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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended August 3, 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. [X] Yes [ ] No

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | Shares Outstanding of the Registrant’s Common Stock | | |  |  |
|  | Class | | | Outstanding at August 3, 2002 |  |
|  |  |  |  |  |  |
|  | Common stock, $0.002 par value | | | 120,031,009 |  |
|  |  |  |  |  |  |



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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**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **July 31,** | |  |  | **January 31,** | |  |
|  |  |  | **2002** |  |  |  | **2002** |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| Current assets: |  |  |  |  |  |  |  |  |
|  | Cash and cash equivalents | $ | 108,871 |  | $ | | 114,483 |  |  |
|  | Short-term investments |  | 141,479 |  |  |  | 135,761 |  |  |
|  | Accounts receivable, net of allowances of $1,256 and $1,232 |  | 70,218 |  |  |  | 42,150 |  |  |
|  | Inventory |  | 49,478 |  |  |  | 23,600 |  |  |
|  | Prepaid expenses and other current assets |  | 12,839 |  |  |  | 14,135 |  |  |
|  | Deferred income taxes |  | 9,287 |  |  |  | 9,287 |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  | Total current assets |  | 392,172 |  |  |  | 339,416 |  |  |
|  | Property and equipment, net |  | 60,446 |  |  |  | 52,924 |  |  |
|  | Goodwill and acquired intangible assets |  | 1,638,094 |  |  |  | 1,680,740 |  |  |
|  | Other noncurrent assets |  | 31,067 |  |  |  | 17,975 |  |  |
|  |  |  |  |  |  | |  |  |  |
|  | Total assets | $ | 2,121,779 |  | $ | | 2,091,055 |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  | **LIABILITIES AND SHAREHOLDERS’ EQUITY** |  |  |  |  |  |  |  |  |
|  | Current liabilities: |  |  |  |  |  |  |  |  |
|  | Accounts payable | $ | 63,055 |  | $ | | 30,990 |  |  |
|  | Accrued liabilities |  | 10,875 |  |  |  | 14,083 |  |  |
|  | Accrued employee compensation |  | 12,317 |  |  |  | 11,755 |  |  |
|  | Accrued facility consolidation charge |  | 15,491 |  |  |  | — | |  |
|  | Income taxes payable |  | 19,223 |  |  |  | 17,744 |  |  |
|  | Deferred income |  | 13,563 |  |  |  | 8,907 |  |  |
|  | Current portion of capital lease obligations |  | 1,266 |  |  |  | 1,039 |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  | Total current liabilities |  | 135,790 |  |  |  | 84,518 |  |  |
|  | Capital lease obligations |  | 9,134 |  |  |  | 10,017 |  |  |
|  | Other long-term liabilities |  | 6,055 |  |  |  | 6,793 |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  | Total liabilities |  | 150,979 |  |  |  | 101,328 |  |  |
| Shareholders’ equity: | |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  | Common stock, $0.002 par value; 242,000 shares authorized; 120,031 and 118,577 shares issued |  |  |  |  |  |  |  |  |
|  | and outstanding |  | 240 |  |  |  | 238 |  |  |
|  | Additional paid-in capital |  | 2,668,295 |  |  |  | 2,646,757 |  |  |
|  | Deferred stock-based compensation |  | (11,074) | |  |  | (10,099) | |  |
|  | Accumulated other comprehensive income |  | 1,714 |  |  |  | 946 |  |  |
|  | Accumulated deficit |  | (688,375) | |  |  | (648,115) | |  |
|  |  |  |  |  |  |  |  |  |  |
|  | Total shareholders’ equity |  | 1,970,800 |  |  |  | 1,989,727 |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  | Total liabilities and shareholders’ equity | $ | 2,121,779 |  | $ | | 2,091,055 |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

**See accompanying notes to condensed consolidated financial statements.**

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**MARVELL TECHNOLOGY GROUP LTD.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(Unaudited)**

**(In thousands, except per share amounts)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **Three Months Ended** | | | | | |  |  |  | **Six Months Ended** | | | | |  |
|  |  |  |  |  |  | **July 31,** | |  |  |  |  |  |  | **July 31,** | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  | **2002** |  |  |  | **2001** |  |  |  | **2002** |  |  |  | **2001** |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net revenue | | $ | 119,694 |  | $ | | 68,649 |  | $ | | 218,494 |  | $ | | 132,879 |  |  |
|  | Operating costs and expenses: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Cost of goods sold(1) | |  | 56,033 |  |  |  | 31,419 |  |  |  | 99,813 |  |  |  | 61,580 |  |  |
|  | Research and development(1) | |  | 33,599 |  |  |  | 21,843 |  |  |  | 64,208 |  |  |  | 41,909 |  |  |
|  | Selling and marketing(1) | |  | 12,321 |  |  |  | 10,103 |  |  |  | 23,333 |  |  |  | 19,648 |  |  |
|  | General and administrative(1) | |  | 3,523 |  |  |  | 3,734 |  |  |  | 7,165 |  |  |  | 6,719 |  |  |
|  | Amortization of stock-based compensation | |  | 2,192 |  |  |  | 4,095 |  |  |  | 4,474 |  |  |  | 8,208 |  |  |
|  | Amortization of goodwill and acquired intangible assets | |  | 21,323 |  |  |  | 104,508 |  |  |  | 42,646 |  |  |  | 209,016 |  |  |
|  | Facilities consolidation charge | |  | — | |  |  | — | |  |  | 17,799 |  |  |  | — | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Total operating costs and expenses | |  | 128,991 |  |  |  | 175,702 |  |  |  | 259,438 |  |  |  | 347,080 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Operating loss | |  | (9,297) | |  |  | (107,053) | |  |  | (40,944) | |  |  | (214,201) | |  |
|  | Interest and other income, net | |  | 1,906 |  |  |  | 2,459 |  |  |  | 4,045 |  |  |  | 5,426 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loss before income taxes | |  | (7,391) | |  |  | (104,594) | |  |  | (36,899) | |  |  | (208,775) | |  |
|  | Provision for income taxes | |  | 1,935 |  |  |  | 603 |  |  |  | 3,361 |  |  |  | 1,388 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net loss | | $ | (9,326) | | $ | | (105,197) | | $ | | (40,260) | | $ | | (210,163) | |  |
| Net loss per share: | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Basic | | $ | (0.08) | | $ | | (0.93) | | $ | | (0.34) | | $ | | (1.86) | |  |
|  |  |  |  |  | |  | |  | |  | |  | |  | |  | |  |
|  |  |  |  |  |  |  | |  |  |  | |  |  |  | |  |  |  |
|  | Diluted | | $ | (0.08) | | $ | | (0.93) | | $ | | (0.34) | | $ | | (1.86) | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Weighted average shares: | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Basic | |  | 118,886 |  |  |  | 113,714 |  |  |  | 118,487 |  |  |  | 113,115 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Diluted | |  | 118,886 |  |  |  | 113,714 |  |  |  | 118,487 |  |  |  | 113,115 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

1. Excludes amortization of stock-based compensation as follows:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Cost of goods sold | $ | 118 | $ | 81 | $ | 163 | $ | 163 |  |
| Research and development |  | 1,421 |  | 2,682 |  | 2,915 |  | 5,375 |  |
| Selling and marketing |  | 456 |  | 724 |  | 859 |  | 1,451 |  |
| General and administrative |  | 197 |  | 608 |  | 537 |  | 1,219 |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  | $ | 2,192 | $ | 4,095 | $ | 4,474 | $ | 8,208 |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

**See accompanying notes to condensed consolidated financial statements.**

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**MARVELL TECHNOLOGY GROUP LTD.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

**(In thousands)**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **Six Months Ended** | | | | |  |
|  |  |  |  |  | **July 31,** | | | |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  | **2002** | |  | **2001** | | |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| **Cash flows from operating activities:** |  |  |  |  |  |  |  |  |
|  | Net loss | $ (40,260) | | | $(210,163) | | | |  |
|  | Adjustments to reconcile net loss to net cash provided by operating activities: |  |  |  |  |  |  |  |  |
|  | Depreciation and amortization | 8,772 | |  | 7,611 | | |  |  |
|  | Amortization of stock-based compensation | 4,474 | |  | 8,208 | | |  |  |
|  | Amortization of goodwill and acquired intangible assets | 42,646 | |  | 209,016 | | |  |  |
|  | Changes in assets and liabilities, net of acquisitions: |  |  |  |  |  |  |  |  |
|  | Accounts receivable | (26,668) | | | (473) | | | |  |
|  | Inventory | (24,025) | | | 6,194 | | |  |  |
|  | Prepaid expenses and other assets | (3,648) | | | (3,287) | | | |  |
|  | Accounts payable | 31,673 | |  | 2,344 | | |  |  |
|  | Accrued liabilities and other | (2,168) | | | (2,902) | | | |  |
|  | Accrued employee compensation | (1,215) | | | 2,063 | | |  |  |
|  | Accrued facility consolidation charge | 15,491 | |  |  |  | — | |  |
|  | Income taxes payable | 2,175 | |  | 998 | | |  |  |
|  | Deferred revenue | 4,656 | |  | (1,374) | | | |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  | Net cash provided by operating activities | 11,903 | |  | 18,235 | | |  |  |
| **Cash flows from investing activities:** | |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |
|  | Purchases of short-term investments | (34,587) | | | (9,038) | | | |  |
|  | Sales and maturities of short-term investments | 28,941 | |  | 13,007 | | |  |  |
|  | Purchases of investments | (10,000) | | | (667) | | | |  |
|  | Cash received from acquisitions | 1,098 | |  |  |  | — | |  |
|  | Acquisition costs |  | — | | (29,326) | | | |  |
|  | Purchases of property and equipment | (16,484) | | | (9,706) | | | |  |
|  | Purchases of technology licenses |  | — | | (1,916) | | | |  |
|  |  |  |  |  |  | |  |  |  |
|  | Net cash used in investing activities | (31,302) | | | (37,646) | | | |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| **Cash flows from financing activities:** |  |  |  |  |  |  |  |  |
|  | Proceeds from the issuance of common stock | 14,276 | |  | 9,635 | | |  |  |
|  | Repurchases of common stock | (2) | | | (112) | | | |  |
|  | Principal payments on capital lease obligations | (757) | | | (37) | | | |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  | Net cash provided by financing activities | 13,517 | |  | 9,486 | | |  |  |
|  | |  |  |  |  | |  |  |  |
| Net decrease in cash and cash equivalents | | (5,612) | | | (9,925) | | | |  |
|  | Cash and cash equivalents at beginning of period | 114,483 | |  | 184,128 | | |  |  |
|  | |  |  |  |  | |  |  |  |
| Cash and cash equivalents at end of period | | $108,871 | |  | $ 174,203 | | |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

**See accompanying notes to condensed consolidated financial statements.**

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**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. On June 19, 2002, the Company acquired SysKonnect GmbH (“SysKonnect”), a German corporation. SysKonnect develops and markets client-server products.

**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 only, 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 July 31, 2002, the results of its operations for the three and six months ended July 31, 2002 and 2001, and its cash flows for the six months ended July 31, 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 and six months ended July 31, 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.

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**Available-for-sale investments**

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  | Gross | |  |  |  |  | Gross | |  |  | Estimated | |  |
|  |  |  |  |  |  | Amortized | | |  |  |  | Unrealized | | |  |  |  | Unrealized | | |  |  | Fair | |  |
|  | As of July 31, 2002 |  |  |  |  | Cost | | |  |  |  |  | Gains | |  |  |  | Losses | | |  |  | Value | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Corporate debt securities | $108,347 | | | | |  |  | $1,500 | | | | |  | $(139) | | | | | | $ | | 109,708 |  |  |
|  | U.S., state, county and municipal debt securities | 33,236 | | | | |  |  | 220 | | | | |  | (1) | | | | | |  |  | 33,455 |  |  |
|  | Foreign government securities | 9,674 | | | | |  |  | 147 | | | | |  | (123) | | | | | |  |  | 9,698 |  |  |
|  | Equity securities | 1,440 | | | | |  |  | 169 | | | | |  |  |  |  |  | — | |  |  | 1,609 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | 152,697 | | | | |  |  | 2,036 | | | | |  | (263) | | | | | |  |  | 154,470 |  |  |
|  | Less amounts classified as cash equivalents | (12,991) | | | | | | |  |  |  |  | — | |  |  |  |  | — | |  |  | (12,991) | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Short-term investments | $139,706 | | | | |  |  | $2,036 | | | | |  | $(263) | | | | | | $ | | 141,479 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  | Gross | |  |  |  |  | Gross | |  |  | Estimated | |  |
|  |  |  |  |  |  | Amortized | | |  |  |  | Unrealized | | |  |  |  | Unrealized | | |  |  | Fair | |  |
|  | As of January 31, 2002 |  |  |  |  | Cost | | |  |  |  |  | Gains | |  |  |  | Losses | | |  |  | 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):

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | July 31, | |  | January 31, | | |  |
|  |  | 2002 | |  | 2002 | | |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| Work-in-process | $43,745 | |  | $16,727 | | |  |  |
|  | Finished goods | 5,733 | |  | 6,873 | | |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  | $49,478 | |  | $23,600 | | |  |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

**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 impairment test required upon the adoption of SFAS 142 was completed during the six months ended July 31, 2002 and did not identify any impairment of goodwill. The Company plans to perform an annual impairment review during the fourth quarter of each year, beginning in fiscal 2003, or more frequently if indicators of impairment exist.

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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 and six months ended

July 31, 2001:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | Three months ended | | | | |  |  |  |  | Six months ended | | | | |  |
|  |  |  |  |  |  | July 31, | |  |  |  |  |  |  |  | July 31, | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  | 2002 |  |  |  |  | 2001 |  |  |  | 2002 |  |  |  |  | 2001 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net loss — as reported | $ | (9,326) | | $ | | | (105,197) | | $ | | (40,260) | | $ | | | (210,163) | |  |
|  | Adjustments: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Amortization of goodwill |  | — | |  |  |  | 83,707 |  |  |  | — | |  |  |  | 167,414 |  |  |
|  | Amortization of acquired workforce previously classified as a |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | purchased intangible asset |  | — | |  |  |  | 522 |  |  |  | — | |  |  |  | 1,044 |  |  |
|  | Change in amortization life of trade name |  | — | |  |  |  | (831) | |  |  | — | |  |  |  | (1,662) | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Net adjustments |  | — | |  |  |  | 83,398 |  |  |  | — | |  |  |  | 166,796 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net loss — as adjusted | $ | (9,326) | | $ | | | (21,799) | | $ | | (40,260) | | $ | | | (43,367) | |  |
|  | |  |  |  |  | | |  |  |  | |  |  |  | | |  |  |  |
|  | |  |  |  |  | | |  |  |  | |  |  |  | | |  |  |  |
| Basic and diluted net loss per share — as reported | | $ | (0.08) | | $ | | | (0.93) | | $ | | (0.34) | | $ | | | (1.86) | |  |
|  | Amortization of goodwill |  | — | |  |  |  | 0.74 |  |  |  | — | |  |  |  | 1.48 |  |  |
|  | Amortization of acquired workforce previously classified as a |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | purchased intangible asset |  | — | |  |  |  | 0.01 |  |  |  | — | |  |  |  | 0.01 |  |  |
|  | Change in amortization life of trade name |  | — | |  |  |  | (0.01) | |  |  | — | |  |  |  | (0.01) | |  |
|  | |  |  |  |  | | |  |  |  | |  |  |  | | |  |  |  |
| Basis and diluted net loss per share — as adjusted | | $ | (0.08) | | $ | | | (0.19) | | $ | | (0.34) | | $ | | | (0.38) | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | As of July 31, 2002 | | | | | |  |  | As of January 31, 2002 | | | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  | Gross | |  |  |  |  |  |  | Gross | |  |  |  |  |  |
|  |  |  | Carrying | |  | Accumulated | | |  |  | Carrying | |  | Accumulated | | |  |
|  |  |  | Amount | |  | Amortization | | |  |  | Amount | |  | Amortization | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Purchased technology | $ | 388,955 |  | $(118,184) | | | | $ | | 388,955 |  | $ | | (79,288) | |  |
|  | Trade name |  | 33,241 |  | (7,138) | | | |  |  | 33,241 |  |  |  | (3,388) | |  |
|  | Assembled workforce |  | — | |  |  | — | |  |  | 12,532 |  |  |  | (2,128) | |  |
|  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |
|  | Total identified intangible assets |  | 422,196 |  | (125,322) | | | |  |  | 434,728 |  |  |  | (84,804) | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Goodwill |  | 1,686,674 |  | (345,454) | | | |  |  | 1,674,142 |  |  |  | (343,326) | |  |
|  |  |  |  |  |  | |  |  |  | |  |  |  | |  |  |  |
|  | Total intangible assets | $ | 2,108,870 |  | $(470,776) | | | | $ | | 2,108,870 |  | $ | | (428,130) | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

The aggregate amortization expense of identified intangible assets was $21.3 million and $20.8 million in the second quarter of fiscal years 2003 and 2002, respectively. The aggregate amortization expense of identified intangible assets was $42.6 million and $41.6 million for the six months ended July 31, 2002 and 2001, respectively. The estimated total annual 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.

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**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 | | | | | |  |  |  |  | Six Months Ended | | | | |  |
|  |  |  |  |  | July 31, | |  |  |  |  |  |  | July 31, | | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  | 2002 |  |  |  | 2001 |  |  |  | 2002 |  |  |  |  | 2001 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Numerator: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Net loss | $ | (9,326) | | $ | | (105,197) | | $ | | (40,260) | | $ | | | (210,163) | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Denominator: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Weighted average shares of common stock outstanding |  | 119,713 |  |  |  | 115,944 |  |  |  | 119,376 |  |  |  |  | 115,643 |  |  |
|  | Less: unvested common shares subject to repurchase |  | (827) | |  |  | (2,230) | |  |  | (889) | |  |  |  | (2,528) | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Weighted average shares — basic |  | 118,886 |  |  |  | 113,714 |  |  |  | 118,487 |  |  |  |  | 113,115 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Effect of dilutive securities- |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Unvested common shares subject to repurchase |  | — | |  |  | — | |  |  | — | |  |  |  | — | |  |
|  | Common stock options |  | — | |  |  | — | |  |  | — | |  |  |  | — | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Weighted average shares — diluted |  | 118,886 |  |  |  | 113,714 |  |  |  | 118,487 |  |  |  |  | 113,115 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Basic and diluted net loss per share | $ | (0.08) | | $ | | (0.93) | | $ | | (0.34) | | $ | | | (1.86) | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

Options to purchase 24,808,100 common shares at a weighted average exercise price of $16.95 per share have been excluded from the computation of diluted net loss per share for the three months ended July 31, 2002, and options to purchase 24,824,080 common shares at a weighted average exercise price of $16.97 per share have been excluded from the computation of diluted net loss per shares for the six months ended July 31, 2002, as their effect would have been anti-dilutive. Options to purchase 21,985,101 common shares at a weighted average exercise price of $13.34 per share have been excluded from the computation of diluted net loss per share for the three months ended July 31, 2001, and options to purchase 22,144,639 common shares at a weighted average exercise price of $13.34 per share have been excluded from the computation of diluted net loss per shares for the six months ended July 31, 2001, as their effect would have been anti-dilutive. Additionally, 826,798 and 888,729 common shares subject to repurchase by the Company have been excluded from the computations of diluted net loss per share for the three and six months ended July 31, 2002, respectively, and 2,230,185 and 2,527,534 common shares subject to repurchase by the Company have been excluded from the computations of diluted net loss per share for the three and six months ended July 31, 2001, respectively.

**Comprehensive loss**

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | Three Months Ended | | | | |  |  |  |  | Six Months Ended | | | | |  |
|  |  |  |  |  | July 31, | | | |  |  |  |  |  | July 31, | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | 2002 | |  | 2001 | | |  | 2002 | | |  | 2001 | | | |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net loss | $(9,326) | | | $(105,197) | | | | $(40,260) | | | | $(210,163) | | | | |  |
|  | Other comprehensive income: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Unrealized gains on available-for-sale investments | 1,326 | |  | 1,254 | | |  | 768 | | |  | 1,275 | | | |  |  |
|  | |  |  |  |  | |  |  |  | |  |  |  | | |  |  |  |
| Total comprehensive loss | | $(8,000) | | | $(103,943) | | | | $(39,492) | | | | $(208,888) | | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

Accumulated other comprehensive income, 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. Acquisition**

On June 19, 2002, the Company acquired 100% of the shares of SysKonnect through a share purchase agreement. SysKonnect develops and markets client-server products. The acquisition has been accounted for using the purchase method of accounting, and the operating results of SysKonnect have been included in the Company’s consolidated financial statements from the date of acquisition. The total purchase price of the acquisition was approximately $9.5 million. The purchase price consisted of restricted shares and options granted to SysKonnect shareholders to purchase a total of 300,000 shares of the Company’s common stock (fair value of $7.3 million), settlement of a loan receivable of $1.9 million, and acquisition related expenses of approximately $0.3 million.

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|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| The aggregate purchase price was allocated as follows (in thousands): | |  |  |  |  |
|  |  |  |  |  |  |
| Net tangible assets | $4,060 | |  |  |
|  | Deferred compensation | 5,450 | |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |
| Aggregate purchase price | $9,510 | |  |  |
|  |  |  |  |  |  |
|  |  |  |  |  |  |

The amount allocated to deferred stock-based compensation relates to the intrinsic value of the unvested restricted stock and stock options issued. The restricted stock and stock options vest over a period of four years. This deferred stock-based compensation is amortized on an accelerated basis over the vesting period of the individual awards consistent with the method described in FIN28.

**3. 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 location. The lease abandonment 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 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 July 31, 2002 and may change as the Company obtains subleases for the abandoned facilities and sublease income is known. At July 31, 2002, cash payments of $1.8 million had been made in connection with this charge, and $15.5 million had been accrued and is payable through 2010.

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Remaining** | | |  |
|  |  |  | **Total** | |  |  | **Cash** | |  | **Non-Cash** | | |  | **Liability at** | | |  |
|  |  |  | **Charge** | |  | **Payments** | | |  | **Charges** | | |  | **July 31, 2002** | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Accrued losses on abandoned leased facilities: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Non-cancelable lease commitments | $10,847 | |  | $ | | (972) | | $ | | — | | $ | | 9,875 |  |  |
|  | Property and leasehold improvements | 5,999 | |  |  |  | — | |  |  | (383) | |  |  | 5,616 |  |  |
|  | Duplicate facility lease costs and other | 953 | |  |  |  | (871) | |  |  | (82) | |  |  | — | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | $17,799 | |  | $ | | (1,843) | | $ | | (465) | | $ | | 15,491 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

**4. Net Revenue**

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

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | Three Months Ended | | | | | |  |  |  | Six Months Ended | | |  |  |  |
|  |  |  |  |  | July 31, | | | | |  |  |  | July 31, | | |  |  |  |
|  | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net Revenue: | | |  | 2002 | 2001 | | | |  | 2002 | | |  |  |  | 2001 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Storage products | | $ | 68,198 | $36,868 | | | |  | $131,966 | | | $ | | | 65,457 |  |  |
|  | Communications products | |  | 51,496 | 31,781 | | | |  | 86,528 | | |  |  |  | 67,422 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  | $ | 119,694 | $68,649 | | | |  | $218,494 | | | $ | | | 132,879 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

**5. Recent Accounting Pronouncements**

In October 2001, the Financial Accounting Standards Board (“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

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adopted SFAS 144 on February 1, 2002, and the adoption did not have a significant impact on its financial position and results of operations.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145 (“SFAS 145”), Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.” SFAS 145 will generally require gains and losses on extinguishments of debt to be classified as income or loss from continuing operations rather than as extraordinary items as previously required under SFAS 4. Extraordinary treatment will be required for certain extinguishments as provided in APB Opinion No. 30. The statement also amended SFAS 13 for certain sales-leaseback transactions and sublease accounting. The Company is required to adopt the provisions of SFAS 145 effective February 2, 2003. The Company does not expect the adoption of SFAS 145 to have a significant impact on its financial position and results of operations.

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146 (“SFAS 146”), Accounting for Costs Associated with Exit or Disposal Activities. SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit and Activity (including Certain Costs Incurred in Restructuring). SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when a liability is incurred rather than when an exit or disposal plan is approved. The Company is required to adopt the provisions of SFAS 146 for any exit or disposal activities initiated after December 31, 2002. The effect of adoption of SFAS 146 will be a change on a prospective basis of the timing of when restructuring charges are recorded from a commitment date approach to when a liability is recorded.

**6. 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 whom 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 early 2003. 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.

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**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 the 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 June 2002, the Company acquired 100% of the shares of SysKonnect through a share purchase agreement. SysKonnect develops and markets client-server products for the Gigabit and 10 Gigabit markets. The acquisition has been accounted for using the purchase method of accounting, and the operating results of SysKonnect have been included in the Company’s consolidated financial statements from the date of acquisition.

In the communications market, we offer transceiver products, switching products, communications controller 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 SOCs, 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 six months ended July 31, 2002, approximately 68% of our net revenue was derived from sales to five 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 87% of our net revenue for the six months ended July 31, 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. Substantially 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 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.

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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.

**Critical Accounting Policies**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates, and such differences could affect the results of operations reported in future periods. For a description of our critical accounting policies and estimates, please refer to the “Critical Accounting Policies” section of our Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended January 31, 2002, as filed with the Securities Exchange Commission. There have been no material changes in any of the Company’s accounting policies since January 31, 2002.

**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** | | | | | |  |  | **Six Months Ended** | | | | | | |  |
|  |  |  |  |  | **July 31,** | | | |  |  |  |  | **July 31,** | | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | **2002** | |  | **2001** | | |  | **2002** | | |  | **2001** | | | |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net revenue | 100.0% | | | 100.0% | | | | 100.0% | | | | 100.0% | | | | |  |
|  | Operating costs and expenses: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Cost of goods sold | 46.8 | |  | 45.8 | | |  | 45.7 | | |  | 46.3 | | | |  |  |
|  | Research and development | 28.1 | |  | 31.8 | | |  | 29.4 | | |  | 31.5 | | | |  |  |
|  | Selling and marketing | 10.3 | |  | 14.7 | | |  | 10.7 | | |  | 14.8 | | | |  |  |
|  | General and administrative | 3.0 | |  | 5.4 | | |  | 3.3 | | |  | 5.1 | | | |  |  |
|  | Amortization of stock-based compensation | 1.8 | |  | 6.0 | | |  | 2.1 | | |  | 6.2 | | | |  |  |
|  | Amortization of goodwill and acquired intangible assets | 17.8 | |  | 152.2 | | |  | 19.5 | | |  | 157.3 | | | |  |  |
|  | Facilities consolidation charge |  | — | |  |  | — | | 8.1 | | |  |  |  |  | — | |  |
|  |  |  |  |  |  | |  |  |  | |  |  |  | | |  |  |  |
|  | Total operating costs and expenses | 107.8 | |  | 255.9 | | |  | 118.8 | | |  | 261.2 | | | |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Operating loss | (7.8) | | | (155.9) | | | | (18.8) | | | | (161.2) | | | | |  |
|  | Interest and other income, net | 1.6 | |  | 3.6 | | |  | 1.9 | | |  | 4.1 | | | |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Loss before income taxes | (6.2) | | | (152.3) | | | | (16.9) | | | | (157.1) | | | | |  |
|  | Provision for income taxes | (1.6) | | | (0.9) | | | | (1.5) | | | | (1.1) | | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Net loss | (7.8)% | | | (153.2)% | | | | (18.4)% | | | | (158.2)% | | | | |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

**Three and Six Months Ended July 31, 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 revenuederived from development contracts with our customers. Net revenue was $119.7 million for the three months ended July 31, 2002 compared to $68.6 million for the three months ended July 31, 2001. Net revenue was $218.5 for the six months ended July 31, 2002 compared to $132.9 million for the six months ended July 31, 2001. The increases in net revenue reflect a significant increase in volume shipments of our storage and Gigabit Ethernet products during the three months and six months ended July 31, 2002, primarily due to increased acceptance of our SOC storage products which began shipping in volume in the second half of fiscal 2002 and continued adoption of the Gigabit Ethernet products as a replacement for Fast Ethernet products. Revenue from storage products totaled

$68.2 million in the second quarter of fiscal 2003 compared to $36.9 million in the second quarter of fiscal 2002 and totaled $132.0 million in the first six months of fiscal 2003 compared to $65.5 million in the first six months of fiscal 2002. Revenue from communications products was $51.5 million in the second quarter of fiscal 2003 compared to $31.8 million in the second quarter of fiscal 2002 and totaled $86.5 million for the first six months of fiscal 2003 and $67.4 million for the first six months of fiscal 2002. Revenue derived from development contracts increased in absolute dollars during the second quarter and first six months of fiscal 2003 compared to the second quarter and first six months of fiscal 2002, but represented less than 10% of net revenues for each period. We expect that revenue from storage products for fiscal 2003 will increase from the level of revenue from

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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 overheadcosts, 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, decreased to 53.2% in the three months ended July 31, 2002 from 54.2% in the three months ended July 31, 2001. Gross margin increased to 54.3% in the six months ended July 31, 2002 from 53.7% in the six months ended July 31, 2001. The decrease in gross margin in the second quarter of fiscal 2003 compared to the second quarter of fiscal 2002 was primarily due to a product mix change which included production ramps of large volume lower margin desktop computer products and increased pricing pressures from our customers as well as from our competitors. The increase in gross margin in the first six months of fiscal 2003 compared to the first six months of fiscal 2002 was primarily due to higher margins on our storage products which resulted in a shift in product mix to newer, higher-margin products, and to a lesser extent an increase in the amount of development revenue recognized in first six months of fiscal 2003 compared to the first six months 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 of 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 and continued pricing pressure from our customers in the end markets.

***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

$33.6 million, or 28.1% of net revenue, for the three months ended July 31, 2002 compared to $21.8 million, or 31.8% of net revenue, for the three months ended July 31, 2001. Research and development expense was $64.2 million, or 29.4% of net revenue, for the six months ended July 31, 2002 compared to $41.9 million, or 31.5% of net revenue for the six months ended July 31, 2001. The increase in research and development expense in absolute dollars in the second quarter of fiscal 2003 compared to the second quarter of fiscal 2002 was primarily due to the hiring of additional development personnel, including personnel related to our acquisition of SysKonnect, which resulted in an increase in salary and related costs of $5.1 million, increased costs of $3.1 million for prototype and related product tape-out costs for new product initiatives, increased depreciation and amortization expense of $2.4 million arising from purchases of property, equipment and technology licenses, and other allocated expenses of $1.1 million related to our expanding operations. The increase in research and development expense in absolute dollars in the first six months of fiscal 2003 compared to the first six months of fiscal 2002 was primarily due to the hiring of additional development personnel, including personnel related to our acquisition of SysKonnect, which resulted in an increase in salary and related costs of $10.0 million, increased costs of $4.7 million for prototype and related product tape-out costs for new product initiatives, increased depreciation expense of $2.8 million arising from purchases of property, equipment and technology licenses and other allocated expenses of $3.3 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 $12.3 million, or 10.3% of net revenue, for the three months ended July 31, 2002 compared to $10.1 million, or 14.7% of net revenue, for the three months ended July 31, 2001. Selling and marketing expense was $23.3 million, or 10.7% of net revenue, for the six months ended July 31, 2002 compared to $19.6 million, or 14.8% of net revenue, for the six months ended July 31, 2001. The increase in selling and marketing expense in absolute dollars in the second 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 $1.5 million, increased travel costs of $0.3 million, and increased facility and other allocated expenses of $0.2 million related to our expanding operations. The increase in selling and marketing expense in absolute dollars in the first six months of fiscal 2003 compared to the first six months of fiscal 2002 was primarily due to the hiring of additional sales and marketing personnel which resulted in an increase of salary and related costs of $3.0 million and increased facility and allocated expenses of $0.7 million related to our expanding operations, partially offset by a reduction in commission expense of $0.9 million. The reduction in commission expense was due to the transition of 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

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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 andadministrative personnel, fees for professional services and allocated occupancy costs for these operations. General and administrative expense was $3.5 million, or 3.0% of net revenue, for the three months ended July 31, 2002 compared to $3.7 million, or 5.4% of net revenue, for the three months ended July 31, 2001. General and administrative expense was $7.2, or 3.3% of net revenue, for the six months ended July 31, 2002 compared to $6.7 million, or 5.1% of net revenue, for the six months of July 31, 2001. The increase in general and administrative expense in absolute dollars in the first six months of fiscal 2003 compared to the first six months of fiscal 2002 was primarily related to increased legal and other professional fees of $0.8 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 second 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 ouremployees and directors prior to our initial public offering of common stock, in connection with the assumption of stock options as a result of our acquisition of Galileo, and in connection with the grant of stock options as a result of our acquisition of SysKonnect. Deferred stock-based compensation is being amortized using an accelerated method over the remaining option vesting period. Amortization of stock-based compensation was $2.2 million, or 1.8% of net revenue, for the three months ended July 31, 2002 compared to $4.1 million, or 6.0% of net revenue, for the three months ended July 31, 2001. Amortization of stock-based compensation was $4.5, or 2.1% for net revenue, for the six months ended July 31, 2002 compared to $8.2 million, or 6.2% of net revenue, for the six months ended July 31, 2001. The decrease in amortization expense in both absolute dollars and percentage of net revenue in the second quarter and first six months of fiscal 2003 compared to the second quarter and first six months of fiscal 2002 primarily resulted from a reduced balance of deferred stock-based compensation being amortized in the second quarter and first six months of fiscal 2003 compared to the second quarter and first six months of fiscal 2002 prior to recording additional deferred stock-based compensation and amortization expense in connection with the acquisition of SysKonnect.

***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 17.8% of net revenue, for the three months ended July 31, 2002 compared to $104.5 million, or 152.2% of net revenue, for the three months ended July 31, 2001. Goodwill and acquired intangible asset amortization expense was $42.6 million, or 19.5% of net revenue, for the six months ended July 31, 2002 compared to $209.0 million, or 157.3% of net revenue, for the six months ended July 31, 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. The impairment test required upon adoption of SFAS 142 was completed during the six months ended July 31, 2002 and did not identify any impairment of goodwill. We plan to perform an annual impairment review during the fourth quarter of each year, beginning in fiscal 2003, or more frequently if we believe indicators of impairment exist.

***Facilities Consolidation Charge.*** During the three months ended April 30, 2002, we recorded a $17.8 million charge associated with costs of consolidation ofour 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 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

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the dual occupation of our current and abandoned facilities. The facilities consolidation charge is an estimate as of July 31, 2002 and may change as we obtain subleases for the abandoned facilities and sublease income is known. At July 31, 2002, cash payments of $1.8 million had been made in connection with this charge, and $15.5 million was 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 investmentbalances, offset by interest paid on capital lease obligations. Interest and other income, net was $1.9 million for the three months ended July 31, 2002 compared to $2.5 million for the three months ended July 31, 2001. Interest and other income, net was $4.0 million for the six months ended July 31, 2002 compared to

$5.4 million for the six months ended July 31, 2001. The decrease in interest and other income, net in the second quarter and first six months of fiscal 2003 compared to the second quarter and first six months of fiscal 2002 was primarily 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 $1.0 in the first six months of fiscal 2003.

***Provision for Income Taxes.*** Our effective tax rate was (26)% and (9)% for the three and six months ended July 31, 2002 respectively, compared to (1)% forthe three and six months ended July 31, 2001. Our effective rates for the second quarter and first six months 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 second quarter and first six months of fiscal 2003 was 12%, compared to 15% for the second quarter and first six months of fiscal 2002. Our adjusted effective tax rate has decreased to 12% in the second quarter and first six months of fiscal 2003 from 15% in the second quarter and first six months 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 July 31, 2002 consisted of $250.4 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. We also received $1.1 million of cash and cash equivalents, before acquisition costs, as a result of our acquisition of SysKonnect in June 2002.

Net cash provided by operating activities was $11.9 million for the six months ended July 31, 2002 and $18.2 million for the six months ended July 31, 2001. The cash inflow from operations in the first six 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), increases in accounts payable and accrued facility consolidation charge, partially offset by an increase in accounts receivable and inventory. The cash inflow from operations in the first six 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), a decrease in inventory, and increases in accounts payable and accrued employee compensation, partially offset by increases in prepaid expenses and other assets and a decrease in 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 to 60 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, as well as the initial production ramp for significant design wins. 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 $31.3 million for the six months ended July 31, 2002 and $37.6 million for the six months ended July 31, 2001. The net cash used in investing activities in the first six months of fiscal 2003 was due to purchases of property and equipment of $16.5 million, purchases of investments of $10.0 million, and purchases of short-term investments of $34.6 million, partially offset by the proceeds from maturities of short-term investments of $28.9 million. The net cash used in investing activities in the first six months of fiscal 2002 was primarily due to the payment of $29.3 million of accrued acquisition costs relating to our acquisition of Galileo, purchases of property and equipment of $9.7 million, and purchases of short-term investments of $9.0 million, partially offset by the proceeds from maturities of short-term investments of $13.0 million.

Net cash provided by financing activities was $13.5 million for the six months ended July 31, 2002 and $9.5 million for the six months ended July 31, 2001. In the first six months of fiscal 2003 and 2002, net cash provided by financing activities was attributable

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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 July 31, 2002, our foundries had incurred approximately $35.2 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 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 July 31, 2002 and may change as we obtain subleases for the abandoned facilities and sublease income is known. At July 31, 2002, cash payments of $1.8 million had been made in connection with this charge, and $15.5 million was 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. We believe that our existing cash, cash equivalent and short-term investment balances will be sufficient to meet our working capital needs, capital requirements, investment requirements and commitments for at least the next 12 months. 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 July 31, 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 - 3** | | |  |  |  | **After 3** | |  |  |  |  |  |  |
|  |  |  | **1 Year** | |  |  | **Years** | |  |  | **Years** | |  |  | **Total** | |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | (remaining | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | six months) | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Contractual obligations: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | Operating leases | $ | 4,839 |  | $18,935 | | |  | $15,508 | | |  | $39,282 | | |  |  |  |
|  | Capital lease obligations |  | 1,508 |  | 9,831 | | |  |  |  | — | | 11,339 | | |  |  |  |
|  | Purchase commitments to foundries |  | 35,175 |  |  |  | — | |  |  | — | | 35,175 | | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Total contractual cash obligations | $ | 41,522 |  | $28,766 | | |  | $15,508 | | |  | $85,796 | | |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | 17 | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
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**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.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145 (“SFAS 145”), Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections.” SFAS 145 will generally require gains and losses on extinguishments of debt to be classified as income or loss from continuing operations rather than as extraordinary items as previously required under SFAS 4. Extraordinary treatment will be required for certain extinguishments as provided in APB Opinion No. 30. The statement also amended SFAS 13 for certain sales-leaseback transactions and sublease accounting. The Company is required to adopt the provisions of SFAS 145 effective February 2, 2003. We do not expect the adoption of SFAS 145 to have a significant impact on our financial position and results of operations.

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146 (“SFAS 146”), Accounting for Costs Associated with Exit or Disposal Activities. SFAS 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit and Activity (including Certain Costs Incurred in Restructuring). SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when a liability is incurred rather than when an exit or disposal plan is approved. We are required to adopt the provisions of SFAS 146 for any exit or disposal activities initiated after December 31, 2002. The effect of adoption of SFAS 146 will be a change on a prospective basis of the timing of when restructuring charges are recorded from a commitment date approach to when a liability is recorded.

**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 slowdown in the worldwide economy, which has negatively affected our revenues and results of operations. 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 60% of our net revenue in the first six months 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.

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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.***

For the six months ended July 31, 2002, approximately 68% of our net revenue was derived from sales to five customers, each of whom individually accounted for 10% or more of our net revenue during this period. Of these customers, Samsung accounted for 15%, Toshiba accounted for 14%, Hitachi accounted for 13%, Intel accounted for 13%, and Seagate accounted for 13%. 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:

* 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 by completing volumes sales of 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:

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* 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;
* 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, SysKonnect, 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.

We acquired SysKonnect on June 19, 2002. We accounted for this acquisition using the purchase method of accounting, and the results of SysKonnect’s operations are included in our consolidated financial statements from the date of acquisition. The acquisition of SysKonnect did not result in any goodwill as the fair value of net tangible assets acquired approximated the value of the consideration. Deferred stock-based compensation of approximately $5.5 million was recorded and is being amortized over the remaining option vesting periods of no more than four years. There can be no assurance than any future acquisitions will not result in goodwill being recorded.

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

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of next-generation technology and have delayed or rescheduled existing orders for products that incorporate our technology. 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 $1.6 billion as of July 31, 2002. An impairment review could result in a write-down of all or a portion of these assets to their fair values. The impairment test required upon the adoption of SFAS 142 was completed during the six months ended July 31, 2002 and did not identify any impairment of goodwill. We plan to perform an annual impairment review during the fourth quarter of each year, beginning in fiscal 2003, or more frequently if we believe indicators of impairment exist. 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 and potential competitors have longer operating histories, significantly greater resources and name recognition and a larger base of customers than we have. 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 we may. 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 we may, which would allow them to respond more quickly than we might 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 serving that market than we have. 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

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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 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 we are 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

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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 Officer; Weili Dai, our co-founder and Executive Vice President; and Dr. Pantas Sutardja, our co-founder, Vice President and Chief Technology Officer. 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, or after we begin transacting on the new system, 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. Our failure to implement this ERP system will impair our ability to effectively manage the logistics of our business.

***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 July 31, 2002 and may change as we obtain subleases for the abandoned facilities and sublease income is known.

***Negative publicity about companies incorporated in Bermuda may lead to new tax legislation that could increase our tax burden and may affect our relationship with our clients.***

In recent months there has been an increasing focus on “corporate inversions,” which involve a United States based corporation reincorporating in a foreign jurisdiction. While we have since our inception been incorporated in Bermuda due to the international nature of our business, the negative publicity surrounding corporate inversions may lead to new tax legislation that could affect all Bermuda corporations and could increase our tax burden. Any such tax legislation, as well as the general negative publicity surrounding Bermuda corporations, may have a negative affect on our business and on our relationships with our customers.

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***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 87% of our net revenue in the first six months of fiscal 2003, and represented 83% and 92% of our net revenue in fiscal 2002 and 2001, respectively.

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 wars, terrorism, other 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.

***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 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.

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***We rely on third-party distributors and manufacturers’ representatives to distribute and sell our products 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 SOCs, 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.

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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; 26



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* 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 contractual 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 other third-parties, 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:

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* 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.

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***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 August 31, 2002, our executive officers and directors beneficially owned or controlled, directly or indirectly, approximately 41% of the outstanding shares our common stock. Additionally, Dr. Sehat Sutardja and Weili Dai are husband and wife and Dr. Sehat Sutardja and Dr. Pantas Sutardja are brothers. All three are directors and together they held approximately 30% of our outstanding common stock as of August 31, 2002. As a result, if the directors and officers as a group or any of Sehat Sutardja, Weili Dai, and Pantas Sutardja 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.

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***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 whom 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 early 2003. 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 August 31, 2002, we had 120,049,129 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.

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**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 ourinvestments 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 July 31, 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** | | | | |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  | **2003** |  |  | **2004** |  |  | **2005** |  |  | **2006** |  |  | **Total** |  |  | **Fair Value** |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Variable Rate | $ | 7,607 | $ | | 3,345 | $ | | — | $ | | — | | $ | 10,952 | $ | | 10,829 |  |
|  | Average Interest Rate |  | 1.95% |  |  | 2.25% |  |  | — |  |  | — | |  | 2.04% |  |  |  |  |
|  | Fixed Rate | $ | 24,911 | $ | | 41,622 | $ | | 38,501 | $ | | 35,272 |  | $ | 140,305 | $ | | 142,032 |  |
|  | Average Interest Rate |  | 3.60% |  |  | 3.70% |  |  | 3.65% |  |  | 4.37% |  |  | 3.84% |  |  |  |  |

*Investment Risk.* We invest in equity instruments of privately-held companies for business and strategic purposes. These investments are included in othernoncurrent 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, wehave 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.

**Item 4. *Controls and Procedures***

In the quarter ended July 31, 2002, there were no significant changes in our internal controls or other factors that could significantly affect these controls, including any corrective actions with regards to significant deficiencies and material weaknesses. We periodically review our internal control for effectiveness and we plan to conduct an evaluation of our disclosure controls and procedures each quarter.

**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 whom 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.

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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 early 2003. 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***

At our 2002 Annual General Meeting of Shareholders held on June 21, 2002, the following proposals were adopted by the margins indicated.

1. To elect three directors constituting Class 2 of our Board of Directors, each to hold office for a three-year term and until their successor is duly elected and qualified.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | Votes |  | Votes |  | Votes |  | Broker |  |
|  |  | For |  | Against |  | Abstained |  | Nonvotes |  |
|  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |
| Diosdado P. Banatao | 111,089,702 |  | — | 242,179 | |  | — |  |
|  | Kuo Wei (Herbert) Chang | 111,298,702 |  | — | 33,179 | |  | — |  |
|  | Ronald D. Verdoorn | 111,298,713 |  | — | 33,268 | |  | — |  |

Other directors whose term of office as a director continued after the Annual General Meeting were Sehat Sutardja, Weili Dai, Pantas Sutardja, John M Cioffi, Paul R. Gray and Manuel Alba.

1. To re-appoint PricewaterhouseCoopers LLP as our independent auditors for our 2003 fiscal year ending February 1, 2003 and to authorize the Board to fix the auditors remuneration.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | Votes |  | Votes |  | Votes |  | Broker |  |
|  | For |  | Against |  | Abstained |  | Nonvotes |  |
|  |  |  |  |  |  |  |  |  |
|  | 111,165,882 | 152,162 | | 13,837 | |  | — |  |
|  |  | 32 | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |



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**Item 5. *Other Information***

On July 30, 2002, the Sarbanes-Oxley Act of 2002 (the “Act”) was signed into law. In accordance with Section 10A(i)(2) of the Securities Act of 1934, and added by Section 202 of the Act, the Company plans to disclose the non-audit services to be performed by our external auditors, PricewaterhouseCoopers LLP, which our audit committee has approved, in our quarterly report for the period ending October 31, 2002.

**Item 6. *Exhibits and Reports on Form 8-K***

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

10.16 Supply Agreement for the Fabrication and Purchase of Semiconductor Products dated June 13, 2002 by and between Marvell Semiconductor, Inc.

and Western Digital Technologies, Inc.

99.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Dr. Sehat Sutardja Ph.D., Chief Executive Officer

99.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of George A. Hervey, Chief Financial Officer

(b) Reports on Form 8-K:

On May 23, 2002, we filed a current report on Form 8-K in connection with the issuance of a press release dated May 23, 2002 announcing our financial results for the first quarter of fiscal 2003.

On June 24, 2002, we filed a current report of Form 8-K in connection with the issuance of a press release dated June 21, 2002 announcing the acquisition of all of the shares of SysKonnect GmbH.

**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. | |
| September 16, 2002 | By: /s/ GEORGE A. HERVEY | |
|  |  |  |
| Date |  | George A. Hervey |
|  |  | Vice President and Chief Financial Officer |
|  | 33 |  |
|  |  |  |



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**SARBANES-OXLEY ACT SECTION 302(a) CERTIFICATION**

I, Dr. Sehat Sutardja, Ph.D., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Marvell Technology Group Ltd.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

|  |  |  |  |
| --- | --- | --- | --- |
| September 16, 2002 | | By: /s/ SEHAT SUTARDJA | |
|  |  |  |  |
| Date | |  | Dr. Sehat Sutardja, Ph.D. |
|  |  |  | Co-Chairman of the Board, |
|  |  |  | President and Chief Executive Officer |
| I, George A. Hervey, certify that: | |  |  |

1. I have reviewed this quarterly report on Form 10-Q of Marvell Technology Group Ltd.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

|  |  |  |
| --- | --- | --- |
| September 16, 2002 | By: /s/ GEORGE A. HERVEY | |
|  |  |  |
| Date |  | George A. Hervey |
|  |  | Vice President and Chief Financial Officer |
|  | 34 |  |
|  |  |  |



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|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  | **EXHIBIT INDEX** |
| Exhibit |  |  |  |
| Number |  |  | Description |
|  |  |  | |
| 10.16 |  | Supply Agreement for the Fabrication and Purchase of Semiconductor Products dated June 13, 2002 by and between Marvell Semiconductor, Inc. | |
|  |  | and Western Digital Technologies, Inc.\* | |
| 99.1 |  | Certification Pursuant to 18 | U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Dr. Sehat Sutardja |
|  |  | Ph.D., Chief Executive Officer | |
| 99.2 |  | Certification Pursuant to 18 | U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of George A. Hervey, |
|  |  | Chief Financial Officer |  |



* Portions redacted pursuant to a request for confidential treatment filed with the Securities and Exchange Commission. 35

Exhibit 10.16

Certain confidential information has been omitted from this Exhibit 10.16 pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission. The omitted information is indicated by the symbol "[\*]" at each place in this Exhibit 10.16 where the omitted information appeared in the original.

SUPPLY AGREEMENT FOR THE FABRICATION AND PURCHASE OF

SEMICONDUCTOR PRODUCTS

BY AND BETWEEN

MARVELL SEMICONDUCTOR, INC.,

MARVELL ASIA PTE LTD

and

WESTERN DIGITAL TECHNOLOGIES, INC.

Certain confidential information has been omitted from this Exhibit 10.16 pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission. The omitted information is indicated by the symbol "[\*]" at each place in this Exhibit 10.16 where the omitted information appeared in the original.

|  |  |  |  |
| --- | --- | --- | --- |
|  | SUPPLY AGREEMENT FOR THE FABRICATION AND PURCHASE OF | |  |
|  | SEMICONDUCTOR PRODUCTS |  |  |
| Section |  | Page |  |
| - ------- | | ------ |  |
| 1.0 | Definitions | Page 3 |  |
| 2.0 | Term of Agreement | Page 4 |  |
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| 4.0 | Forecast of Product Purchases | Page 5 |  |
| 5.0 | Purchase Orders | Page 5 |  |
| 6.0 | Supplier's [\*] Obligation and | Page 6 |  |
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| Rescheduling Shipment Dates | Page 7 |  |
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| 11.0 | Quarterly Business Review | Page 9 |  |
| 12.0 | Invoicing, Payment Terms, Taxes | Page 9 |  |
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| 20.0 | Notice | Page 13 |  |
| 21.0 | General Provisions | Page 14 |  |
| Exhibit | A |  |  |
| Exhibit | B |  |  |
| Exhibit | C |  |  |
|  | 2 |  |  |

Certain confidential information has been omitted from this Exhibit 10.16 pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission. The omitted information is indicated by the symbol "[\*]" at each place in this Exhibit 10.16 where the omitted information appeared in the original.

SUPPLY AGREEMENT FOR THE FABRICATION AND PURCHASE OF

SEMICONDUCTOR PRODUCTS

THIS SUPPLY AGREEMENT FOR THE FABRICATION AND PURCHASE OF SEMICONDUCTOR PRODUCTS (this "Agreement"), dated June 13, 2002, is made and entered into by and among WESTERN DIGITAL TECHNOLOGIES, INC. ("Buyer"), MARVELL SEMICONDUCTOR, INC., ("MSI"), MARVELL ASIA PTE LTD ("MAPL")(MSI AND MAPL are collectively the "Supplier"). Buyer and Supplier are each a "party" and, collectively, are the "parties" to this Agreement.

Buyer agrees to purchase from Supplier, and Supplier agrees to supply to Buyer, Buyer's read channel supply requirements in accordance with the terms and conditions stated in this Agreement and in any written exhibits agreed to by the parties, attached to this Agreement and incorporated herein.

1.0 DEFINITIONS

1.1 Commencement Date: June 13, 2002.

1.2 Engineering Change: A mechanical or electrical change to a Product which may effect the form, fit, function or maintainability of the Product

1.3 Plant of Manufacture: Buyer's manufacturing facility or assigned JIT hubs.

1.4 Product(s): For the purposes of this Agreement, Product or Products, as the case shall be, shall mean Supplier's [\*] series read channel integrated circuit devices. The parties agree that from time to time, the parties may amend the definition of Products hereunder, but only if both parties agree to do so in writing. The parties agree that, until amended, the prices for each Product shall be as set forth in Exhibit A.

1.5 Purchase Order: An order submitted by Buyer for the purchase of Products under this Agreement.

1.6 Purchase Order Lead Time: The required minimum amount of time between Supplier's receipt of a Purchase Order issued by Buyer and the requested Shipment Date necessary to complete Seller's entire manufacturing cycle time, including Front End Manufacturing Cycle Time and Back End Manufacturing Cycle Time. Purchase Order Lead Time shall be jointly determined by Buyer and Supplier [\*].

1.7 Front End Manufacturing Cycle Time: Lead-time from wafer start through probe and shipping.

1.8 Back End Manufacturing Cycle Time: Lead-time from probe, die bank, assembly, test and shipping.

1.9 Shipment Date: Date for shipment of Products specified by Buyer in a Purchase Order or Pull Signal accepted by Supplier.

1.10 Related Company: A corporation, company or other entity which controls or is controlled by a party hereunder or any another Related Company of such party,

3

Certain confidential information has been omitted from this Exhibit 10.16 pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission. The omitted information is indicated by the symbol "[\*]" at each place in this Exhibit 10.16 where the omitted information appeared in the original.

where control means ownership or control, direct or indirect, of more than fifty (50) percent of: (i) the outstanding voting shares or securities (representing the right to vote for the election of directors or managing authority), or (ii) the ownership interests representing the right to make decisions for such a corporation, company or other entity (as the case may be in a partnership, joint venture or unincorporated association having no outstanding shares or securities). However, any such corporation, company or other entity shall be deemed to be a Related Company of such party only so long as such ownership or control exists.

1.11 Unit(s): A single unit of the Product.

1.12 Phase out: Supplier's determination to exit the ASIC business as defined in this Agreement.

1.13 LCBI: Lot Control Burn In.

1.14 Epidemic Failure: In the case of: (i) customer line integration, any component-related failure resulting in a DPPM level of [\*]; (ii) a field failure, any component-related failure resulting in a DPPM level or [\*] measured over a [\*] day period; or, (iii) at an end user site, a higher than expected failure rate as measured against the installed base and the root cause of such failure is attributable to a single component, the root cause of which is directly attributable to Supplier's integrated circuit design or an integrated circuit fabrication issue.

1.15 Field Recall: Buyer-initiated recall of shipped units of Buyer's products directly resulting from a failure of Supplier's Products directly attributable to Supplier's integrated circuit design or an integrated circuit fabrication issue. Field Recall shall not include normal warranty returns over time.

1.16 QBR: Quarterly Business Review conducted by the parties hereto during the term of this Agreement.

1.17 SQR: Supplier Quality Rating.

1.18 SSR: Supplier Service Rating.

1.19 SDR: Supplier Development Rating.

2.0 TERM OF AGREEMENT

The term of this Agreement shall commence on the Commencement Date and shall expire five (5) years thereafter, unless otherwise terminated by either of the parties in accordance with the provisions of this Agreement.

3.0 [\*]

No later than June 24, 2002, Supplier shall [\*]

4

Certain confidential information has been omitted from this Exhibit 10.16 pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission. The omitted information is indicated by the symbol "[\*]" at each place in this Exhibit 10.1b where the omitted information appeared in the original.

[\*]

4.0 FORECAST OF PRODUCT PURCHASES

4.1 Buyer shall issue to Supplier a forecast covering a period of [\*] to [\*] months (current fiscal quarter and [\*] subsequent quarters) on the first week of every Buyer fiscal quarter or more regularly as Buyer deems necessary. Seller shall acknowledge receipt and acceptance of Buyer's forecast by return facsimile or e-mail within forty-eight (48) hours of Buyer's issuing such forecast. If Supplier fails to respond to Buyer's forecast within forty-eight (48) hours, such forecast shall be deemed accepted by Buyer. Both Supplier and Buyer agree that forecasts constitute good faith estimates of Buyer's anticipated requirements of Products for the periods indicated based on current market conditions, and Supplier's acceptance shall constitute Supplier's agreement that it will exercise good faith efforts to quote and supply the requirements set forth in such forecast if finally ordered by Buyer in accordance with applicable provisions of this Agreement.

4.2 If Supplier cannot meet Buyer's requirements as set forth in a forecast or Buyer greatly reduces its forecast, Supplier and Buyer agree to engage in good faith discussions to resolve the issue on terms satisfactory to both parties.

5.0 PURCHASE ORDERS

5.1 Buyer shall submit a Purchase Order to Supplier on a quarterly basis. The Purchase Order shall specify [\*] for the Products [\*] covered by the Purchase Order and shall be based on [\*] as of the date of the Purchase Order.

5.2 Subject to the rescheduling and cancellation provisions herein, Buyer agrees that it shall [\*]. Supplier will ship Products during the quarter by the Shipment Dates specified in the Purchase Order or, if Buyer chooses, by Shipment Dates specified in Pull Signals issued by Buyer throughout the quarter. Any [\*], unless Buyer informs Supplier otherwise in advance and in writing.

5.3 Supplier will acknowledge receipt and acceptance of Buyer's Purchase Orders within 48 hours of receipt. If Supplier fails to respond to Buyer's Purchase Order within forty-eight (48) hours, such Purchase Order will be deemed accepted by Supplier. Purchase Orders must be placed in advance, with at least the Purchase Order Lead Time agreed to by the Parties, to allow Supplier to meet Buyer's requested Shipment Date. Buyer may request, without incurring any liability

5

Certain confidential information has been omitted from this Exhibit 10.16 pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission. The omitted information is indicated by the symbol "[\*]" at each place in this Exhibit 10.1b where the omitted information appeared in the original.

hereunder, improved Shipment Dates, and Supplier will [\*].

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| 5.4 | Purchase Order Lead | Times shall be [\*]. | | | | Purchase Order Lead Times may | |
|  | not increase above [\*] | | weeks during | | the | term | of this Agreement. Supplier |
|  | shall undertake [\*] | to | reduce | Purchase | | Order | Lead Times during the Term |
|  | of this Agreement to [\*] lead | | | times | of | [\*] weeks. | |

5.5 Purchase Orders and acknowledgements thereof exchanged by the parties will be used to convey Product order information only. If the terms of a Purchase Order conflict with the terms of this Agreement, the terms of this Agreement shall govern.

5.6 Supplier shall supply [\*] the Products at the prices set forth in Exhibit A attached hereto [\*].

5.7 Buyer's Purchase Orders issued hereunder shall specify and include the following information:

1. Buyer's [\*] for the Product being purchased;
2. Quantity of Product requested;
3. Product price agreed to by the parties per the applicable exhibit to this Agreement;
4. Location to which the Buyer specifies the Products shall be shipped and the Shipment Date specified by the Buyer; and
5. Reference to this Agreement.

6.0 SUPPLIER'S [\*] OBLIGATION AND BUYER'S [\*] OBLIGATIONS.

6.1 [\*], Supplier shall [\*] in accordance with EXHIBIT B from [\*] through

* and shall [\*] supply Buyer with up to [\*] Product units per month beginning in [\*] and

6

Certain confidential information has been omitted from this Exhibit 10.16 pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission. The omitted information is indicated by the symbol "[\*]" at each place in this Exhibit 10.1b where the omitted information appeared in the original.

continuing through the life of the Buyer hard drive products incorporating Supplier's Products.

6.2 In consideration of (i) Supplier [\*] on Buyer's behalf as set forth above, (ii) Supplier [\*] and (iii) [\*] contemplated in Section [\*] below and Supplier's performance thereon, Buyer agrees that Buyer shall

[\*] during the Term of this Agreement.

6.3 Buyer and Supplier agree to work in good-faith to mutually define the development and design milestones, pricing, delivery and other reasonable requirements of all Products supplied hereunder. Notwithstanding the contrary provisions of this section, Buyer's obligation to [\*].

6.4 Buyer agrees to work in good faith to complete [\*]. Buyer agrees to [\*] to complete the [\*], and agrees to work [\*].

7.0 RESCHEDULING SHIPMENT DATES

7.1 Buyer may reschedule, without incurring any charge or liability to Seller, the Shipment Date for up to 100% of the amount of the Products specified in a Purchase Order accepted by Supplier, provided that Buyer has provided to Supplier written notice of such rescheduled Shipment Date within the time periods specified in the table below. Buyer may reschedule each shipment of Products a single time for up to ninety (90) days without incurring any charge or liability to Supplier.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  |  | Maximum amount of | |  |
| Number of Calendar | Amount of Purchase | days | a reschedule |  |
| quantity can be | |  |
| Days' Notice Prior to | Order Subject to | moved from original | |  |
| Shipment Date | Reschedule | ship | date |  |

---------------------------------------------------------------------

|  |  |
| --- | --- |
| 0 to [\*] days | 0 |

---------------------------------------------------------------------

[\*] to [\*] days [\*] [\*] days

---------------------------------------------------------------------

7

Certain confidential information has been omitted from this Exhibit 10.16 pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission. The omitted information is indicated by the symbol "[\*]" at each place in this Exhibit 10.16 where the omitted information appeared in the original.

---------------------------------------------------------------------

[\*] to [\*] days [\*] [\*] days

---------------------------------------------------------------------

[\*] days or more [\*] [\*] days

---------------------------------------------------------------------

8.0 CANCELLATION OF PURCHASE ORDERS

8.1 Buyer may cancel a Purchase Order upon written notice to Supplier only in accordance with the terms of this Agreement. Once Supplier has received Buyer's notice of cancellation, Supplier will immediately cease all work assembling Products in support of such canceled Purchase Order and will provide a status report of the works in progress ("WIP") to assess Buyer's liability for such WIP. Buyer shall have the right to inspect the WIP to verify the accuracy of Supplier's status report. Buyer agrees that upon notifying Supplier that a Purchase Order is cancelled, Buyer shall assume liability for such WIP according to the following schedule based on the Purchase Order Price (POP) for each outstanding Purchase Order

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Finished Goods | | [\*] of (POP) | | |
| Final | Test | [\*] of POP | | |
| Assembly | | [\*] of POP | | |
| Die Bank | | [\*] | of | POP |
| Wafer | Fab | [\*] | of | POP |

8.2 No cancellation charges will be due if:

1. [\*] a Purchase Order because of a [\*] of more than [\*] from a designated Shipment Date due [\*];
2. Buyer cancels a Purchase Order because Supplier executes an unauthorized Engineering Change or an unauthorized change to the Product qualification plan of record agreed to by the parties (i.e. change of fabrication site, assembly site, and or test site); or
3. [\*] a Purchase Order because [\*].

9.0 PULL SIGNALS

9.1 Each week during the term hereof, Buyer shall issue to Seller a Pull Signal which shall cover a [\*] week period commencing on the day Supplier receives such Pull Signal and continuing through the subsequent calendar week. Such Pull Signal shall specify the amount of Products and the Shipment Dates by which Products are to be delivered during such [\*] week period.

9.2 Supplier shall acknowledge, by return facsimile or e-mail, its receipt and acceptance of each Pull Signal within [\*] of Buyer's issuing such Pull Signal. Any Pull Signal not so accepted will be deemed rejected.

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9.3 If the Pull Signal is or is deemed rejected by Supplier, Supplier shall notify Buyer within [\*] of receiving the Pull Signal and provide Buyer with an alternative to the Product amounts and Shipment Dates contained in the Pull Signal. If Buyer is not satisfied with Supplier's response, both Buyer and Supplier agree to immediately hold discussions to resolve their disagreement.

1. [\*] PROGRAM

Supplier will maintain a [\*] approximately [\*] remaining in such [\*]. The [\*] will consist of [\*] designated by Buyer [\*] designated by Supplier but acceptable to Buyer. Any change [\*] set forth above must be mutually agreed upon between Buyer and Supplier. Supplier will have [\*] Product ramp and, thereafter, shall [\*] for the term of this Agreement. Buyer and Supplier will monitor Buyer's demand for Products quarter to quarter with the intent of [\*] the [\*] that there is no further requirement for the Product.

1. QUARTERLY BUSINESS REVIEW

Buyer and Supplier shall meet on a quarterly basis for a QBR. The QBR shall focus on the SDR, SQR and SSR that Supplier has earned for the preceding quarter. The parties shall review the Supplier's performance during the preceding quarter, identify areas for improvement and recommend actions to be taken by either Supplier or Buyer or both Supplier and Buyer to satisfy the parties' business goals.

12.0 INVOICING, PAYMENT TERMS, TAXES

12.1 Supplier shall invoice Buyer for all Products shipped to Buyer's JIT Hub located in Malaysia or to such other location, as Buyer shall designate from time to time hereunder. Supplier shall ship all Products [\*] from Supplier's facility. Supplier will invoice Buyer once the Product is pulled from Buyer's JIT Hub, and Buyer shall complete full and final payment of such invoice within [\*] of the date of Supplier's invoice. Buyer will maintain good-faith efforts [\*]. In the event that Buyer does not pay Supplier's invoice within [\*] days of the date of the invoice, Buyer shall pay subsequent Supplier invoices no later than [\*] days after the date of Supplier's invoice. If Buyer thereafter pays all invoices within [\*] days of the date of Supplier's invoice for three successive

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months, Buyer shall again be permitted to pay subsequent invoices from Supplier within [\*] days of the date of such invoices [\*].

12.2 Buyer agrees to pay any taxes resulting from the transactions contemplated under this Agreement unless Buyer can provide appropriate exemption certificates.

12.3 Buyer represents that it holds a valid Reseller's exemption certificate for Products purchased for resale in each applicable taxing jurisdiction. Based on this representation, Supplier shall, where the law permits, treat Buyer as exempt from applicable state and/or local sales tax for Products purchased hereunder.

12.4 Buyer shall promptly notify Supplier in writing of any modification or revocation of Buyer's exempt status. Buyer shall reimburse Supplier for any and all assessments resulting from a refusal by a taxing jurisdiction to recognize any Buyer exemption certificates, or from Buyer's failure to have a valid certificate.

1. TERMINATION

13.1 If either party is in default of any material provision of this Agreement and such default is not corrected within [\*] days of receipt of written notice, this Agreement may be terminated by the party not in default. If the default is such that is cannot be reasonably cured within [\*] days, then the defaulting party must commence cure within

* days and proceed to cure [\*]. These provisions shall not affect Supplier's obligations to Buyer set forth below in this Section 13, in the event of Supplier's breach of a material provision of this Agreement.

13.2 If Buyer terminates this Agreement due to Supplier's default, all outstanding Purchase Orders shall be [\*].

13.3 If Supplier terminates this Agreement due to Buyer's default, at Supplier's discretion, all outstanding Purchase Orders shall be automatically cancelled and the cancellation charges set forth in this Agreement shall apply [\*].

13.4 If Supplier (i) decides to [\*] or (ii) Supplier is unable to [\*], then

Supplier agrees to do the following:

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[\*].

1. ENGINEERING CHANGES

Supplier shall not make any Engineering Changes to Products under this Agreement once final production level Product is qualified unless such Engineering Change is specified in writing and expressly accepted by Buyer.

1. QUALITY STANDARDS

Supplier agrees to make [\*] to achieve all quality and reliability requirements to be set forth in a Statement of Quality (the "SOQ"), in substantially the same form as Exhibit C hereto, to be mutually agreed upon by the parties. Supplier agrees that the requirements set forth in the SOQ shall apply to all Products that Supplier supplies to Buyer hereunder.

1. PRODUCT WARRANTY

16.1 Notwithstanding any other provision of this Agreement, Supplier warrants that for a period of [\*] each unit of Product delivered will comply with each [\*] part of the [\*] including all changes to and iterations of [\*] and that such Product will be [\*] provided, that, such use is in conformance with the [\*]. All [\*] are provided [\*].

16.2 If Buyer determines during the warranty period that a Product does not conform to the [\*], Supplier's obligation shall be limited to (i) replacing such Product with a new Product that conforms to Seller's warranty or (ii) issuing Buyer a credit equal to the amount that Buyer paid for the Product, at Supplier's option.

16.3 In addition to Supplier's obligations under Section 16.2, in the event of an [\*] of a Product during Supplier's warranty term or

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Buyer's warranty term, whichever is shorter, Buyer and Supplier shall meet and attempt to develop a mutually satisfactory resolution regarding liability resulting from [\*]. In the event that the parties are unable to reach a mutually satisfactory resolution, each party reserves all claims and defenses available to it, at law or in equity, regarding such [\*].

16.4 Subject to the confidentiality provisions of this Agreement, Buyer agrees to provide Supplier with Buyer's [\*] that Buyer generates [\*] of manufacturing its hard drive products that incorporate the Products.

17.0 SUPPLIER'S INDEMNITY

17.1 Supplier agrees to indemnify, defend and hold harmless Buyer and its Related Companies and their respective directors, officers, employees, representatives, agents, successors and assigns, from and against any claims, losses, damages, liabilities, causes of action, suits, costs and expenses, including all reasonable attorneys' fees and disbursements of counsel and expenses of investigation, finally awarded against Buyer or its Related Companies arising out of or related to (a) any claims, actions, suits or proceedings alleging that any Products that Buyer purchases or otherwise receives from Supplier infringe any patent, trade secret, copyright or other intellectual property rights of any third party and (b) any claims, actions, suits or proceedings whether in tort, contract or otherwise alleging personal injury or death, or any damage to any property, caused or allegedly caused by any negligent act or omission by Supplier or any defect in any Products that Buyer purchases or otherwise receives from Supplier. Notwithstanding the foregoing, Supplier is not obligated to defend or settle any such suit and is not obligated to pay any such damages or costs, if such claim arises out of

1. a combination of the Supplier's technology with technology not supplied by the Supplier or (ii) a modification, alteration or amendment of the Supplier's Technology. In the event that any Products are alleged to be infringing, Supplier agrees, in its sole discretion and at its own expense, to (i) procure for Buyer the right to continue to use such Products, (ii) replace such Products with noninfringing products that comply with Section 16.1 above, or (iii) modify such Products so that they become noninfringing and continue to comply with Section 16.1 above.

17.2 Buyer agrees to indemnify, defend and hold harmless Supplier and its Related Companies and their respective directors, officers, employees, representatives, agents, successors and assigns from and against any claims, losses, damages, liabilities, causes of action, suits, costs and expenses, including all reasonable attorneys' fees and disbursements of counsel and expenses of investigation, finally awarded against Supplier or its Related Companies arising out of or related to any claims, actions, suits or proceedings alleging that any specification, design or implementation detail that Supplier receives from Buyer or that Supplier is

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required to incorporate into any Products as a result of Buyer's requirements or technical specifications infringes any patent, trade secret, copyright or other intellectual property right of a third party.

1. CONFIDENTIAL INFORMATION

18.1 Except as set forth below, all information exchanged under this Agreement will be deemed to be non-confidential. If either party determines that it becomes necessary to exchange confidential information in order to perform under this Agreement, the exchange of such confidential information will be made under a separate written nondisclosure agreement.

18.2 Each party (i) will keep the existence of this Agreement confidential until the first Unit is shipped by Supplier to Buyer, (ii) will keep the contents of this Agreement confidential during the term of the Agreement and for a period of [\*] thereafter, and (iii) will not, without first obtaining the written consent of the other party, disclose any portion of this Agreement or any information contained herein to any third party except as may be required to enforce this Agreement or as may be required by applicable statute, regulation or court order. In the event such disclosure is required, the party making such disclosure will provide the other party sufficient notice for the other party to seek appropriate protection, in court if necessary. In the event of disclosure thereafter, the party making the disclosure will keep such disclosure to a minimum and protect the information so disclosed by a protective order or the like unless otherwise agreed by the parties.

The parties agree that each party may be required to file this Agreement as an exhibit to filings each party makes with the U.S. Securities and Exchange Commission (the "SEC"). In connection with any such filing, each party agrees to seek confidential treatment of the terms of the Agreement from the SEC, and each party further agrees to notify the other party in advance of such filing and to work cooperatively with the other party regarding the form and content of such confidential treatment request.

1. SUPPLIER ENGINEERING SUPPORT

Supplier agrees to support [\*] for the Products and any other [\*] covered by this Agreement. Support to include [\*] all of which [\*] shall be subject to the provisions of the NDA.

1. NOTICES

Any notices or other communications given by either party under this Agreement shall be in writing and shall be (a) delivered personally, (b) transmitted by facsimile machine with

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confirmation in writing mailed first class, (c) sent by a nationally recognized overnight courier or overnight mail service that guarantees overnight delivery or (d) sent by registered certified United States mail with return receipt requested, postage prepaid, addressed as follows:

If to Buyer:

Western Digital Technologies, Inc.

20511 Lake Forest Drive

Lake Forest, CA 92630

Attn: General Counsel

Tel: (949) 672-7000

Fax: [\*]

If to Supplier:

Marvell Asia Pte Ltd

151 Lorong Chuan #02-05

New Tech Park

Singapore 556741

Attn: General Manager

Tel: (65) 756-1600

Fax: [\*]

With a copy to:

Marvell Semiconductor, Inc.

700 First Avenue

Sunnyvale, CA 94089

Attn: Vice President of Business Affairs

and General Counsel

Tel: (408) 222-2500

Fax: [\*]

Any such notice shall be effective (a) upon receipt if personally delivered, (b) on the date of the facsimile transmission (which date is indicated by the facsimile machine of the party) if sent by facsimile and confirmed by mail, (c) on the first business day if sent by a nationally recognized overnight courier or overnight mail that guarantees overnight delivery and (d) on the third business day following the date of mailing if sent by registered or certified mail. Each party may change the address to which notices are to be delivered by giving notice as provided in this section.

1. GENERAL PROVISIONS

21.1 Subject to the confidentiality and intellectual property provisions contained herein, neither this Agreement nor any activities hereunder will impair any right of Supplier or Buyer to design, develop, manufacture, market, service, or otherwise deal in, directly or indirectly, products or services including those which are competitive with those offered by Supplier or Buyer.

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21.2 This Agreement may be modified only by a written amendment signed by authorized representatives of the Buyer and the Supplier.

21.3 All obligations and duties which by their nature survive the expiration or termination of this Agreement shall remain in effect beyond any such expiration or termination.

21.4 Except for the obligation to pay any monetary sums due, neither party shall be responsible for failure to fulfill its obligations under this Agreement due to fire, flood, war or other such cause beyond its control and without its fault or negligence provided it promptly notifies the other party.

21.5 Neither party shall assign this Agreement or any rights hereunder without the prior written consent of the other party, except that Supplier's rights to payments under the Agreement are freely assignable. In the event that Buyer merges with or into, or is acquired by, another entity such that Buyer is not the surviving entity of such merger or acquisition (the "Successor Entity"), the rights and obligations of Buyer under this Agreement shall automatically become the rights and obligations of the Successor Entity. A sale by Buyer of all or substantially all of its assets to a third party shall be deemed to be a merger with or into, or an acquisition by, such party for purposes of this provision. In the event any Successor Entity is unable or unwilling to assume the rights and obligations of this Agreement, then such Successor Entity shall immediately [\*].

21.6 The waiver by either party of an instance of the other party's noncompliance with any obligation or responsibility herein shall not be deemed a waiver of subsequent instances or of either party's remedies for such noncompliance.

21.7 Each party will comply with all applicable federal, state and local laws, regulations and ordinances including, but not limited to, the regulations of the U.S. Government relating to the export or re-export of machines, commodities, software and technical date insofar as they relate to the activities under this agreement. Buyer agrees that machines, commodities, software and technical data provided under this Agreement may be subject to restrictions under the export control laws and regulations of the United States of America, including, but not limited to, the U.S. Export Administration act and the U.S. Export Administration Regulations. Buyer hereby agrees that neither machines, commodities, software or technical data provided by Supplier under this Agreement, nor the direct product thereof, is intended to be shipped, directly or indirectly, to prohibited countries or nationals thereof. Buyer agrees it is responsible for obtaining required government documents and approvals to export any machine, commodity, software or technical data.

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21.8 This Agreement may be executed in counterparts, each of which shall be deemed an original but all of which taken together shall constitute one and the same instrument. Facsimile signatures shall be deemed to be originals.

16

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|  |  |  |
| --- | --- | --- |
| SUPPLIER | BUYER |  |
| Marvell Semiconductor, Inc. | Western Digital Technologies, Inc. |  |
| 700 First Avenue | 20511 Lake Forest Drive |  |
| Sunnyvale, CA 94089 | Lake Forest, CA 92630 |  |
| By: /s/ Sehat Sutardja | By: /s/ WILLIAM JOHNS |  |
| -------------------------------Dr.SEHATSUTARDJA, | --------------------------------- |  |
|  |  |
| PRESIDENT and CEO | Title: VP Worldwide Matls. |  |
|  |  |
|  | ------------------------------ |  |
| Marvell Asia Pte Ltd |  |  |
| 151 Lorong Chuan #02-05 |  |  |
| Singapore 556741. |  |  |
| By: /s/ Dr. H. Kuong |  |  |
| ------------------------------- |  |  |
| Dr. H. KUONG, |  |  |
| GENERAL MANAGER |  |  |
|  | 17 |  |

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EXHIBIT A

PRODUCT PRICES

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

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|  |  |  |  |
| --- | --- | --- | --- |
|  |  | EXHIBIT B |  |
| TIME PERIOD | [\*] | COMMENT |  |
| ----------- | --- | ----------------------------------- |  |
| July 02 | [\*] | Deliveries starting July 15th |  |
| August 02 | [\*] | Actual quantity needed |  |
| September 02 | [\*] | Actual quantity needed |  |
| Q3 TOTAL | [\*] | Finalize by July 1st |  |
| October 02 | [\*] |  |
| November 02 | [\*] | Finalize by August 1st |  |
| December 02 | [\*] | Finalize by September 1st |  |
| Q4 TOTAL | [\*] | [\*], Finalize January by October 1st |  |
| 2003 QUARTERLY [\*] | [\*] |  |

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[WESTERN DIGITAL LOGO] [MARVELL LOGO]

[\*]

Statement of Quality

- --------------------------------------------------------------------------------

[\*]

[\*]

STATEMENT OF QUALITY

Page 1 of 5

Certain confidential information has been omitted from this Exhibit 10.16 pursuant to a confidential treatment request filed separately with the Securities and Exchange Commission. The omitted information is indicated by the symbol "[\*]" at each place in this Exhibit 10.16 where the omitted information appeared in the original.

[WESTERN DIGITAL LOGO] [MARVELL LOGO]

[\*]

Statement of Quality

- --------------------------------------------------------------------------------

[\*] STATEMENT OF QUALITY (REVISION 1.0)

This Statement of Quality (this "SoQ") is agreed to as of June 24, 2002 by and between Western Digital TECHNOLOGIES ("WD") and Marvell asia pte ltd ("MAPL").

1. PURPOSE

The purpose of this document is to specify the quality and reliability requirements for the [\*] and to document the processes and procedures MAPL shall employ to attain those requirements.

1. OVERVIEW OF [\*] PROGRAM

* is the first generation of a family [\*]. The intent of [\*] and follow-on versions is to take advantage of cost reduction opportunities. The [\*] is targeted for use in the WD [\*] line of hard disk drive products.

2.1 Description of [\*]

* is an [\*] product for WD that integrates MAPL's proven technology cores. [\*] wafer fabrication uses the [\*] process technology [\*] and is packaged in [\*] body outline [\*] package. Approximate die size for [\*] is [\*].

2.2 Description of [\*] Manufacturing Flow

Wafer fab is [\*]. Wafer probe is performed at [\*]. Package assembly subcontractor is [\*] Final test [\*]. Parts are finished, packed and shipped from [\*].

Page 2 of 5

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[WESTERN DIGITAL LOGO] [MARVELL LOGO]

[\*]

Statement of Quality

- --------------------------------------------------------------------------------

1. QUALITY REQUIREMENTS

It is central to WD's mission to provide best-in-class quality and reliability product to our customers. Consequently, components used in WD HDD products must meet stringent levels of quality and reliability in terms of expected fitness-for-use and failure during PCBA assembly and test, HDD assembly and test, end customer integration, and field use. These requirements are subject to review and change as the business situation warrants, but no less than annually. MAPL understands and agrees that failure to meet these quality levels will require immediate and resolute actions to rectify in the most expeditious manner possible [\*]. WD will cooperate fully in these efforts. It is not WD's intention to reject component shipments based upon occasional and marginal failure to meet these quality levels. However, sustained quality excursions and/or inability to correct quality problems to meet these requirements will affect WD's ability to integrate said components and may be cause for business interruptions, such as stop-ship orders (MSSO).

Current requirements as stated below should be viewed as minimum acceptable criteria for[\*]:

3.1 [\*]

3.2 [\*]

3.3 [\*]

3.4 [\*]

3.5 [\*]

3.6 [\*]

1. COMPONENT QUALIFICATION

WD has a comprehensive process in place to qualify components for integration into our products. This process involves Engineering teams in the US and in our factories and our suppliers, and concludes when the component is listed unfettered on our Approved Vendor List (AVL). It must be demonstrated that the component in question can achieve the quality requirements listed above through direct measurement as well as artifices such as accelerated life tests. The [\*] attached hereto as Exhibit 1 lists related actions required of the supplier in detail. It is incumbent upon both parties to schedule this work such that the successful conclusion of these tests occurs well before WD builds and ships products containing said components.

Page 3 of 5

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[WESTERN DIGITAL LOGO] [MARVELL LOGO]

[\*]

Statement of Quality

* --------------------------------------------------------------------------------

4.1 [\*] qualification summary

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Activity | [\*] | Who | ECD |  |
| -------- | --- | ----- | --- |  |
| Wafer-level reliability 1st wafer lot | [\*] | Marv |  |  |
| 2nd wafer lot |  | Marv |  |  |
| 3rd wafer lot | [\*] | Marv |  |  |
| Device construction analysis | WD |  |  |
|  |  | Marv |  |  |
| High temperature operating life | [\*] | Marv |  |  |
| [\*] |  | Marv |  |  |
| [\*] |  | Marv |  |  |
| [\*] | [\*] | Marv |  |  |
| High temp storage [\*] | Marv |  |  |
| Corner lot characterization | [\*] | Marv |  |  |
| Rogue lot screening program | [\*] | Marv |  |  |
| CPCP reporting program | [\*] | Marv |  |  |
| Latch-up sensitivity | [\*] | Marv |  |  |
| ESD sensitivity | [\*] | Marv |  |  |
| JEDEC precondition | [\*] | Marv |  |  |
| Pkg thermal cycle [\*] | [\*] | Marv |  |  |
| Pkg pressure cooker ([\*] | [\*] | Marv |  |  |
| Pkg construction analysis | [\*] | Marv |  |  |

1. QUALITY PROCESSES

Western Digital firmly believes that high quality products germinate from high quality processes. In order to assure visibility into the quality of our suppliers' processes, we request certain manufacturing data be made available on a routine basis. This data is often expressed as process capability measurements, wherein [\*] is viewed as a minimum to assure consistent product attributes. The following is a list of typical critical manufacturing parameters for [\*]:

|  |  |
| --- | --- |
| Parameter | Frequency |
| --------- | --------- |
| [\*] | [\*] |
| [\*] | [\*] |
| [\*] | [\*] |
| [\*] | [\*] |
| [\*] | [\*] |
| [\*] | [\*] |
| [\*] | [\*] |

Page 4 of 5

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[WESTERN DIGITAL LOGO] [MARVELL LOGO]

[\*]

Statement of Quality

- --------------------------------------------------------------------------------

5. Quality Processes (con't)

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

[\*]

1. SUPPLIER QUALITY MEASUREMENT

Suppliers of significant components are measured by WD in a formal ongoing process, culminating in the Quarterly Business Review (QBR) meeting. [\*]% of the QBR rating is the Supplier Quality Rating (SQR), a method of rating and ranking suppliers according to achieving the required quality and reliability metrics. The most heavily-weighted elements of the SQR are [\*].

1. SIGNATURES FOR STATEMENT OF QUALITY

|  |  |  |
| --- | --- | --- |
| WESTERN DIGITAL TECHNOLOGIES | MARVELL ASIA PTE LTD |  |
| /s/ DOUGLAS BLACKE | /s/ DR. H. KUONG |  |
| - ------------------------------------ | ------------------------------ |  |
| Douglas Blacke | Dr. H. Kuong |  |
| Sr. Director, Supplier Engineering | General Manager |  |
| /s/ MARTY FINKBEINER | ------------------------------ |  |
| - ---------------------------------- |  |
| Marty Finkbeiner |  |  |
| Vice President, HDS Quality |  |  |
|  | Page 5 of 5 |  |

EXHIBIT 99.1

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Marvell Technology Group Ltd. (the "Company") on Form 10-Q for the period ending July 31, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Dr. Sehat Sutardja, Ph.D., Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ Sehat Sutardja

* --------------------------------

Dr. Sehat Sutardja, Ph.D. Co-Chairman of the Board, President and Chief Executive Officer September 16, 2002

EXHIBIT 99.2

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADOPTED PURSUANT TO

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Marvell Technology Group Ltd. (the "Company") on Form 10-Q for the period ending July 31, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, George A. Hervey, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ George A. Hervey

* --------------------------------

George A. Hervey

Vice President and Chief Financial Officer September 16, 2002