturers tend to order more components than they may need during growth periods, and sharply reduce orders for components during periods of contraction. In addition, advances in existing technologies and the introduction of new technologies may result in lower demand for disk drive storage devices, thereby reducing demand for our products.

Rapid technological changes in the hard disk drive industry often result in significant and rapid shifts in market share among the industry’s participants. If the hard disk drive manufacturers supplied by our customers do not retain or increase market share, our sales may decrease.

Our Galileo subsidiary is incorporated under the laws of, and its principal offices are located in, the State of Israel and therefore its business operations may be harmed by adverse political, economic and military conditions affecting Israel.

Galileo is both incorporated under the laws of and has its principal offices in the State of Israel. In addition, Galileo maintains its research and development operations in Israel. Thus, Galileo is directly influenced by the political, economic and military conditions affecting Israel. Major hostilities involving or within Israel could disrupt Galileo’s research and development and other business operations. For example, continued hostilities between Israel and the Palestinian Authority in recent months caused substantial political unrest, which could lead to a potential economic downturn in Israel. Also, the interruption or curtailment of trade between Israel and its present trading partners or a significant downturn in the economic or financial condition of Israel could reduce Galileo’s sales and its financial results. A number of countries restrict business with Israel or Israeli companies, and if the countries in which Galileo’s customers or potential customers conduct their businesses adopt restrictive laws or policies toward Israel or Israeli businesses this could harm Galileo’s ability to retain or increase its sales.

We depend on a small number of large customers for a significant portion of our sales. The loss of, or a significant reduction or cancellation in sales to, any key customer would significantly reduce our revenues.

In the first quarter of fiscal 2003, approximately 60% of our net revenue was derived from sales to four customers, each of whom individually accounted for 10% or more of our net revenue during this period. Of these

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customers, Samsung accounted for 21%, Seagate accounted for 15%, Toshiba accounted for 13% and Hitachi accounted for 11%. Sales to our largest customers have fluctuated significantly from period to period primarily due to the timing and number of design wins with each customer, as well as the continued diversification of our customer base as we expand into new markets, and will likely continue to fluctuate dramatically in the future. The loss of any of our largest customers, a significant reduction in sales we make to them, or any problems we encounter collecting amounts from them would likely seriously harm our financial condition and results of operations. Our operating results in the foreseeable future will continue to depend on sales to a relatively small number of customers, as well as the ability of these customers to sell products that incorporate our products. In the future, these customers may decide not to purchase our products at all, to purchase fewer products than they did in the past, or to alter their purchasing patterns in some other way, particularly because:

- we do not have any long-term purchase arrangements or contracts with these or any of our other customers or exclusive arrangements with any customers;
- substantially all of our sales are made on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with little or no notice to us and without penalty;
- our customers purchase integrated circuits from our competitors; and
- our customers may discontinue sales in the markets for which they purchase our products.

If we are unable to develop new and enhanced products that achieve market acceptance in a timely manner, our operating results and competitive position will be harmed.

Our future success will depend on our ability, in a timely and cost-effective manner, to develop new products for the broadband communications market and to introduce enhancements to our products for the storage market. We must also achieve market acceptance for these products and enhancements. If we do not successfully develop and achieve market acceptance for new and enhanced products, our ability to maintain or increase revenues will suffer. The development of our products is highly complex. We occasionally have experienced delays in completing the development and introduction of new products and product enhancements, and we could experience delays in the future. In particular, we have a limited history in developing products for the broadband communications market and may encounter technical difficulties in developing wireless LAN or other products for this market that could prevent or delay their successful introduction. Unanticipated problems in developing broadband communications products could also divert substantial engineering resources, which may impair our ability to develop new products and enhancements for the storage market, and could substantially increase our costs. Even if the new and enhanced products are introduced to the market, we may not be able to achieve market acceptance of these products in a timely manner.

Successful product development and market acceptance of our products depends on a number of factors, including:

- timely and cost-effective completion and introduction of new product designs;
- adoption of our products by customers that are among the first to adopt new technologies and by customers perceived to be market leaders;
- timely qualification and certification of our products for use in our customers' products;
- the level of acceptance of our products by existing and potential customers;
- cost and availability of foundry, assembly and testing capacity;
- availability, price, performance, power, use and size of our products and competing products and technologies;
- our customer service and support capabilities and responsiveness;

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- successful development of our relationships with existing and potential customers and strategic partners; and
- our ability to predict and respond to changes in technology, industry standards or end-user preferences.

Our acquisition of Galileo and any future acquisitions could harm our operating results and share price.

We expect to continue to make acquisitions of, and investments in, businesses that offer complementary products, services and technologies, augment our market segment coverage, or enhance our technological capabilities. These acquisitions could materially adversely affect our operating results as a result of possible concurrent issuances of dilutive equity securities. In addition, the purchase price of such acquired businesses may exceed the current fair values of the net tangible assets of the acquired businesses. As a result, we would be required to record material amounts of goodwill and other intangible assets, which could result in significant impairment charges and amortization expense in future periods. These charges, in addition to the results of operations of such acquired businesses, could have a material adverse effect on our business, financial condition and results of operations. We cannot forecast the number, timing or size of future acquisitions, or the effect that any such acquisitions might have on our operating or financial results.

We acquired Galileo Technology Ltd. on January 21, 2001. We accounted for this acquisition using the purchase method of accounting, and the results of Galileo's operations are included in our consolidated financial statements from the date of acquisition. The excess of cost over the fair value of the net tangible assets acquired from our acquisition of Galileo has been recorded as goodwill, other intangible assets and deferred stock-based compensation. The acquisition of Galileo resulted in goodwill of approximately \$1.7 billion, other intangible assets of approximately \$434.7 million and deferred stock-based compensation of approximately \$19.8 million. Prior to the adoption of SFAS 142, goodwill was being amortized over its estimated economic life of five years and other intangible assets were being amortized over their estimated economic lives of between five and ten years. Deferred stock-based compensation is being amortized over the remaining option vesting periods of no more than four years. Upon adoption of SFAS 142, goodwill and the acquired workforce are no longer amortized, but are instead subject to annual impairment reviews. Also upon adoption of SFAS 142, the estimated useful life of the Galileo trade name was changed from ten years to five years. After the adoption of SFAS 142, we will continue to record significant amounts of amortization expense over the estimated economic lives of our intangible assets and over the remaining option vesting periods, which will have a significant negative impact on our operating results and could cause our stock price to decline.

Under generally accepted accounting principles, we are required to review our intangible assets for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. In addition, we are required to review our goodwill and indefinite-lived intangible assets on an annual basis. Over the last year, there has been a slowdown in worldwide economies, including the United States, which has affected our business. End customers for our products have slowed their purchases of next-generation technology and have delayed or rescheduled existing orders for products that incorporate our technology. As part of the process of adopting SFAS 142, we are required to perform an impairment review of our goodwill. If the economic downtrend continues or if other presently unforeseen events or changes in circumstances arise which indicate that the carrying value of our goodwill or other intangible assets may not be recoverable, we will be required to perform impairment reviews of these assets, which have carrying values of approximately \$1.7 billion as of April 30, 2002. An impairment review could result in a write-down of these assets to their fair values. In light of the large carrying value associated with our goodwill and intangible assets, any write-down of these assets may result in a significant charge to our statement of operations in the period any impairment is determined and could cause our stock price to decline.

We are a relatively small company with limited resources compared to some of our current and potential competitors, and we may not be able to compete effectively and increase or maintain revenue and market share.

We may not be able to compete successfully against current or potential competitors. If we do not compete successfully, our market share and revenues may not increase or may decline. In addition, most of our current

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and potential competitors have longer operating histories, significantly greater resources and name recognition and a larger base of customers than us. As a result, these competitors may have greater credibility with our existing and potential customers. Moreover, our competitors may foresee the course of market developments more accurately than us. They also may be able to adopt more aggressive pricing policies and devote greater resources to the development, promotion and sale of their products than us, which would allow them to respond more quickly than us to new or emerging technologies or changes in customer requirements. In addition, new competitors or alliances among existing competitors could emerge. We expect to face competition in the future from our current competitors, other manufacturers and designers of integrated circuits, and innovative start-up integrated circuit design companies. Many of our customers are also large, established integrated circuit suppliers. Our sales to and support of such customers may enable them to become a source of competition to us, despite our efforts to protect our intellectual property rights.

In the broadband communications market, we face competition from a number of additional competitors who have a longer history of serving that market. Many of these competitors have more-established reputations in that market and longer-standing relationships with the customers to whom we sell our products, which could prevent us from competing successfully. Competition could increase pressure on us to lower our prices and lower our margins.

Due to our limited operating history, we may have difficulty in accurately predicting our future sales and appropriately budgeting for our expenses, and we may not be able to maintain our existing growth rate.

Our limited operating experience, combined with the rapidly changing nature of the markets in which we sell our products, limits our ability to accurately forecast quarterly and annual sales. Additionally, because many of our expenses are fixed in the short term or incurred in advance of anticipated sales, we may not be able to decrease our expenses in a timely manner to offset any shortfall of sales. We are currently expanding our staffing and increasing our expense levels in anticipation of future sales growth. If our sales do not increase as anticipated, significant losses could result due to our higher expense levels.

Although we have experienced sales and earnings growth in prior quarterly and annual periods, we may not be able to sustain these growth rates, particularly in the period of economic slowdown we are currently experiencing. Accordingly, you should not rely on the results of any prior quarterly or annual periods as an indication of our future performance.

Because we do not have long-term commitments from our customers, we must estimate customer demand, and errors in our estimates can have negative effects on our inventory levels, sales and operating results.

Our sales are made on the basis of individual purchase orders rather than long-term purchase commitments. In addition, our customers may cancel or defer purchase orders. We have historically placed firm orders for products with our suppliers up to 16 weeks prior to the anticipated delivery date and typically prior to receiving an order for the product. Therefore, our order volumes are based on our forecasts of demand from our customers. This process requires us to make multiple demand forecast assumptions, each of which may introduce error into our estimates. If we overestimate customer demand, we may allocate resources to manufacturing products that we may not be able to sell when we expect or at all. As a result, we would have excess inventory, which would harm our financial results. Conversely, if we underestimate customer demand or if insufficient manufacturing capacity is available, we would forego revenue opportunities, lose market share and damage our customer relationships. On occasion, we have been unable to adequately respond to unexpected increases in customer purchase orders, and therefore, were unable to benefit from this increased demand.

We rely on independent foundries and subcontractors for the manufacture, assembly and testing of our integrated circuit products, and the failure of any of these third-party vendors to deliver products or otherwise perform as requested could damage our relationships with our customers, decrease our sales and limit our growth.

We do not have our own manufacturing or assembly facilities and have very limited testing facilities. Therefore, we must rely on third-party vendors to manufacture, assemble and test the products we design. We currently rely on TSMC to produce substantially all of our integrated circuit products. We also currently rely on

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TSMC and other third-party assembly and test subcontractors to assemble, package and test our products. If these vendors do not provide us with high quality products and services in a timely manner, or if one or more of these vendors terminates its relationship with us, we may be unable to obtain satisfactory replacements to fulfill customer orders on a timely basis, our relationships with our customers could suffer, our sales could decrease and our growth could be limited. Other significant risks associated with relying on these third-party vendors include:

- our customers or their customers may fail to approve or delay approving our selected supplier;
- we have reduced control over product cost, delivery schedules and product quality;
- the warranties on wafers or products supplied to us are limited; and
- we face increased exposure to potential misappropriation of our intellectual property.

We currently do not have long-term supply contracts with any of our third-party vendors. Therefore, they are not obligated to perform services or supply products to us for any specific period, in any specific quantities, or at any specific price, except as may be provided in a particular purchase order. None of our third-party foundry or assembly and test subcontractors have provided contractual assurances to us that adequate capacity will be available to us to meet future demand for our products. These foundries may allocate capacity to the production of other companies' products while reducing deliveries to us on short notice. In particular, foundry customers that are larger and better financed than us or that have long-term agreements with these foundries may cause these foundries to reallocate capacity to those customers, decreasing the capacity available to us. If we need another integrated circuit foundry or assembly and test subcontractor because of increased demand or the inability to obtain timely and adequate deliveries from our providers at the time, we might not be able to develop relationships with other vendors who are able to satisfy our requirements. Even if other integrated circuit foundries or assembly and test subcontractors are available at that time to satisfy our requirements, it would likely take several months to acquire a new provider. Such a change may also require the approval of our customers, which would take time to effect and could cause our customers to cancel orders or fail to place new orders.

If our foundries do not achieve satisfactory yields or quality, our relationships with our customers and our reputation will be harmed.

The fabrication of integrated circuits is a complex and technically demanding process. Our foundries have from time to time experienced manufacturing defects and reduced manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials by our foundries could result in lower than anticipated manufacturing yields or unacceptable performance. Many of these problems are difficult to detect at an early stage of the manufacturing process and may be time consuming and expensive to correct. Poor yields from our foundries, or defects, integration issues or other performance problems in our products could cause us significant customer relations and business reputation problems, harm our financial results and result in financial or other damages to our customers. Our customers could also seek damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend. In addition, defects in our existing or new products could result in significant warranty, support and repair costs, and divert the attention of our engineering personnel from our product development efforts.

We depend on key personnel with whom we do not have employment agreements to manage our business, and if we are unable to retain our current personnel and hire additional personnel, our ability to develop and successfully market our products could be harmed.

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering and sales and marketing personnel. The loss of any key employees or the inability to attract or retain qualified personnel, including engineers and sales and marketing personnel, could delay the development and introduction of, and harm our ability to sell, our products. We believe that our future success is highly dependent on the contributions of Dr. Sehat Sutardja, our co-founder, President and Chief Executive

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Officer; Dr. Pantas Sutardja, our co-founder and Vice President; and Weili Dai, our co-founder and Executive Vice President. We do not have employment contracts with these or any other key personnel, and their knowledge of our business and industry would be extremely difficult to replace.

There is currently a shortage of qualified technical personnel with significant experience in the design, development, manufacture, marketing and sales of integrated circuits for use in communications products. In particular, there is a shortage of engineers who are familiar with the intricacies of the design and manufacture of products based on analog technology, and competition for these engineers is intense. Our key technical personnel represent a significant asset and serve as the source of our technological and product innovations. We may not be successful in attracting and retaining sufficient numbers of technical personnel to support our anticipated growth.

Our rapid growth has strained our resources and our inability to manage any future growth could harm our profitability.

Our rapid growth has placed, and any future growth of our operations will continue to place, a significant strain on our management personnel, systems and resources. We anticipate that we will need to implement a variety of new and upgraded operational and financial systems, procedures and controls, including the improvement of our accounting and other internal management systems. We also expect that we will need to continue to expand, train, manage and motivate our workforce. All of these endeavors will require substantial management effort. If we are unable to effectively manage our expanding operations, our operating results could be harmed.

We are currently in the process of implementing a new Enterprise Resource Planning, or ERP, system. An ERP system implementation is a very complex, costly and time-consuming process. Any unforeseen delays or difficulties in the system implementation may divert the attention of management and other employees and disrupt our ongoing business and could have a material adverse impact on our financial condition and results of operations.

If we are not successful in subleasing our unused office space, we will be required to pay the full amount of our contracted lease payments while the facilities are vacant or if they are subleased at a future date at lesser rates.

In October 2001, we entered into a lease agreement with Yahoo! Inc. to lease a building in California consisting of approximately 213,000 square feet. The lease commenced on January 1, 2002 and continues through March 16, 2006. Total rent payments over the term of the lease will be approximately \$19.4 million. In February 2002, we consolidated our three existing facilities in California into this new building. The lease on one of our former facilities expired in February 2002, but we have ongoing, non-cancelable leases for the two other facilities. We are currently attempting to secure subtenants for the remainder of our lease terms for these two facilities. Since we have been unable to sublease these two facilities, we will continue to be required to pay the full amount of our contracted lease payments while the facilities are vacant or if they are subleased at a future date at lesser rates. In the first quarter of fiscal 2003, we recorded a \$17.8 million charge associated with costs of consolidating our facilities. This charge includes the remaining lease commitments of these facilities reduced by the estimated sublease income throughout the duration of the lease term. The facilities consolidation charge is an estimate as of April 30, 2002 and may change as we obtain subleases for the abandoned facilities and sublease income is known.

We face foreign business, political and economic risks, which may harm our results of operations, because a majority of our products and our customers' products are manufactured and sold outside of the United States.

A substantial portion of our business is conducted outside of the United States and, as a result, we are subject to foreign business, political and economic risks. All of our products are manufactured outside of the United States. Our current qualified integrated circuit foundries are located in the same region within Taiwan, and our primary assembly and test subcontractors are located in the Pacific Rim region. In addition, many of our customers are located outside of the United States, primarily in Asia, which further exposes us to foreign risks. Sales to customers located in Asia represented approximately 86% of our net revenue in the first quarter of fiscal 2003, and represented 83% and 92% of our net revenue in fiscal 2002 and 2001, respectively.

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We anticipate that our manufacturing, assembly, testing and sales outside of the United States will continue to account for a substantial portion of our operations and revenue in future periods. Accordingly, we are subject to international risks, including:

- difficulties in obtaining domestic and foreign export, import and other governmental approvals, permits and licenses;
- compliance with foreign laws;
- difficulties in staffing and managing foreign operations;
- trade restrictions or higher tariffs;
- transportation delays;
- difficulties of managing distributors, especially because we expect to continue to increase our sales through international distributors;
- political and economic instability, including hostilities and political unrest, boycotts, curtailment of trade and other business restrictions; and
- inadequate local infrastructure.

Because all of our sales to date have been denominated in United States dollars, increases in the value of the United States dollar will increase the price of our products so that they become relatively more expensive to customers in the local currency of a particular country, potentially leading to a reduction in sales and profitability for us in that country. A portion of our international revenue may be denominated in foreign currencies in the future, which will subject us to risks associated with fluctuations in exchange rates for those foreign currencies.

In the past, the State of California has experienced electricity shortages that have resulted in corresponding increases in prices and rolling blackouts. If electricity shortages occur in the future, our research and development and other operations may be negatively affected.

In the past, the State of California has experienced electricity shortages that have resulted in corresponding increases in prices and “rolling blackouts.” During fiscal 2001, this resulted in one instance in which we were subjected to a rolling blackout. When we are subjected to rolling blackouts, all electricity to our facilities is cut off and we are unable to use our computers, telephones and other equipment that is critical to our research and development and other functions. Some of our customers who have operations in California were also negatively affected by the electricity shortage. If we are subjected to a series of rolling blackouts or to a single extended rolling blackout as a result of any future electricity shortages in California, our research and development and other operations will be negatively affected.

Our third-party foundries and subcontractors are concentrated in Taiwan and elsewhere in the Pacific Rim, an area subject to significant earthquake risks. Any disruption to the operations of these foundries and subcontractors resulting from earthquakes or other natural disasters could cause significant delays in the production or shipment of our products.

Substantially all of our products are manufactured by Taiwan Semiconductor Manufacturing Company, which is located in Taiwan. Currently our only alternative manufacturing sources are located in Taiwan and China. In addition, substantially all of our assembly and testing facilities are located in Singapore, Taiwan and the Philippines. The risk of an earthquake in Taiwan and elsewhere in the Pacific Rim region is significant due to the proximity of major earthquake fault lines to the facilities of our foundries and assembly and test subcontractors. In September 1999, a major earthquake in Taiwan affected the facilities of several of these third-party contractors. As a consequence of this earthquake, these contractors suffered power outages and disruptions that impaired their production capacity. In March 2002, another major earthquake occurred in Taiwan. Although

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our foundries and subcontractors did not suffer any significant damage as a result of this most recent earthquake, the occurrence of additional earthquakes or other natural disasters could result in the disruption of our foundry or assembly and test capacity. Any disruption resulting from such events could cause significant delays in the production or shipment of our products until we are able to shift our manufacturing, assembling or testing from the affected contractor to another third-party vendor. We may not be able to obtain alternate capacity on favorable terms, if at all.

We rely on third-party distributors and manufacturers' representatives and the failure of these distributors and manufacturers' representatives to perform as expected could reduce our future sales.

We sell our communications products to customers primarily through distributors and manufacturers' representatives. Our relationships with some of our distributors and manufacturers' representatives have been established within the last year, and we are unable to predict the extent to which our distributors and manufacturers' representatives will be successful in marketing and selling our products. Moreover, many of our manufacturers' representatives and distributors also market and sell competing products. Our representatives and distributors may terminate their relationships with us at any time. Our future performance will also depend, in part, on our ability to attract additional distributors or manufacturers' representatives that will be able to market and support our products effectively, especially in markets in which we have not previously distributed our products. If we cannot retain our current distributors or manufacturers' representatives or recruit additional or replacement distributors or manufacturers' representatives, our sales and operating results will be harmed. The loss of one or more of our distributors or manufacturers' representatives could harm our sales and results of operations. We generally realize a higher gross margin on direct sales and from sales through manufacturers' representatives than on sales through distributors. Accordingly, if our distributors were to account for an increased portion of our net sales, our gross margins may decline.

Any future acquisitions and transactions may not be successful.

We expect to continue to make acquisitions of, and investments in, businesses that offer complementary products, services and technologies, augment our market segment coverage, or enhance our technological capabilities. We may also enter into strategic alliances or joint ventures to achieve these goals. We cannot assure you that we will be able to identify suitable acquisition, investment, alliance, or joint venture opportunities or that we will be able to consummate any such transactions or relationships on terms and conditions acceptable to us, or that such transactions or relationships will be successful.

Any transactions or relationships will be accompanied by the risks commonly encountered with those matters. Risks that could have a material adverse affect on our business, results of operations or financial condition include, among other things:

- the difficulty of assimilating the operations and personnel of an acquired businesses;
- the potential disruption of our ongoing business;
- the distraction of management from our business;
- the potential inability of management to maximize the financial and strategic position of us as a result of an acquisition;
- the potential difficulty maintaining uniform standards, controls, procedures and policies;
- the impairment of relationships with employees and clients as a result of any integration of new management personnel;
- the risk of entering market segments in which we have no or limited direct prior experience and where competitors in such market segments have stronger market segment positions; and
- the potential loss of key employees of an acquired company.

The average selling prices of products in our markets have historically decreased rapidly and will likely do so in the future, which could harm our revenues and gross profits.

The products we develop and sell are used for high volume applications. As a result, the prices of those products have historically decreased rapidly. Our gross profits and financial results will suffer if we are unable to offset any reductions in our average selling prices by increasing our sales volumes, reducing our costs, or developing new or enhanced products on a timely basis with higher selling prices or gross profits. We expect that our gross margin as a percentage of net revenue will decrease during fiscal 2003 due to (i) the anticipated production ramps of large volume design wins in lower margin businesses such as the desktop computer sector, and (ii) an increase in sales of SOC's, which typically have lower margins than standalone read channel devices. In addition, if our sales of storage products into the desktop computer market were to increase as a percentage of total storage revenues, our margins would also likely decrease because gross margins on sales into this market are generally lower than for sales into the enterprise and mobile computer markets, where we currently generate the substantial majority of our storage product revenues.

Additionally, because we do not operate our own manufacturing, assembly or testing facilities, we may not be able to reduce our costs as rapidly as companies that operate their own facilities, and our costs may even increase, which could also reduce our margins. In the past, we have reduced the average selling prices of our products in anticipation of future competitive pricing pressures, new product introductions by us or our competitors and other factors. We expect that we will have to do so again in the future.

We have a lengthy and expensive storage product sales cycle that does not assure product sales, and that if unsuccessful, may harm our operating results.

The sales cycle for our storage products is long and requires us to invest significant resources with each potential customer without any assurance of sales to that customer. Our sales cycle typically begins with a three to six month evaluation and test period, also known as qualification, during which our products undergo rigorous reliability testing by our customers.

Qualification is typically followed by a 12 to 18 month development period by our customers and an additional three to six month period before a customer commences volume production of equipment incorporating our products. This lengthy sales cycle creates the risk that our customers will decide to cancel or change product plans for products incorporating our integrated circuits. During our sales cycle, our engineers assist customers in implementing our products into the customers' products. We incur significant research and development and selling, general and administrative expenses as part of this process, and this process may never generate related revenues. We derive revenue from this process only if our design is selected. Once a customer selects a particular integrated circuit for use in a storage product, the customer generally uses solely that integrated circuit for a full generation of its product. Therefore, if we do not achieve a design win for a product, we will be unable to sell our integrated circuit to a customer until that customer develops a new product or a new generation of its product. Even if we achieve a design win with a customer, the customer may not ultimately ship products incorporating our products or may cancel orders after we have achieved a sale. In addition, we will have to begin the qualification process again when a customer develops a new generation of a product for which we were the successful supplier.

Also, during the final production of a mature product, our customers typically exhaust their existing inventory of our integrated circuits. Consequently, orders for our products may decline in those circumstances, even if our products are incorporated into both our customers' mature and replacement products. A delay in a customer's transition to commercial production of a replacement product may cause the customer to lose sales, which would delay our ability to recover the lost sales from the discontinued mature product. In addition, customers may defer orders in anticipation of new products or product enhancements from our competitors or us.

We are subject to the cyclical nature of the integrated circuit industry. The current and any future downturns will likely reduce our revenue and result in excess inventory.

The integrated circuit industry is highly cyclical and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life cycles and wide fluctuations in product supply and demand. The industry has experienced, and is currently experiencing, significant downturns, often connected with, or in anticipation of, maturing product cycles of both integrated circuit companies' and their customers' products and declines in general economic conditions. These downturns have been characterized by diminished product demand, production overcapacity, high inventory levels and accelerated erosion of average selling prices. The current downturn and any future downturns may reduce our revenue or our percentage of revenue growth on a quarter-to-quarter basis and result in us having excess inventory.

Furthermore, any upturn in the integrated circuit industry could result in increased competition for access to third-party foundry, assembly and test capacity.

When demand for foundry capacity is high, we may take various actions to try to secure sufficient capacity, which may be costly and harm our operating results.

Availability of foundry capacity has in the recent past been reduced due to strong demand. In order to secure sufficient foundry capacity when demand is high, we may enter into various arrangements with suppliers that could be costly and harm our operating results, including:

- option payments or other prepayments to a foundry;
- nonrefundable deposits with or loans to foundries in exchange for capacity commitments;
- contracts that commit us to purchase specified quantities of integrated circuits over extended periods;
- issuance of our equity securities to a foundry;
- investment in a foundry; and
- other partnership relationships with foundries.

We may not be able to make any such arrangement in a timely fashion or at all, and any arrangements may be costly, reduce our financial flexibility, and not be on terms favorable to us. Moreover, if we are able to secure foundry capacity, we may be obligated to use all of that capacity or incur penalties. These penalties may be expensive and could harm our financial results.

The development and evolution of markets for our integrated circuits are dependent on factors, such as industry standards, over which we have no control. For example, if our customers adopt new or competing industry standards with which our products are not compatible or fail to adopt standards with which our products are compatible, our existing products would become less desirable to our customers and our sales would suffer.

The emergence of markets for our integrated circuits is affected by a variety of factors beyond our control. In particular, our products are designed to conform to current specific industry standards. Our customers may not adopt or continue to follow these standards, which would make our products less desirable to our customers and reduce our sales. Also, competing standards may emerge that are preferred by our customers, which could also reduce our sales and require us to make significant expenditures to develop new products.

We have made a significant investment in the development and production of our Gigabit Ethernet products. However, the Gigabit Ethernet technology is relatively new compared to the more established 10 and 100 megabit per second Fast Ethernet technologies. If the Gigabit Ethernet technology does not achieve widespread market acceptance, our revenue and operating results may be harmed. We have also made a significant investment in the development of wireless LAN products based on the IEEE 802.11b standard. Wireless LAN technologies are relatively new and many competing standards, such as IEEE 802.11a and Bluetooth™, exist. If

the 802.11b standard does not achieve widespread market acceptance, our revenue and operating results may be harmed.

We may be unable to protect our intellectual property, which would negatively affect our ability to compete.

We believe one of our key competitive advantages results from our collection of proprietary technologies that we have developed since our inception. If we fail to protect these intellectual property rights, competitors could sell products based on technology that we have developed, which could harm our competitive position and decrease our revenues. We believe that the protection of our intellectual property rights is and will continue to be important to the success of our business. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to protect our proprietary technologies. We also enter into confidentiality or license agreements with our employees, consultants and business partners, and control access to and distribution of our documentation and other proprietary information. We have been issued several United States patents and have a number of pending United States patent applications. However, a patent may not be issued as a result of any applications or, if issued, claims allowed may not be sufficiently broad to protect our technology. In addition, it is possible that existing or future patents may be challenged, invalidated or circumvented. Despite our efforts, unauthorized parties may attempt to copy or otherwise obtain and use our products or proprietary technology. Monitoring unauthorized use of our technology is difficult, and the steps that we have taken may not prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States.

Significant litigation over intellectual property in our industry may cause us to become involved in costly and lengthy litigation, which could subject us to liability, require us to stop selling our products or force us to redesign our products.

Litigation involving patents and other intellectual property is widespread in the high-technology industry and is particularly prevalent in the integrated circuit industry, where a number of companies aggressively bring numerous infringement claims to protect their patent portfolios. From time to time we receive, and may continue to receive in the future, notices that claim we have infringed upon, misappropriated or misused the proprietary rights of other parties. These claims could result in litigation which, in turn, could subject us to significant liability for damages. These lawsuits, regardless of their success, would likely be time-consuming and expensive to resolve and would divert management time and attention. Any potential intellectual property litigation also could force us to do one or more of the following:

- stop selling products or using technology that contains the allegedly infringing intellectual property;
- pay damages to the party claiming infringement;
- attempt to obtain a license to the relevant intellectual property, which license may not be available on reasonable terms or at all; and
- attempt to redesign those products that contain the allegedly infringing intellectual property.

We are incorporated in Bermuda, and, as a result, it may not be possible for our shareholders to enforce civil liability provisions of the securities laws of the United States.

We are organized under the laws of Bermuda. As a result, it may not be possible for our shareholders to effect service of process within the United States upon us, or to enforce against us in United States courts judgments based on the civil liability provisions of the securities laws of the United States. Most of our executive officers and directors are residents of the United States. However, there is significant doubt as to whether the courts of Bermuda would recognize or enforce judgments of United States courts obtained against us or our directors or officers based on the civil liability provisions of the securities laws of the United States or any state or hear actions brought in Bermuda against us or those persons based on those laws. The United States and Bermuda do not currently have a treaty providing for the reciprocal recognition and enforcement of judgments in civil and commercial matters. Therefore, a final judgment for the payment of money rendered by any federal or

state court in the United States based on civil liability, whether or not based solely on United States federal or state securities laws, would not be automatically enforceable in Bermuda.

Our Bye-laws contain a waiver of claims or rights of action by our shareholders against our officers and directors, which will severely limit our shareholders' right to assert a claim against our officers and directors under Bermuda law.

Our Bye-laws contain a broad waiver by our shareholders of any claim or right of action, both individually and on our behalf, against any of our officers and directors. The waiver applies to any action taken by an officer or director, or the failure of an officer or director to take any action, in the performance of his or her duties with or for us, other than with respect to any matter involving any fraud or dishonesty on the part of the officer or director. This waiver will limit the rights of our shareholders to assert claims against our officers and directors unless the act complained of involves actual fraud or dishonesty. Thus, so long as acts of business judgment do not involve actual fraud or dishonesty, they will not be subject to shareholder claims under Bermuda law. For example, shareholders will not have claims against officers and directors for a breach of trust, unless the breach rises to the level of actual fraud or dishonesty.

We are subject to uncertainty regarding how the United States federal income tax laws apply to our business. If our application of the tax code is incorrect, our operating results could be harmed.

As a Bermuda corporation, we are subject to United States federal income tax at regular corporate rates and to United States branch profits tax, in each case to the extent that our income is effectively connected with the conduct of a trade or business in the United States. The determination of whether income of a foreign corporation is effectively connected with the conduct of a trade or business in the United States and, therefore, is subject to United States tax, involves a consideration of all the facts and circumstances and the application of legal standards that are uncertain. There have been few court cases or rulings by the Internal Revenue Service addressing the application of these legal standards, and we believe that none of these cases or rulings relates to facts precisely like ours. Our position is that our business operations do not generate any income that is effectively connected with a United States trade or business. Because of the uncertainty as to how United States federal income tax laws apply to the way we conduct our business, we believe the Internal Revenue Service may disagree with our past or future positions as to the amount of effectively connected income that we earn. Therefore, if our positions are disallowed, the amount we have accrued in our financial statements for United States federal income taxes may be insufficient to the extent of the difference between the income tax rate ultimately determined to apply and the tax rate that we have used to accrue for income taxes in our financial statements. In addition, we could be required to make significant cash payments for back taxes and interest based on the difference between the income tax rate ultimately determined to apply and the rate at which we paid those taxes.

Tax benefits we receive may be terminated or reduced in the future, which would increase our costs.

Under current Bermuda law, we are not subject to tax on our income or capital gains. We have obtained from the Minister of Finance of Bermuda under the Exempt Undertakings Tax Protection Act 1966, as amended, an undertaking that, in the event that Bermuda enacts any legislation imposing tax computed on income or capital gains, those taxes should not apply to us until March 28, 2016. However, this exemption may not be extended beyond that date.

The Economic Development Board of Singapore granted Pioneer Status to our wholly-owned subsidiary in Singapore in July 2000 for a period of at least six years, commencing July 1, 1999. As a result, we anticipate that a significant portion of the income we earn in Singapore during this period will be exempt from the 26% Singapore tax rate. We are required to meet several requirements as to investment, headcount and activities in Singapore to retain this status. If our Pioneer Status is terminated early, our financial results could be harmed.

The Israeli government has granted Approved Enterprise Status to our wholly-owned subsidiary in Israel, which provides a tax holiday on undistributed income derived from operations within certain "development regions" in Israel. In order to maintain our qualification, we must continue to meet specified conditions, including the making of investments in fixed assets in Israel. As our tax holidays expire, we expect that we will

start paying income tax on our operations within these development regions. Some of our regional tax holidays have already expired and we are currently paying income taxes in these regions.

If we are classified as a passive foreign investment company, our shareholders may suffer adverse tax consequences.

Because we are incorporated in Bermuda and have operations in the United States, Israel and Singapore, we are subject to special rules and regulations, including rules regarding a passive foreign investment company, or PFIC. We believe that we are not a PFIC, and we expect to continue to manage our affairs so that we will not become a PFIC. However, whether we should be treated as a PFIC is a factual determination that is made annually and is subject to change. If we are classified as a PFIC, then each United States holder of our common stock would, upon qualifying distributions by us or upon the pledge or sale of their shares of common stock at a gain, be liable to pay tax at the then prevailing rates on ordinary income plus an interest charge, generally as if the distribution or gain had been earned ratably over the shareholder's holding period. In addition to the risks related to PFIC status, our shareholders and we could also suffer adverse tax consequences if we are classified as a foreign personal holding company, a personal holding company or a controlled foreign corporation.

Our officers and directors own a large percentage of our voting stock, and three existing directors, who are also significant shareholders, are related by blood or marriage. These factors may allow the officers and directors as a group or the three related directors to control the election of directors and the approval or disapproval of significant corporate actions.

As of May 31, 2002, our executive officers and directors beneficially owned or controlled, directly or indirectly, approximately 40% of the outstanding shares of our common stock. Additionally, Sehat Sutardja and Weili Dai are husband and wife and Sehat Sutardja and Pantas Sutardja are brothers. All three are directors and together they held approximately 30% of our outstanding common stock as of May 31, 2002. As a result, if the directors and officers as a group or any of Sehat Sutardja, Pantas Sutardja and Weili Dai act together, they will significantly influence, and will likely control, the election of our directors and the approval or disapproval of our significant corporate actions. This influence over our affairs might be adverse to the interests of other shareholders. In addition, the voting power of these officers or directors could have the effect of delaying or preventing an acquisition of us on terms that other shareholders may desire.

Under Bermuda law all of our officers, in exercising their powers and discharging their duties, must act honestly and in good faith with a view to our best interests and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Majority shareholders do not owe fiduciary duties to minority shareholders. As a result, the minority shareholders will not have a direct claim against the majority shareholders in the event the majority shareholders take actions that damage the interests of minority shareholders. Class actions and derivative actions are generally not available to shareholders under the laws of Bermuda, except the Bermuda courts would be expected to follow English case law precedent, which would permit a shareholder to bring an action in our name if the directors or officers are alleged to be acting beyond our corporate power, committing illegal acts or violating our Memorandum of Association or Bye-laws. In addition, minority shareholders would be able to challenge a corporate action that allegedly constituted a fraud against them or required the approval of a greater percentage of our shareholders than actually approved it. The winning party in such an action generally would be able to recover a portion of attorneys' fees incurred in connection with the action.

Class action litigation due to stock price volatility or other factors could cause us to incur substantial costs and divert our management's attention and resources.

On July 31, 2001, a putative class action suit was filed against two investment banks that participated in the underwriting of our initial public offering, or IPO, on June 29, 2000. That lawsuit, which did not name Marvell or any of our officers or directors as defendants, was filed in the United States District Court for the Southern District of New York. Plaintiffs allege that the underwriters received "excessive" and undisclosed commissions and entered into unlawful "tie-in" agreements with certain of their clients in violation of Section 10(b) of the Securities Exchange Act of 1934. Thereafter, on September 5, 2001, a second putative class action was filed in the Southern District of New York relating to our IPO. In this second action, plaintiffs named three underwriters

as defendants and also named as defendants Marvell and two of our officers, one of who is also a director. Relying on many of the same allegations contained in the initial complaint in which Marvell was not named as a defendant, plaintiffs allege that the defendants violated various provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. In both actions, plaintiffs seek, among other items, unspecified damages, pre-judgment interest and reimbursement of attorneys' and experts' fees. These two actions relating to our IPO have been consolidated with hundreds of other lawsuits filed by plaintiffs against approximately 40 underwriters and approximately 300 issuers across the United States. To date, there have been no significant developments in the consolidated litigation. It is expected that a small number of cases will be designated as "test cases" for purposes of initial challenges to the pleadings, which are not expected to be briefed, argued and decided before mid-2002. We believe that the claims asserted against Marvell and our officers are without merit and intend to defend these claims vigorously. Based on currently available information, we do not believe that the ultimate disposition of the lawsuit naming Marvell and our officers will have a material adverse impact on our business or financial condition. However, these claims and any resulting litigation could result in substantial costs and could divert the attention and resources of our management.

In the past, securities class action litigation often has been brought against a company following periods of volatility in the market price of its securities. Companies in the integrated circuit industry and other technology industries are particularly vulnerable to this kind of litigation due to the high volatility of their stock prices. Accordingly, we may in the future be the target of securities litigation. Any securities litigation could result in substantial costs and could divert the attention and resources of our management.

Future sales of our common stock in the public market may depress our stock price.

A substantial number of our shares remain available for sale pursuant to Rule 144. Future sales of a substantial number of shares of our common stock in the public market could cause our stock price to decline. As of May 31, 2002, we had 119,705,325 shares outstanding and none of these shares are subject to any lock-up agreements. The market price of our stock could drop significantly if holders of a substantial number of our shares sell them or are perceived by the market as intending to sell them. In addition, the sale of our shares could impair our ability to raise capital through the sale of additional stock.

Our Bye-laws contain provisions that could delay or prevent a change in corporate control, even if the change in corporate control would benefit our shareholders.

Our Bye-laws contain change in corporate control provisions which include:

- authorizing the issuance of preferred stock without shareholder approval;
- providing for a classified board of directors with staggered, three-year terms; and
- requiring a vote of two-thirds of the outstanding shares to approve any change of corporate control.

These change in corporate control provisions could make it more difficult for a third-party to acquire us, even if doing so would be a benefit to our shareholders.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk. The primary objective of our investment activities is to preserve principal while at the same time maximize the income we receive from our investments without significantly increasing risk. Some of the securities that we have invested in may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline, while variable rate securities may produce less income than expected if interest rates fall. To minimize this risk, we maintain our portfolio of cash equivalents and short-term investments in a variety of fixed and variable rate securities including money market funds; corporate debt securities; State, county and municipal debt securities; and foreign government securities. In general, money market funds are not subject to market risk because the interest paid on such funds fluctuates with the prevailing interest rate. The following table presents the amounts of our cash equivalents and short-term investments that are subject to market risk by range of expected maturity and weighted-average interest rates as of April 30, 2002 (in thousands). This table does not include money market funds because those funds are not subject to market risk.

	Expected Fiscal Year Maturity Date				Total	Fair Value
	2003	2004	2005	2006		
Variable Rate	\$ 9,415	\$ 3,345	\$ —	\$ —	\$ 12,760	\$ 12,741
Average Interest Rate	2.05%	2.25%	—	—	2.11%	
Fixed Rate	\$21,671	\$36,410	\$52,546	\$31,474	\$142,101	\$141,892
Average Interest Rate	3.58%	3.70%	3.89%	4.43%	3.91%	

Investment Risk. We invest in equity instruments of privately-held companies for business and strategic purposes. These investments are included in other noncurrent assets in the accompanying balance sheets and are accounted for under the cost method as our ownership is less than 20% and we do not have the ability to exercise significant influence over the operations on these companies. Since our initial investment, one of these equity investments in a privately-held company has become marketable upon the investee completing an initial public offering. Such an investment is subject to significant fluctuations in fair market value due to the volatility of the stock market. This investment is recorded at market value and is classified as a short-term investment in the accompanying balance sheets.

Foreign Currency Exchange Risk. All of our sales and the majority of our expenses to date have been denominated in United States dollars, and, as a result, we have relatively little exposure to foreign currency exchange risk. We do not currently enter into forward exchange contracts to hedge exposures denominated in foreign currencies or any other derivative financial instruments for trading or speculative purposes. However, in the event our exposure to foreign currency risk increases, we may choose to hedge those exposures in the future.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

On July 31, 2001, a putative class action suit was filed against two investment banks that participated in the underwriting of our initial public offering, or IPO, on June 29, 2000. That lawsuit, which did not name Marvell or any of our officers or directors as defendants, was filed in the United States District Court for the Southern District of New York. Plaintiffs allege that the underwriters received “excessive” and undisclosed commissions and entered into unlawful “tie-in” agreements with certain of their clients in violation of Section 10(b) of the Securities Exchange Act of 1934. Thereafter, on September 5, 2001, a second putative class action was filed in the Southern District of New York relating to our IPO. In this second action, plaintiffs named three underwriters as defendants and also named as defendants Marvell and two of our officers, one of who is also a director. Relying on many of the same allegations contained in the initial complaint in which Marvell was not named as a defendant, plaintiffs allege that the defendants violated various provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. In both actions, plaintiffs seek, among other items, unspecified damages, pre-judgment interest and reimbursement of attorneys’ and experts’ fees. These two actions relating to our IPO have been consolidated with hundreds of other lawsuits filed by plaintiffs against approximately 40 underwriters and approximately 300 issuers across the United States. To date, there have been no significant developments in the consolidated litigation. It is expected that a small number of cases will be designated as “test cases” for purposes of initial challenges to the pleadings, which are not expected to be briefed, argued and decided before mid-2002. We believe that the claims asserted against Marvell and our officers are without merit and intend to defend these claims vigorously. Based on currently available information, we do not believe that the ultimate disposition of the lawsuit naming Marvell and our officers will have a material adverse impact on our business or financial condition. However, these claims and any resulting litigation could result in substantial costs and could divert the attention and resources of our management.

On September 12, 2001, Jasmine Networks, Inc. (“Jasmine”) filed a lawsuit in the Santa Clara County Superior Court asserting claims against Company personnel and the Company for improperly obtaining and using information and technologies during the course of the negotiations with Company personnel regarding the potential acquisition of Jasmine by the Company. The lawsuit claims that Company officers improperly obtained and used such information and technologies after the Company signed a non-disclosure agreement with Jasmine. The Company believes the claims asserted against its officers and it are without merit and intends to defend all claims vigorously. Based on currently available information, the Company does not believe that the ultimate disposition of this lawsuit will have a material adverse impact on its business or financial condition.

We are also party to other claims and litigation proceedings arising in the normal course of business. Although the legal responsibility and financial impact with respect to such claims and litigation cannot currently be ascertained, we do not believe that these matters will result in our payment of monetary damages, net of any applicable insurance proceeds, that, in the aggregate, would be material in relation to our consolidated financial position or results of operations.

Item 2. *Changes in Securities and Use of Proceeds*

Not applicable.

Item 3. *Defaults Upon Senior Securities*

Not applicable.

Item 4. *Submission of Matters to a Vote of Security Holders*

Not applicable.

Item 5. *Other Information*

Not applicable.

Item 6. Exhibits and Reports on Form 8-K

- (a) The following exhibits are filed as part of this report:

Not applicable.

- (b) Reports on Form 8-K:

On March 1, 2002, we filed a current report on Form 8-K in connection with the issuance of a press release dated February 28, 2002 announcing our financial results for the fourth quarter of fiscal 2002 and our fiscal year ended February 2, 2002.

On April 12, 2002, we filed a current report of Form 8-K in connection with the issuance of a press release dated April 12, 2002 announcing the retirement of Avigdor Willenz from our Board of Directors.

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.

MARVELL TECHNOLOGY GROUP LTD.

June 14, 2002

Date

By: /s/ GEORGE A. HERVEY

George A. Hervey
Vice President and Chief Financial Officer