**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended October 28, 2006**

**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** | **77-0481679** |
| (State or other jurisdiction of | (I.R.S. Employer |
| incorporation or organization) | Identification No.) |

**Canon’s Court, 22 Victoria Street, Hamilton HM 12, Bermuda**

**(441) 296-6395**

(Address, including Zip Code, of Principal Executive Offices and

Registrant’s telephone number, including area code)

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. o Yes x No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer o

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

The number of shares of the registrant’s common stock outstanding as of May 31, 2007 was 587,591,437 shares.



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**Explanatory Note**

In this Form 10-Q, we are restating our consolidated financial statements and related disclosures as of January 28, 2006 and for the three and nine months ended October 29, 2005. This Form 10-Q also reflects the restatement of “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Item 2 for the third quarter of fiscal 2006, “Controls and Procedures” in Item 4 and new management certifications.

For more information regarding our internal review of historical stock option practices and related accounting matters and the restatement of stock-based compensation and other items, please refer to Note 1, “Restatement of Consolidated Financial Statements” to Item 1, “Financial Statements” and Item 2, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”. For more information regarding the deficiencies noted in the internal review relating to stock option practices and our remedial measures, refer in Part I to “Management’s Discussion and Analysis of Financial Condition and Results of Operation” in Item 2 and “Controls and Procedures” in Item 4.

We have not amended any of our other previously filed annual reports on Form 10-K or quarterly reports on Form 10-Q for the periods affected by the restatement except for the Form 10-Q/A concurrently filed with this Form 10-Q for the first quarter of fiscal 2007. Consequently, the consolidated financial statements and related financial information contained in such previously filed reports should no longer be relied upon. Our Form 10-K for fiscal year ended January 27, 2007 includes the restatement of all periods through the first quarter of fiscal 2007.

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**PART I: FINANCIAL INFORMATION**

**Item 1. *Financial Statements***

**MARVELL TECHNOLOGY GROUP LTD.**

**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In thousands, except par value)**

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **October 28,** |  |  | **January 28,** | |
|  |  | **2006** |  |  | **2006** |  |
|  |  |  |  |  | **(restated) (1)** |  |
| **ASSETS** |  |  |  |  |  |  |
| Current assets: |  |  |  |  |  |  |
| Cash and cash equivalents | $ | 839,441 | $ | | 348,431 |  |
| Short-term investments |  | 36,231 |  |  | 572,591 |  |
| Accounts receivable, net of allowances of $3,549 and $3,028 |  | 294,216 |  |  | 245,164 |  |
| Inventories |  | 227,872 |  |  | 211,374 |  |
| Prepaid expenses and other current assets |  | 103,479 |  |  | 104,307 |  |
| Deferred income taxes |  | 3,945 |  |  | 3,945 |  |
| Total current assets |  | 1,505,184 |  |  | 1,485,812 |  |
| Property and equipment, net |  | 366,731 |  |  | 260,921 |  |
| Goodwill |  | 1,654,376 |  |  | 1,558,209 |  |
| Acquired intangible assets |  | 224,342 |  |  | 111,973 |  |
| Other noncurrent assets |  | 151,809 |  |  | 87,591 |  |
| Total assets | $ | 3,902,442 |  | $ | 3,504,506 |  |



**LIABILITIES AND SHAREHOLDERS’ EQUITY**

Current liabilities:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Accounts payable | $ | 199,677 |  | $ | | 196,606 |  |
| Accrued liabilities |  | 78,186 |  |  |  | 34,905 |  |
| Accrued employee compensation |  | 62,408 |  |  |  | 59,177 |  |
| Income taxes payable |  | 28,006 |  |  |  | 24,394 |  |
| Deferred income |  | 31,672 |  |  |  | 29,773 |  |
| Current portion of capital lease obligations |  | 19,443 |  |  |  | 16,563 |  |
| Total current liabilities |  | 419,392 |  |  |  | 361,418 |  |
| Capital lease obligations, net of current portion |  | 23,748 |  |  |  | 24,447 |  |
| Non-current income taxes payable |  | 110,845 |  |  |  | 86,545 |  |
| Other long-term liabilities |  | 35,701 |  |  |  | 24,871 |  |
| Total liabilities |  | 589,686 |  |  |  | 497,281 |  |
| Commitments and contingencies (Note 7) |  |  |  |  |  |  |  |
| Shareholders’ equity: |  |  |  |  |  |  |  |
| Common stock, $0.002 par value; 992,000 shares authorized; 587,423 and 582,776 shares issued and outstanding |  | 1,175 |  |  |  | 1,165 |  |
| Additional paid-in capital |  | 3,747,626 |  |  |  | 3,634,239 |  |
| Deferred stock-based compensation |  | — | |  |  | (61,987) | |
| Accumulated other comprehensive loss |  | (102) | |  |  | (1,759) | |
| Accumulated deficit |  | (435,943) | |  |  | (564,433) | |
| Total shareholders’ equity |  | 3,312,756 |  |  |  | 3,007,225 |  |
| Total liabilities and shareholders’ equity | $ | 3,902,442 |  |  | $ | 3,504,506 |  |
|  |  |  |  |  |  |  |  |



(1) See Note 1 – Restatement of Consolidated Financial Statements

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

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**MARVELL TECHNOLOGY GROUP LTD. UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME (In thousands, except per share amounts)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | | |  | **Nine Months Ended** | | | | | |  |
|  |  | **October 28,** | |  |  | **October 29,** |  |  | **October 28,** | |  |  | **October 29,** |  |  |
|  |  | **2006** |  |  |  | **2005** |  |  | **2006** |  |  |  | **2005** |  |  |
|  |  |  |  |  |  | **(restated) (1)** |  |  |  |  |  |  | **(restated) (1)** |  |  |
| Net revenue | $ | 520,398 |  | $ | | 426,026 |  | $ | 1,615,579 |  | $ | | 1,181,250 |  |  |
| Operating costs and expenses: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Cost of goods sold |  | 256,090 |  |  |  | 197,580 |  |  | 775,398 |  |  |  | 558,816 |  |  |
| Research and development and other |  | 152,939 |  |  |  | 83,043 |  |  | 434,812 |  |  |  | 249,098 |  |  |
| Selling and marketing |  | 37,875 |  |  |  | 23,129 |  |  | 116,004 |  |  |  | 71,290 |  |  |
| General and administrative |  | 40,427 |  |  |  | 11,833 |  |  | 78,674 |  |  |  | 38,851 |  |  |
| Amortization of acquired intangible assets |  | 27,405 |  |  |  | 19,746 |  |  | 72,161 |  |  |  | 59,258 |  |  |
| Total operating costs and expenses |  | 514,736 |  |  |  | 335,331 |  |  | 1,477,049 |  |  |  | 977,313 |  |  |
| Operating income |  | 5,662 |  |  |  | 90,695 |  |  | 138,530 |  |  |  | 203,937 |  |  |
| Interest and other income, net |  | 6,845 |  |  |  | 5,244 |  |  | 15,552 |  |  |  | 13,240 |  |  |
| Income before income taxes |  | 12,507 |  |  |  | 95,939 |  |  | 154,082 |  |  |  | 217,177 |  |  |
| Provision for income taxes |  | 6,461 |  |  |  | 12,584 |  |  | 34,438 |  |  |  | 32,776 |  |  |
| Income before change in accounting principle |  | 6,046 |  |  |  | 83,355 |  |  | 119,644 |  |  |  | 184,401 |  |  |
| Cumulative effect of change in accounting principle, net of tax effect |  | — | |  |  | — | |  | 8,846 |  |  |  | — | |  |
| Net income | $ | 6,046 |  |  | $ | 83,355 |  | $ | 128,490 |  |  | $ | 184,401 |  |  |
| Basic income per share: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Income before change in accounting principle | $ | 0.01 |  | $ | | 0.15 |  | $ | 0.20 |  | $ | | 0.33 |  |  |
| Cumulative effect of change in accounting principle, net of tax effect |  | — | |  |  | — | |  | 0.02 |  |  |  | — | |  |
| Basic net income per share | $ | 0.01 |  |  | $ | 0.15 |  | $ | 0.22 |  |  | $ | 0.33 |  |  |
| Shares used in basic per share computation |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 587,348 |  |  |  | 567,310 |  |  | 585,728 |  |  |  | 562,243 |  |  |
| Diluted income per share: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Income before change in accounting principle | $ | 0.01 | | $ | | 0.13 | | $ | 0.19 | | $ | | 0.29 | |  |
| Cumulative effect of change in accounting principle, net of tax effect |  | — | |  |  | — | |  | 0.01 |  |  |  | — | |  |
| Diluted net income per share | $ | 0.01 |  |  | $ | 0.13 |  | $ | 0.20 |  |  | $ | 0.29 |  |  |
| Shares used in diluted per share computation |  | 628,104 |  |  |  | 632,424 |  |  | 633,718 |  |  |  | 626,673 |  |  |



(1) See Note 1 – Restatement of Consolidated Financial Statements

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

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

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Nine Months Ended** | | | | |  |
|  |  |  | **October 28,** | |  | **October 29,** |  |  |
|  |  |  | **2006** |  |  | **2005** |  |  |
|  |  |  |  |  |  | **(restated) (1)** |  |  |
| **Cash flows from operating activities:** |  |  |  |  |  |  |  |  |
| Net income | $ | | 128,490 |  | $ | 184,401 |  |  |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |  |  |  |  |  |  |
| Cumulative effect of change in accounting principle, net |  |  | (8,846) | |  | — | |  |
| Depreciation and amortization |  |  | 52,519 |  |  | 41,840 |  |  |
| Stock-based compensation |  |  | 146,494 |  |  | 48,794 |  |  |
| Amortization of acquired intangible assets |  |  | 72,161 |  |  | 59,258 |  |  |
| Excess tax benefits from stock-based compensation |  |  | (889) | |  | — | |  |
| Changes in assets and liabilities, net of acquisitions: |  |  |  |  |  |  |  |  |
| Accounts receivable |  |  | (49,052) | |  | (52,383) | |  |
| Inventories |  |  | 10,306 |  |  | (21,040) | |  |
| Prepaid expenses and other assets |  |  | (51,790) | |  | (105,044) | |  |
| Accounts payable |  |  | 3,072 |  |  | 60,441 |  |  |
| Accrued liabilities and other |  |  | 13,772 |  |  | 3,358 |  |  |
| Accrued employee compensation |  |  | (767) | |  | 4,901 |  |  |
| Income taxes payable |  |  | 29,092 |  |  | 29,562 |  |  |
| Deferred income |  |  | 1,899 |  |  | 9,854 |  |  |
| Net cash provided by operating activities |  |  | 346,461 |  |  | 263,942 |  |  |
| **Cash flows from investing activities:** |  |  |  |  |  |  |  |  |
| Cash paid in acquisitions |  |  | (282,978) | |  | — | |  |
| Purchases of short-term investments |  |  | (266,938) | |  | (490,811) | |  |
| Sales and maturities of short-term investments |  |  | 804,902 |  |  | 533,876 |  |  |
| Acquisition costs |  |  | (4,233) | |  | — | |  |
| Purchases of property and equipment |  |  | (121,412) | |  | (62,309) | |  |
| Purchases of technology licenses |  |  | (8,029) | |  | — | |  |
| Net cash provided by (used in) investing activities |  |  | 121,312 |  |  | (19,244) |  |  |
| **Cash flows from financing activities:** |  |  |  |  |  |  |  |  |
| Proceeds from the issuance of common stock |  |  | 36,035 |  |  | 65,732 |  |  |
| Principal payments on capital lease obligations |  |  | (13,687) | |  | (12,042) | |  |
| Excess tax benefits from stock-based compensation |  |  | 889 |  |  | — | |  |
| Net cash provided by financing activities |  |  | 23,237 |  |  | 53,690 |  |  |
| Net increase in cash and cash equivalents |  |  | 491,010 |  |  | 298,388 |  |  |
| Cash and cash equivalents at beginning of period |  |  | 348,431 |  |  | 166,471 |  |  |
| Cash and cash equivalents at end of period |  | $ | 839,441 |  | $ | 464,859 |  |  |
| **Supplemental cash flows information:** |  |  |  |  |  |  |  |  |
| Acquisition of property and equipment under capital lease obligations | $ | | 15,868 |  | $ | 19,797 |  |  |
| Long-term leased assets under construction |  | $ | 7,000 |  | $ | 14,750 |  |  |
| Elimination of deferred stock-based compensation due to adoption of FAS 123R |  |  |  |  |  |  |  |  |
| $ | 61,986 |  | $ | — |  |
|  |  |  |  |  |  |  |  |  |



(1) See Note 1 – Restatement of Consolidated Financial Statements

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

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**MARVELL TECHNOLOGY GROUP LTD.**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Note 1. Restatement of Consolidated Financial Statements**

*Background*

On about May 23, 2006, the Company’s Chief Executive Officer initiated a review of the Company’s past stock option granting practices. Then on May 25, 2006, the Board appointed a committee, chaired by and consisting solely of an independent and disinterested member of the Audit Committee who had no prior involvement in the stock option process, to conduct the internal review of the Company’s historical stock option practices and related accounting matters. This committee retained outside legal counsel at the time to assist with this internal review. In June and July 2006, this committee identified various stock option grants as having been potentially selected with the benefit of hindsight. During this time the Company was also named as a nominal defendant, and a number of the Company’s current and former directors and officers were named as defendants, in purported shareholder derivative actions.

During this time, the Company was informed that its outside legal counsel at the time could not represent both the independent committee and the Company, particularly if that independent committee was going to evaluate and address matters raised by the derivative actions. The Company’s Board met on July 19, 2006 and appointed a successor special committee, titled the Special Committee Regarding Derivative Litigation, to assume responsibility for the stock option review and to evaluate and address matters raised by the derivative action (the “Special Committee”). The same independent director continued as the sole member of the Special Committee and, after consideration of a number of firms, selected new, independent counsel to represent the Special

Committee. The Special Committee subsequently retained a second independent law firm (collectively “Independent Counsel”). Independent Counsel retained forensic accounting experts to assist in the internal review.

The Special Committee reported its preliminary findings on quantitative issues to the Audit Committee and the Board on September 28, 2006. Based on the report of the Special Committee, and upon the recommendation of management and the Audit Committee, the Board concluded on October 2, 2006, that the Company would need to restate historical financial statements to record additional non-cash charges for stock-based compensation expense related to past option grants and that the historical financial statements and all earnings press releases and similar communications issued by the Company relating to periods beginning on or after its initial public offering in June 2000 should no longer be relied upon. The Company reported these conclusions in a current report on Form 8-K filed on the same day.

On February 7, 2007, the former General Counsel of the U.S. subsidiary, Marvell Semiconductor, Inc. (“MSI”), who was a subject of the internal review, raised allegations regarding the independence of the sole member of the Special Committee. The Audit Committee thereafter formed a subcommittee consisting of the Chairman of the Audit Committee to investigate the matter. The subcommittee appointed a former federal judge to serve as independent reviewer for the subcommittee who in turn retained independent counsel. Although the independent reviewer made no findings as to the truth of the allegations themselves and expressed substantial doubt regarding the credibility of the allegations, he nevertheless concluded that the independent director should step down from the Special Committee to ensure compliance with the stringent independence standards developed by courts reviewing the independence of special litigation committees formed to assess the merits of shareholder derivative litigation. The subcommittee also found that the General Counsel violated the Company’s Code of Ethics and Business Conduct for not reporting the allegations timely. The subcommittee accepted the findings of the independent reviewer. The Company has since terminated the General Counsel for the violation. On March 30, 2007, the independent director resigned from the Special Committee and the Board appointed two independent non-director members to the Special Committee to continue the review of the Company’s historical stock option practices and related accounting matters, which action is permitted under the Company’s bye-laws. As a result, the Special Committee thereafter consisted of two non-directors.

On April 27, 2007, the Special Committee reported its findings to the Board of Directors and to the Implementation Committee, which consists of three independent members of the Board. The Implementation Committee was formed by the Board on April 26, 2007 to make such decisions and take such action as the committee determines to be appropriate in light of the Special Committee’s findings and recommendations. On May 8, 2007, the Company disclosed on Form 8-K the completion of the independent review.

*Findings of the Special Committee*

From the Company’s initial public offering through June 9, 2006 (the “Relevant Period”), option grants awarded to employees who were not then executive officers, as defined in Section 16 of the Securities Exchange Act of 1934, as amended (“Section 16

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Officers”), were awarded either by the Board of Directors or the Stock Option Committee of the Board. The Stock Option Committee was formed by the Board of Directors in December 2000 and consisted of the Chief Executive Officer and the former Executive Vice President and Chief Operating Officer. Pursuant to authority delegated by the Board of Directors under Marvell’s 1995 Stock Option Plan, the Stock Option Committee was empowered to act jointly. The Stock Option Committee awarded all grants to non-executive employees after its formation until June 9, 2006.

The Special Committee concluded that only one member of the Stock Option Committee was actively involved in the grant approval process. Of the 59 minutes of meetings of the Stock Option Committee, all of which were prepared by or under the direction of the former General Counsel of MSI, only the first set of minutes were separately prepared for each member’s signature and signed by each of them; subsequently the minutes were only prepared for one member to sign and only one member signed those minutes. Additionally, the Special Committee determined that the Stock Option Committee conducted no meetings with respect to option grants and that minutes reflecting such meetings were false.

The Special Committee determined that in a substantial number of instances grant dates were chosen by management with the benefit of hindsight, so as to provide exercise prices lower than the fair market value on the actual measurement date.

In addition to the foregoing, the review determined that false employee-related paperwork was employed to reflect start dates that preceded the actual first day of employment, and to reflect secondary grant authorizations as if they occurred on dates prior to the original grant date, which facilitated giving the employees favorable prices.

From the Company’s initial public offering in June 2000 through February 28, 2002, grants to the former Chief Financial Officer were awarded only by the Stock Option Committee. The Stock Option Committee was not advised that it lacked the authority to make such awards. Furthermore, the first award made to the former Chief Financial Officer by the Executive Compensation Committee dated October 16, 2002 was backdated and the Special Committee found that the former General Counsel misled the Executive Compensation Committee with respect to the facts and circumstances surrounding the grant, including the grant date.

During the Relevant Period, option grants to Section 16 Officers and members of the Board of Directors were approved by the Board of Directors or the Executive Compensation Committee or made pursuant to the Automatic Director Grant Program under the 1997 Director’s Stock Option Plan. In the absence of a meeting, grant approvals by the Executive Compensation Committee were documented via written consents, which were dated “as of” a specified date but signed at a later time. The Executive Compensation Committee comprised three to four independent members of the Board over the Relevant Period. The Special Committee found that current board members who had served or are serving on the Executive Compensation Committee had not engaged in impropriety or intentional backdating with the benefit of hindsight.

The Special Committee found evidence of recommendations made by representatives of Human Resources and Finance and the Company’s external auditors between 2000 and 2004 to grant options on fixed grant dates In August 2004, the Company implemented revisions to the Company’s stock the Company’s option grant processes and procedures for new hire and secondary grants that generally followed a fixed grant date schedule.

For the period from the Company’s initial public offering in June 2000 through June 2006, the Special Committee found a systemic failure in controls over the stock option process, and that corporate documents, including the Company’s SEC filings on Form 10-K and Form 10-Q, and proxy statements, were false in relation to the accounting and related disclosure covering stock option matters.

The Special Committee found that certain individuals had varying degrees of responsibility for the lack of controls and the inappropriate grant practices.

As to the following individuals, the Special Committee concluded among other things:

Matthew Gloss, MSI’s corporate counsel from April 2000 until February 2001 and thereafter its Vice President and subsequently, General Counsel until his termination in March 2007, failed to properly advise upper management, including Dr. Sutardja and Ms. Dai, about their responsibilities and duties regarding stock options and other financial filings. The minutes of the Stock Option Committee were prepared by or at the direction of Matthew Gloss. Mr. Gloss was also found to have misled the Executive Compensation Committee by creating false minutes and unanimous written consents including in one instance adding or directing the addition of a grant date to a unanimous written consent after that unanimous written consent was executed, or by creating minutes that were incomplete, inaccurate or misleading. He also failed to establish proper controls over the stock option process despite being on notice of various control problems.

George A. Hervey, MSI’s Vice President and Chief Financial Officer throughout the Relevant Period until his resignation in May 2007, failed to properly advise upper management, including Dr. Sutardja and Ms. Dai, about their responsibilities and duties regarding stock options and other financial filings. Mr. Hervey also was found to have been aware of awarding options to two employees prior to their start date. He also failed to establish a system of proper controls despite being on notice of repeated concerns

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raised by others regarding the stock option process. He signed inaccurate external documents, including the Company’s SEC filings and financial statements.

Weili Dai, the Company’s former Board member, who served as Executive Vice President and General Manager of the Communications Business Group from 1999 to April 2006 and thereafter also as Chief Operating Officer until she resigned from such positions in May 2007, played a central role in all Stock Option Committee grants. Ms. Dai participated in the selection of grant dates with the benefit of hindsight and signed false minutes and other employee related corporate documents. The Special Committee also found that she failed to establish proper internal controls and failed to exercise proper review and inquiry as an officer. Certain individuals involved in the process said that they did not feel able to provide her with frank advice. She signed inaccurate external documents, including 10 K’s and proxy statements. She did not personally benefit from any of the grants she approved.

Dr. Sehat Sutardja, the Company’s Chairman of the Board, President and Chief Executive Officer, was found to have had a limited role in the stock option process and to have participated in only a few instances in awards with incorrect measurement dates with respect to which he had received no or inadequate advice. He signed inaccurate external documents, including the Company’s SEC filings, financial statements, and proxy statements. The Special Committee found that he failed to establish proper internal controls and that certain individuals involved in the process to some extent did not feel able to provide him with frank advice. He did not personally benefit from any of the grants he approved.

*Remediation*

With respect to the following employees, the Special Committee made recommendations, and Marvell’s Implementation Committee has implemented or is in the process of implementing the following remedial steps:

The Company accepted the resignation of George A. Hervey on May 2, 2007. All unvested stock options previously awarded to him were cancelled.

The Implementation Committee of the Board of Directors determined, contrary to the recommendation of the Special Committee, that Ms. Dai have no continuing role with the Company, that retaining the services of Ms. Dai in a substantially reduced capacity as Director of Strategic Marketing and Business Development, an individual contributor in a non-managerial role, and under the auspices of the Implementation Committee better serves the interests of all shareholders. Ms. Dai will have no authority to undertake any decisions affecting internal controls or financial matters of the Company. The Implementation Committee will provide periodic compliance updates to the Board of Directors on Ms. Dai’s activities. Additionally, all of Ms. Dai’s outstanding options that were unvested as of May 6, 2007 have been cancelled and the exercisability of already vested options have been limited, notwithstanding her continued employment.

Dr. Sehat Sutardja will remain as President and Chief Executive Officer and as a member of the Board, but will step down as Chairman of the Board in favor of a non-executive Chairman. Dr. Sutardja agreed to reduce the number of shares received in his December 26, 2003 option grant by 500,000 pre-split shares (2,000,000 post-split shares), which is the amount of underlying shares mistakenly awarded by the Executive Compensation Committee in excess of that authorized under the applicable stock option plan.

In April 2007, the Stock Option Committee was formally dissolved; however, it ceased to function during June 2006 and has granted no options since that time. Currently, the Executive Compensation Committee, comprising two independent Board members, holds periodic meetings to approve equity award grants. The process requires that any proposed equity awards be reviewed in advance by the Human Resources, Legal, Finance and Internal Audit Departments, and requires communication of the details of proposed equity awards to committee members prior to each monthly meeting, as well as awarding recipients promptly after the meeting. Equity awards are priced and valued based upon the closing price of our common stock on the date of the meeting. Decisions of the committee meeting are documented by minutes. Additionally, the Executive Compensation Committee adopted a policy regarding the granting of equity-based compensation awards. Following the Special Committee’s recommendations, we are conducting a search for a new Chief Operating Officer, Chief Financial Officer, General Counsel and Vice President of Compliance. Additionally, the Board’s Governance Committee is conducting a search for three new independent directors to fill existing vacancies. One of these independent directors will succeed Dr. Sutardja as Chairman of the Board.

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***Pre-tax Financial Impact of the Equity Award Review***

Approximately 74% of shares granted during the Relevant Period were backdated or resulted in additional accounting charges. Of these re-measured grants, the stock prices on the original grant date were lower than the prices on the appropriate measurement dates for 97% of such shares. Substantially all

options granted (99% of shares granted during the Relevant Period) have been evaluated for appropriate re-measurement dates under Accounting Principles Board Opinion No. 25 “Accounting for Stock Issued to Employees” (“APB 25”).

The types of grant discrepancies uncovered by the internal review (by both the Special Committee and management) and the additional pre-tax stock-compensation expense arising from these adjustments, quantified under APB 25 for periods through fiscal 2006, are summarized as follows (in thousands):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Cumulative** | |  | **Year Ended** | |  | **Year Ended** | |  | **Year Ended** | | | **Year Ended** | | |  | **Year Ended** | | | **Year Ended** | | |  |
|  |  |  | **through** |  |  |  |  | **January 27,** | | |  |
|  |  | **January 28,** | |  | **January 28,** | |  | **January 29,** | |  | **January 31,** | | | **February 1,** | | |  | **February 2,** | | |  | **2001 and** | |  |
|  |  |  | **2006** |  |  | **2006** |  |  | **2005** |  |  | **2004** |  |  | **2003** |  |  |  | **2002** |  |  | **prior** | |  |
| Board of Director |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Grants (a) | $ | | 1 | $ | | 1 | $ | | — | $ | | — | | $ | — | | $ | | — | | $ | — | |  |
| Officer Grants (b) |  |  | 19,577 |  |  | 6,317 |  |  | 12,023 |  |  | 836 |  |  | 270 |  |  |  | 127 |  |  | 4 |  |  |
| Re-priced Officer |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Grants (c) |  |  | 39,658 |  |  | 24,827 |  |  | 9,888 |  |  | 4,943 |  |  | — | |  |  | — | |  | — | |  |
| New Hire Grants – |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| effective hire dates (d) |  |  | 19,879 |  |  | 249 |  |  | 1,530 |  |  | 2,729 |  |  | 4,754 |  |  |  | 7,278 |  |  | 3,339 |  |  |
| Other New Hire (e) |  |  | 49,876 |  |  | 5,313 |  |  | 13,235 |  |  | 13,437 |  |  | 10,322 |  |  |  | 7,061 |  |  | 508 |  |  |
| Secondary Grants (e) |  |  | 18,165 |  |  | 2,360 |  |  | 3,713 |  |  | 3,016 |  |  | 4,432 |  |  |  | 3,975 |  |  | 669 |  |  |
| Re-priced New Hire Grants |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| (f) |  |  | 100,575 |  |  | 49,798 |  |  | 23,727 |  |  | 25,254 |  |  | (1,885) | |  |  | 3,681 |  |  | — | |  |
| Evergreen Grants (g) |  |  | 60,838 |  |  | 9,870 |  |  | 11,082 |  |  | 12,634 |  |  | 17,911 |  |  |  | 9,312 |  |  | 29 |  |  |
| Non-employee |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Grants \* (h) |  |  | 8,800 |  |  | 121 |  |  | 486 |  |  | 1,166 |  |  | (264) | |  |  | 1,884 |  |  | 5,407 |  |  |
| Termination related |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| charges (i) |  |  | 10,006 |  |  | — |  |  | — |  |  | — | |  | — | |  |  | — | |  | 10,006 |  |  |
|  |  | $ | 327,375 |  | $ | 98,856 |  | $ | 75,684 |  | $ | 64,015 |  | $ | 35,540 |  |  | $ | 33,318 |  | $ | 19,962 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |



\*The restated financial statements include charges for non-employee grants of $1,062,000 for fiscal 2000, $139,000 for fiscal 1999, $41,000 for fiscal 1998, $12,000 for fiscal 1997 and $1,000 for fiscal 1996.

1. *Board of Director Grants:* Non-employee directors receive initial and annual grants in their capacity as directors. A grant of 24,000 shares to a non-employee director, issued on an annual general meeting date in accordance with the terms of his appointment letter, was outside the 1997 Directors’ Stock Option Plan and therefore required approval from the Board. The Board approval was obtained at a later date. For accounting purposes, the grant was re-measured based on the Company’s stock price at the date of the Board’s ratification.

In December 2006, the terms of this option were reformed to reflect the revised stock option exercise price.

1. *Officer Grants:* During the Relevant Period, the Company granted options on 13 different dates (including the Re-priced Officer Grants) to the then-Section 16 Officers — Dr. Sehat Sutardja, Weili Dai, Dr. Pantas Sutardja and George Hervey. The Company recorded additional compensation costs for one grant on December 26, 2003 (which represents 75% of options granted) for three of the officers who were also founders of the Company (“Founder Officers”) and six grants (which represents 96% of options granted) for George Hervey. For accounting purposes, the grant of 12,640,000 shares to the Founder Officers was re-measured based on the stock price at the date the Executive Compensation Committee meeting occurred to approve the grants. Grants to George Hervey totaling 1,279,892 shares of options originally

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priced at the “as of” dates of the written consents have been re-measured to the last documented date of approval received from members of the Executive Compensation Committee.

In December 2006, the terms of the options deemed to have been issued at a discount were reformed to reflect the revised stock option exercise prices for all affected Section 16 Officer grants. Of these 5.4 million reformed options, the Company received from the Officers the incremental exercise prices for the portion of these options which had previously been exercised totaling $9.6 million. The reformation of these options did not result in incremental compensation cost in the fourth quarter of fiscal 2007.

The amounts above do not include $7.5 million in unrecognized stock-based compensation that will be recorded in the second quarter of fiscal 2008 in connection with the cancellation of certain officer grants to Dr. Sehat Sutardja and Weili Dai.

1. *Re-priced Officer Grants:* The minutes of the May 22, 2002 Executive Compensation Committee meeting reflect the Executive CompensationCommittee’s approval of a grant to the Founder Officers totaling 1.6 million shares, to be effective on the execution of a unanimous written consent. In June 2002, the Executive Compensation Committee members executed a unanimous written consent dated June 6, 2002 and effective as of May 22,

2002. The Special Committee found that on September 10, 2002 after the former General Counsel had a discussion with two of the Founder Officers who indicated that the setting of the price as of May 22, 2002 was inaccurate, the grant was repriced to the fair market value on June 6, 2002. The Special Committee found that the former General Counsel had misled the Executive Compensation Committee as to the reasons for the change. The Special Committee further found that the amendment was falsely characterized as a documentation error rather than a grant modification. While the affected options were not considered to be issued at a discount on the date of the modification, these shares were subject to variable accounting until the Company’s adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123R”) at the beginning of fiscal 2007.

1. *New Hire Grants – effective hire dates:* The internal review identified that 4,669,200 of options to 30 new hire recipients which required revision toreflect a later date. In all cases, the stock price on the original grant date was lower than the price on the appropriate measurement date. For accounting purposes, the new hire start dates had to be reconstructed through payroll records and evaluated to determine appropriate re-measurement dates.

1. *Other New Hire and Secondary Grants:* In addition to grants issued to new hires at the commencement of their employment, the Company occasionallyissues secondary grants to employees for outstanding performance, retention or other discretionary reasons outside of the annual performance review cycle. During the Relevant Period, the Company granted new hire and secondary options on 86 different dates, excluding assumption of acquisition-related options. These dates included grants made from August 2004 onwards when a fixed grant date schedule was set on the first Friday of each month. As a result of the internal review, the Company recorded additional compensation costs for grants relating to 37 different grant dates, impacting approximately two-thirds of the new hire and secondary grants (totaling 48,708,478 options). The original grant date with respect to such grants preceded the appropriate measurement date and in substantially all instances, the stock price on the former date was lower than the price on the appropriate measurement date. Generally, the terms of new hire grants, except for their exercise prices, are stated in employee offer letters which are acknowledged by employees. For new hire grants, re-measurement dates were determined based on the first instance when the Stock Option Committee grant date was picked. For secondary grants, as there was no other reliable documentation available to support the measurement date, the Company applied the date the grant was submitted to stock administration for processing, which typically indicated the conclusion of the grant process. The last date of submission was used unless the submitted change was proven to be purely administrative in nature and unrelated to the terms of the grant. Absent such submission documentation, the Company used the date the grant entry was created in the option database, as this was the most objectively verifiable date when the terms of the grant were known, in accordance with the SEC Chief Accountant’s letter issued on September 19, 2006, outlining the SEC staff’s interpretation of specific accounting guidance for registrants under APB 25.
2. *Re-priced New Hire Grants:* Of the New Hire grants in the Relevant Period, grant prices were constructively re-set for a segment of grants on three grantdates. Consequently, affected awards totaling 6,224,200 options were subject to variable accounting until the Company’s adoption of SFAS 123R. The re-pricing resulted from the Stock Option Committee’s originally designated grant date being modified to a later grant date.
3. *Evergreen Grants:* During the Relevant Period, there were eight Evergreen grant dates. Substantially all employees are entitled to these grants forretention purposes. There were two Evergreen grant dates in

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both fiscal 2003 and 2004. There was evidence of amendments to the recipients and / or the number of options subsequent to the original grant date. In all cases, the definitive lists of award recipients could not be reasonably determined, until after the original grant date impacting 54,702,828 options. Consequently, all Evergreen grants were re-measured on subsequent dates when the granting process was considered to be finalized. For purposes of the restatement, the Company used the date the grant was submitted to stock administration for processing, which typically indicated the conclusion of the grant process. The last date of submission was used unless the submitted change was proven to be purely administrative in nature and unrelated to the terms of the grant. Absent this supporting documentation, the date the grant entry was created in the option database was used. In substantially all instances, the stock price on the former date was lower than the price on the appropriate measurement date. The last evergreen grant (totaling 7,215,056 options) occurred during fiscal 2007 and the effects on the restatement were included in the restated fair value of the affected grants under SFAS 123R, increasing the grant date fair value of affected options by $0.31 per share.

1. *Non-employee Grants:* Since the inception of the Company, 3,819,000 options were granted to 13 recipients who were not employees or directors of theCompany. These grants were erroneously accounted for under APB 25 as if they had been made to employees. Of these four recipients that were granted a total of 1,483,000 options subsequently became employees or directors of the Company. As a result, the affected awards were accounted for as non-employee grants under EITF 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services, which resulted in the application of variable accounting on these options until exercised or cancelled. Options held by consultants who became employees or directors of the Company have been accounted for under FASB Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, which addresses a change in grantee status.
2. *Termination-related charges:* With respect to option grants to an employee, the post-service exercise period for 605,332 vested stock options waseffectively extended by an unpaid leave of absence arrangement which appears to have lacked substance. The Company applied APB 25 as if the leave of absence arrangement was a constructive modification extending the exercise period of vested awards. The Company recorded $10.0 million in additional deferred compensation charges in fiscal 2001.

Notwithstanding the foregoing, the lack of conclusive evidence in the case of certain grants required management to apply significant judgment in establishing revised measurement dates. The Company determined that the total cumulative, pre-tax, non-cash, stock-based compensation expense resulting from revised measurement dates under APB 25 was $327.4 million for periods through fiscal 2006. There was no impact on revenue. The Company adopted SFAS 123R at the beginning of fiscal 2007.

*Tax Impact of the Equity Award Review and Other*

The majority of the additional $327.4 million stock option compensation is expensed on the financial statements of the entities located in tax jurisdictions having a lower tax rate than that of the U.S. The tax benefits associated with all but $12.0 million of the $327.4 million total expense is recorded in Bermuda at zero percent tax rate. The $12.0 million of compensation expense and associated tax benefits have resulted in a cumulative deferred tax asset of

$2.5 million as of January 28, 2006 and a deferred provision benefit of $4.8 million. The tax impact of the adjustments arising from the equity award review is summarized as follows (in thousands):

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|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Cumulative** | | | **Year Ended** | | | **Year Ended** | | | **Year Ended** | |  | **Year Ended** | | | **Year Ended** | |  | **Year Ended** | | |  |
|  |  | **through** | |  |  |  |
|  | **January 28,** | | | **January 28,** | | | **January 29,** | | | **January 31,** | |  | **February 1,** | | | **February 2,** | |  | **January 27,** | | |  |
|  |  | **2006** |  |  | **2006** |  |  | **2005** |  |  | **2004** |  |  | **2003** |  |  | **2002** |  |  | **2001** |  |  |
| Operating costs and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| expenses - Payroll |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| tax\* (a) | $ | 7,628 |  | $ | 4,384 |  | $ | 2,306 |  | $ | 921 | $ | | 17 |  | $ | — | $ | | — | |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Provision for income tax – |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Deferred Income Tax |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Benefit (b) |  | (4,806) | |  | (1,822) | |  | (1,150) | |  | (1,170) | |  |  | (405) | |  | (259) | |  |  | — | |  |
| Provision for income tax – |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Section 162(m) and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| utilization of deferred |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| tax assets\*\* (c) |  | 27,206 |  |  | 27,206 |  |  | — |  |  | — |  |  |  | — |  |  | — |  |  |  | — |  |  |
| Tax Impact of the | $ | 30,028 |  | $ | 29,768 |  | $ | 1,156 |  | $ | (249) | | $ | | (388) | | $ | (259) | | $ | | — | |  |
| Equity Award Review |  |  |  |  |
| Reduction to deferred tax |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| asset for exemption | $ | 5,275 |  | $ | 3,249 |  | $ | 2,026 |  |  | — | |  |  | — | |  | — | |  |  | — | |  |
| benefit (d) |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |



* $3.0 million of additional employer and employee withholding taxes relating to exercises of affected options, including penalty and interest, and $24.2 million of Section 409A expenses of employees, including penalties and interest was also recorded in fiscal 2007.

\*\* $4.9 million of penalty and interest associated with Section 162(m) liability was also recorded in fiscal 2007.

1. *Payroll Tax -* The revised measurement dates for certain stock options as discussed in this filing may result in adverse federal and state tax consequencesto holders of those options under IRC Section 409A which was enacted in 2004 to impose certain restrictions on deferred compensation arrangements. The adverse tax consequences are that Section 409A may subject the option holder of the re-measured retroactively priced stock options to a penalty tax and interest on the exercise of the options vesting after December 31, 2004. In addition to similar penalty taxes and interest under California and other state income tax laws upon the exercise of the option grant will apply.
   * *Exercised options*. The option grants had been originally issued as incentive stock options. Due to the re-measurement caused by the re-pricing, theyhave become non-statutory stock options. The Company has accrued employment taxes for the exercise in each of the years due to the conversion of the options from incentive to non-statutory. Included in the restated results through fiscal 2006 are additional employer and employee withholding taxes relating to exercises of affected options totaling $7.6 million, including penalties and interest. The amounts represent additional compensation expense and have been classified in their respective functional categories. On a calendar year basis the amounts total: calendar 2003 of $0.8 million, calendar 2004 of $1.9 million, calendar 2005 of $3.7 million, and calendar 2006 of $4.2 million. The above table reflects the amounts on a fiscal year basis. The full amount of compensation, taxes, interest and penalties has been accrued as reflected above as well as in fiscal 2007. The total amount accrued through fiscal 2007 is $10.6 million.
   * *Section 409A*

The Company has informed employees who exercised options in 2006 that any additional tax costs accruing to such employees from Section 409A, ISO disqualification, and employment taxes will be reimbursed by us and grossed up. For the Section 409A affected options exercised during calendar year 2006, the IRS issued guidelines that would allow employers to enter into a global settlement of Section 409A issues on behalf of their employees. California and other states have offered a similar program. This liability does not appear in the above table, but has been accrued in fiscal year 2007 as explained in the remainder of this section.

Because all holders of re-measured stock options generally were not involved in or aware of the retroactive pricing, the Board of Directors approved our plan to deal with the adverse tax consequences that may be incurred by the holders of the re-measured options in the fourth quarter of fiscal 2007. Therefore, the Company recorded in the last quarter of fiscal

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2007 Section 409A expenses for the adverse tax consequences of the re-measured options exercised during calendar year 2006 of approximately $24.2 million, including estimated penalties and interest. The amount represents additional compensation expense and has been classified in the respective functional categories. The Company has sent timely notices to the IRS and the California Franchise Tax Board that it elected to participate in these programs.

* + *Unexercised options*. The IRS has provided taxpayers with the following two ways of correcting unexercised discounted stock options: 1) setting afixed exercise date; and 2) increasing the exercise price of the option up to the fair market price on the date of grant. The Company is actively evaluating these options. The discount associated with unexercised stock options outstanding as of January 27, 2007 amounted to $51.7 million. The Company has not determined the tax consequences associated with these potential future remedies.

1. *Deferred Tax Asset for Stock Based Compensation:* The Company recorded adjustments for the creation of additional deferred tax asset for stock basedcompensation that is deductible at later periods for U.S. income tax purposes on its balance sheets for year end dates of each of fiscal 2002 through fiscal 2006. As a result, additional benefits for income tax arising from stock based compensation was recognized in fiscal 2006 of $1.8 million, fiscal 2005 of $1.1 million, fiscal 2004 of $1.2 million, fiscal 2003 of $0.4 million and fiscal 2002 of $0.3 million. The total gross stock based compensation cost that results in a deferred tax benefit is $12.0 million of the total expense of $327.4 million.

In addition, the Company evaluated the impact of the restatement on its global tax provision. The Company and its subsidiaries file tax returns in multiple tax jurisdictions around the world. In the U.S. jurisdiction one of the company’s subsidiaries claims a tax deduction relative to stock options with regard to the U.S. distributor business. In accordance with FAS 123R for this jurisdiction where the deduction is claimed during fiscal 2007, the Company has recorded a deferred tax asset totaling $3.5 million at January 27, 2007, to reflect future tax deductions to the extent the company believes such asset is recoverable.

1. *Income Tax - Section 162(m) and utilization of deferred tax assets:* The Company has accrued for the current and deferred tax impact of $104.5 million ofnon-deductible officer compensation related to Internal Revenue Code Section 162(m) (“Section 162(m)”) in fiscal 2006. Section 162(m) limits the deductibility of compensation in excess of one million dollars, but exempts stock option compensation where the option was issued at fair market value

on the date of grant. The Company has determined that $104.5 million of executive compensation in fiscal 2006 does not meet the exclusion criteria under Section 162(m), under existing IRS interpretations, and have therefore accrued $21.8 million of current tax expense and $5.4 million of deferred tax expense associated with the utilization of net operating losses. The Company has accrued the penalty and interest totaling $4.9 million associated with this liability in fiscal 2007.

1. *Other:* The Company recorded adjustments to correct an overstatement of deferred tax asset related to the Singapore entity. The original deferred taxasset had not reflected the benefit of the Pioneer status of this entity.

***Accumulated Deficit Impact of Equity Award Review and Other Tax Adjustments***

The table below reflects the breakdown by year of the cumulative adjustment to retained earnings. The consolidated financial statements for periods through fiscal 2006 included in previously filed periodic reports with the SEC for such periods have not been amended. The consolidated financial statements, included in this Form 10-Q, have been restated as follows (in thousands):

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Fiscal 2000 and prior \*

Fiscal 2001

Fiscal 2002

Fiscal 2003

Fiscal 2004

Cumulative effect at

January 31, 2004

Fiscal 2005

Fiscal 2006:

Three months ended April 30, 2005

Three months ended July 30, 2005 Three months ended October 29,

2005

Three months ended January 28, 2006

Total for Fiscal 2006

Cumulative effect at January 28, 2006

Three months ended April 29, 2006

Cumulative effect at April 29, 2006



|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Cumulative** | | | | |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Section** | |  |  |  |  | **effect of** | | | |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  | **Estimated** | | |  | **Additional** | | |  |  | **Additional** | | |  |  |  |  |  |  | **change in** | | | | |  |  |  |  |  |  |  |  |  |  |
|  |  |  | **Stock-based** | | | |  |  |  |  |  |  | **162(m) and** | | | | | | **accounting** | | | | |  |  |  | **Total** | | |  |  |  |  |
|  |  |  |  | **additional** | | |  | **deferred** | | |  |  |  | **deferred** | |  |  |  | **utilization** | | | | | **principle,** | | | | |  |  |  |  |  |  |  |
|  |  |  | **compensation** | | | |  | **payroll tax** | | |  | **income tax** | | |  |  | **income tax** | | |  |  |  | **of deferred** | | | | | **net of tax** | | | | | **Adjustments,** | | | | | |  |  |  |  |
|  |  |  | **expense** | | | |  | **expense** | | |  |  | **benefit** | |  |  | **provision** | | |  |  |  | **tax assets** | | | | |  |  | **effect** | | |  |  | **net of tax** | | | |  |  |  |  |
|  |  |  | $ |  |  | 1,255 |  | $ |  | — |  | $ |  |  | — |  | $ |  |  | — |  | $ |  |  | — |  | $ |  |  | — |  | $ |  |  |  | 1,255 |  |  |  |  |  |  |
|  |  | 18,707 | | | | |  |  |  | — |  |  |  |  | — | | | | | — | | |  |  | — | | |  |  | — | | |  |  |  | 18,707 |  |  |  |  |  |  |
|  |  | 33,318 | | | | |  |  |  | — |  |  | (259) | | | |  |  |  | — | | |  |  | — | | |  |  | — | | |  |  |  | 33,059 |  |  |  |  |  |  |
|  |  | 35,540 | | | | |  |  |  | 17 |  |  | (405) | | | |  |  |  | — | | |  |  | — | | |  |  | — | | |  |  |  | 35,152 |  |  |  |  |  |  |
|  |  |  | 64,015 | | | |  |  |  | 921 |  |  | (1,170) | | | |  |  |  | — | | |  |  | — | | |  |  | — | | |  |  |  | 63,766 |  |  |  |  |  |  |
|  |  |  |  |  |  | |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  | 152,835 | | | |  |  |  | 938 |  |  | (1,834) | | | |  |  |  | — | | |  |  | — | | |  |  | — | | |  |  |  | 151,939 |  |  |  |  |  |  |
|  |  | **Net income** | | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Net income** |  |
|  |  | **as reported** | | | |  | 75,684 | |  |  | 2,306 | |  |  | (1,150) | | | |  | 2,026 | | |  |  |  | — | |  |  | — | | |  |  |  | 78,866 | |  |  |  | **as restated** |  |
|  | $ | 141,661 | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | $ | 62,795 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | — | | |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  | 8,719 | |  |  | 866 | |  |  |  |  | — | | |  | — | |  |  |  | — | |  |  | — | | |  |  |  | 9,585 | |  |  |  |  |  |
|  |  |  |  |  |  |  | 29,120 | |  |  | 1,083 | |  |  |  |  | — | | |  | — | |  |  |  | — | |  |  | — | | |  |  |  | 30,203 | |  |  |  |  |  |
|  |  |  |  |  |  |  | 9,102 | |  |  | 589 | |  |  |  |  | — | | |  | — | |  |  |  | — | |  |  | — | | |  |  |  | 9,691 | |  |  |  |  |  |
|  |  | 331,363 | |  |  |  | 51,915 | |  |  | 1,846 | |  |  | (1,822) | | | |  | 3,249 | | |  |  | 27,206 | | |  |  | — | | |  |  |  | 82,394 | |  |  |  | 199,490 |  |
|  |  |  |  |  | 98,856 | |  |  | 4,384 | |  |  | (1,822) | | |  |  | 3,249 | | |  |  | 27,206 | | |  |  | — | |  |  |  |  | 131,873 | |  |  |  |  |
|  |  |  |  |  |  | 327,375 | | |  |  | 7,628 | |  |  | (4,806) | | | |  | 5,275 | | |  |  | 27,206 | | |  |  | — | | |  |  |  | 362,678 | |  |  |  |  |  |
|  |  | 75,297 | |  |  |  | 4,225 | |  |  | 2,170 | |  |  | (3,325) | | | |  |  | — | |  |  | 3,510 | | |  |  | (8,846) | | |  |  |  | (2,266) | | |  |  | 77,563 |  |
|  |  |  | |  |  |  | | |  |  |  | |  |  |  | | |  |  |  | | |  |  |  | | |  |  |  | |  |  | |  |  | |  |  |  |  |  |
|  |  | $ | | | | 331,600 | | |  | $ | 9,798 | | $ | | (8,131) $ | | | | | 5,275 | | | $ | | 30,716 | | | $ | | (8,846) | | | $ | | | 360,412 | |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |



* Comprised $1,062,000 for fiscal 2000, $139,000 for fiscal 1999, $41,000 for fiscal 1998, $12,000 for fiscal 1997 and $1,000 for fiscal 1996. 15



The restatement adjustments reduced previously reported basic net income per share by $0.24 and $0.14 for fiscal 2006 and 2005, respectively and diluted net income per share by $0.20 and $0.13 for fiscal 2006 and fiscal 2005, respectively.

***Cashflows Impact of Equity Award Review***

The additional payable for payroll taxes associated with these stock option grants of approximately $10.6 million, additional Section 409A expenses for the adverse tax consequences of the re—measured options exercised during calendar year 2006 of approximately $24.2 million, and Section 162(m) liabilities of $26.5 million for cumulative period from fiscal 2001 through 2007, represents future cash outflows totaling $61.3 million.

The following tables present the impact of the financial statement adjustments on the previously reported Consolidated Statement of Operations for the three and nine months ended October 29, 2005:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Three Months Ended October 29, 2005** | | | |  |  |  | **Nine Months Ended October 29, 2005** | | | |  |  |
|  |  |  | **As** |  |  |  | **As** |  |  | **As** |  |  | **As** | |  |
|  |  |  | **Previously** |  | **Adjustments** |  |  |  | **Previously** |  | **Adjustments** |  |
|  |  |  | **Reported** |  |  | **Restated** |  |  | **Reported** |  | **Restated** | |  |
|  |  |  |  |  | **(In thousands, except per share amounts)** | | | | | |  |  |  |  |  |
| Net revenue | $ | | 426,026 | $ | — | $ | 426,026 | $ | | 1,181,250 | $ | — | $ 1,181,250 |  |  |
| Operating costs and expenses: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Cost of goods sold |  |  | 197,077 |  | 503(A) |  | 197,580 |  |  | 555,967 |  | 2,849(A) | 558,816 |  |  |
| Research and development |  |  | 77,689 |  | 5,354(A) |  | 83,043 |  |  | 222,751 |  | 26,347(A) | 249,098 |  |  |
| Selling and marketing |  |  | 21,634 |  | 1,495(A) |  | 23,129 |  |  | 63,898 |  | 7,392(A) | 71,290 |  |  |
| General and administrative |  |  | 9,029 |  | 2,804(A) |  | 11,833 |  |  | 24,107 |  | 14,744(A) | 38,851 |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Amortization of stock-based |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| compensation |  |  | 465 |  |  | (465)(A) | |  |  | — |  |  | 1,853 |  |  | (1,853)(A) | |  | — | |
| Amortization and write-off of goodwill |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| and acquired intangible assets and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| other |  |  | 19,746 |  |  | — | |  |  | 19,746 |  |  | 59,258 |  |  | — | |  | 59,258 |  |
| Total operating costs and expenses |  |  | 325,640 |  |  | 9,691 |  |  |  | 335,331 |  |  | 927,834 |  |  | 49,479 |  |  | 977,313 |  |
| Operating income (loss) |  |  | 100,386 |  |  | (9,691) |  |  |  | 90,695 |  |  | 253,416 |  |  | (49,479) |  |  | 203,937 |  |
| Interest and other income, net |  |  | 5,244 |  |  | — | |  |  | 5,244 |  |  | 13,240 |  |  | — | |  | 13,240 |  |
| Income (loss) before income taxes |  |  | 105,630 |  |  | (9,691) |  |  |  | 95,939 |  |  | 266,656 |  |  | (49,479) |  |  | 217,177 |  |
| Provision for income taxes |  |  | 12,584 |  |  | — | |  |  | 12,584 |  |  | 32,776 |  |  | — | |  | 32,776 |  |
| Net income (loss) |  | $ | 93,046 |  | $ | (9,691) |  |  | $ | 83,355 |  | $ | 233,880 |  | $ | (49,479) |  | $ | 184,401 |  |
| Basic net income (loss) per share |  | $ | 0.16 |  | $ | (0.01) |  |  | $ | 0.15 |  | $ | 0.42 |  | $ | (0.09) |  | $ | 0.33 |  |
| Diluted net income (loss) per share | $ | | 0.15 |  | $ | (0.02) | | $ | | 0.13 | $ | | 0.37 |  | $ | (0.08) | | $ | 0.29 |  |
| Weighted average shares — basic |  |  | 567,310 |  |  |  |  |  |  | 567,310 |  |  | 562,243 |  |  |  |  |  | 562,243 |  |
| Weighted average shares — diluted |  |  | 632,424 |  |  |  |  |  |  | 632,424 |  |  | 626,673 |  |  |  |  |  | 626,673 |  |



(A). Adjustments for additional stock-based compensation expense pursuant to APB 25 and reclassification of previously reported stock-based compensation expenses to the respective functional cost and expense line items.

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The following tables present the impact of the financial statement adjustments on the previously reported Consolidated Balance Sheets as of January 28, 2006:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **January 28, 2006** | |  |  |  |  |
|  |  |  | **As** | |  |  |  |  | **As** | |  |
|  |  |  | **Previously** | |  | **Adjustments** | |  |  |
|  |  |  | **Reported** | |  |  | **Restated** | |  |
|  |  |  | **(In thousands, except per share amounts)** | | | | | |  |  |  |
|  | **ASSETS** |  |  |  |  |  |  |  |  |  |  |
|  | Current assets: |  |  |  |  |  |  |  |  |  |  |
|  | Cash and cash equivalents | $ | 348,431 |  | $ | — | | $ | 348,431 |  |  |
|  | Short-term investments |  | 572,591 |  |  | — | |  | 572,591 |  |  |
|  | Accounts receivable, net of allowance of $3,028 |  | 245,164 |  |  | — | |  | 245,164 |  |  |
|  | Inventories |  | 211,374 |  |  | — | |  | 211,374 |  |  |
|  | Prepaid expenses and other current assets |  | 104,307 |  |  | — | |  | 104,307 |  |  |
|  | Deferred income taxes |  | 18,007 |  |  | (14,062)(B) | |  | 3,945 |  |  |
|  | Total current assets |  | 1,499,874 |  |  | (14,062) |  |  | 1,485,812 |  |  |
|  | Property and equipment, net |  | 260,921 |  |  | — | |  | 260,921 |  |  |
|  | Goodwill |  | 1,558,209 |  |  | — | |  | 1,558,209 |  |  |
|  | Acquired intangible assets, net |  | 111,973 |  |  | — | |  | 111,973 |  |  |
|  | Other non-current assets |  | 82,312 |  |  | 5,279(B) | |  | 87,591 |  |  |
|  | Total assets | $ | 3,513,289 |  | $ | (8,783) |  | $ | 3,504,506 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
| **LIABILITIES AND SHAREHOLDERS’ EQUITY** |  |  |  |  |  |  |  |  |  |  |
|  | Current liabilities: |  |  |  |  |  |  |  |  |  |  |
|  | Accounts payable | $ | 196,606 |  | $ | — | | $ | 196,606 |  |  |
|  | Accrued liabilities |  | 34,905 |  |  | — | |  | 34,905 |  |  |
|  | Accrued employee compensation |  | 51,549 |  |  | 7,628(C) | |  | 59,177 |  |  |
|  | Income taxes payable |  | 3,352 |  |  | 21,042(B) | |  | 24,394 |  |  |
|  | Deferred income |  | 29,773 |  |  | — | |  | 29,773 |  |  |
|  | Current portion of capital lease obligations |  | 16,563 |  |  | — | |  | 16,563 |  |  |
|  | Total current liabilities |  | 332,748 |  |  | 28,670 |  |  | 361,418 |  |  |
|  | Capital lease obligations, net of current portion |  | 24,447 |  |  | — | |  | 24,447 |  |  |
|  | Non-current income taxes payable |  | 85,126 |  |  | 1,419(B) | |  | 86,545 |  |  |
|  | Other long-term liabilities |  | 24,871 |  |  | — | |  | 24,871 |  |  |
|  | Total liabilities |  | 467,192 |  |  | 30,089 |  |  | 497,281 |  |  |
|  | Shareholders’ equity: |  |  |  |  |  |  |  |  |  |  |
|  | Preferred stock, $0.002 par value; 8,000 shares authorized; no shares issued and |  |  |  |  |  |  |  |  |  |  |
|  | outstanding |  | — | |  | — | |  | — | |  |
|  | Common stock, $0.002 par value; 992,000 shares authorized; 582,776 shares |  |  |  |  |  |  |  |  |  |  |
|  | issued and outstanding |  | 1,165 |  |  | — | |  | 1,165 |  |  |
|  | Additional paid-in capital |  | 3,249,587 |  |  | 384,652(A) | |  | 3,634,239 |  |  |
|  | Deferred stock-based compensation |  | (1,141) | |  | (60,846)(A) | |  | (61,987) | |  |
|  | Accumulated other comprehensive loss |  | (1,759) | |  | — | |  | (1,759) | |  |
|  | Accumulated deficit |  | (201,755) | |  | (362,678) | |  | (564,433) | |  |
|  | Total shareholders’ equity |  | 3,046,097 |  |  | (38,872) |  |  | 3,007,225 |  |  |
|  | Total liabilities and shareholders’ equity | $ | 3,513,289 |  | $ | (8,783 | ) | $ | 3,504,506 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |



(A). Adjustments for additional stock-based compensation expense pursuant to APB 25, net of tax benefit from employee stock transactions.

(B). Adjustments to deferred tax assets arising from the stock-based compensation charge.

(C). Adjustments for additional payroll taxes.

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The following tables present the impact of the financial statement adjustments on the previously reported Statements of Cash Flows for three and nine months ended October 29, 2005:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Nine Months Ended October 29, 2005** | | | | | | |  |  |  |
|  |  | **As** | |  |  |  |  |  | **As** | |  |
|  |  | **Previously** | |  | **Adjustments** | |  |  |  |
|  |  | **Reported** | |  |  |  | **Restated** | |  |
|  |  |  |  |  | **(In thousands)** | |  |  |  |  |  |
| **Cash flows from operating activities:** |  |  |  |  |  |  |  |  |  |  |  |
| Net income | $ | 233,880 |  | $ | (49,479) | | $ | | 184,401 |  |  |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |  |  |  |  |  |  |  |  |  |
| Depreciation and amortization |  | 41,840 |  |  | — | |  |  | 41,840 |  |  |
| Stock-based compensation |  | 1,853 |  |  | 46,941(A) | |  |  | 48,794 |  |  |
| Amortization of acquired intangible assets |  | 59,258 |  |  | — | |  |  | 59,258 |  |  |
| Changes in assets and liabilities, net of acquisition: |  |  |  |  |  |  |  |  |  |  |  |
| Accounts receivable |  | (52,383) | |  | — | |  |  | (52,383) | |  |
| Inventories |  | (21,040) | |  | — | |  |  | (21,040) | |  |
| Prepaid expenses and other assets |  | (105,044) | |  | — | |  |  | (105,044) | |  |
| Accounts payable |  | 60,441 |  |  | — | |  |  | 60,441 |  |  |
| Accrued liabilities and other |  | 3,358 |  |  | — | |  |  | 3,358 |  |  |
| Accrued employee compensation |  | 2,363 |  |  | 2,538(B) | |  |  | 4,901 |  |  |
| Income taxes payable |  | 29,562 |  |  | — | |  |  | 29,562 |  |  |
| Deferred income |  | 9,854 |  |  | — | |  |  | 9,854 |  |  |
| Net cash provided by operating activities |  | 263,942 |  |  | — |  |  |  | 263,942 |  |  |
| **Cash flows from investing activities:** |  |  |  |  |  |  |  |  |  |  |  |
| Purchases of short-term investments |  | (490,811) | |  | — | |  |  | (490,811) | |  |
| Sales and maturities of short-term investments |  | 533,876 |  |  | — | |  |  | 533,876 |  |  |
| Purchases of property and equipment |  | (62,309) | |  | — | |  |  | (62,309) | |  |
| Net cash provided by (used in) investing activities |  | (19,244) |  |  | — |  |  |  | (19,244) |  |  |
| **Cash flows from financing activities:** |  |  |  |  |  |  |  |  |  |  |  |
| Proceeds from the issuance of common stock |  | 65,732 |  |  | — | |  |  | 65,732 |  |  |
| Principal payments on capital lease obligations |  | (12,042) | |  | — | |  |  | (12,042) | |  |
| Net cash provided by financing activities |  | 53,690 |  |  | — |  |  |  | 53,690 |  |  |
| Net increase (decrease) in cash and cash equivalents |  | 298,388 |  |  | — |  |  |  | 298,388 |  |  |
| Cash and cash equivalents at beginning of period |  | 166,471 |  |  | — | |  |  | 166,471 |  |  |
| Cash and cash equivalents at end of period | $ | 464,859 |  | $ | — |  |  | $ | 464,859 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |



(A). Adjustments for additional stock-based compensation expense pursuant to APB 25.

(B). Adjustments for additional payroll tax.

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**Note 2. 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 is a leading global semiconductor provider of high-performance analog, mixed-signal, digital signal processing and embedded microprocessor integrated circuits. The Company’s diverse product portfolio includes switching, transceivers, wireless, PC connectivity, gateways, communications controllers, storage and power management solutions that serve diverse applications used in business enterprises, consumer electronics and emerging markets.

**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 years 2007 and 2006

comprised 52-weeks.

On February 21, 2006, the Board of Directors approved a 2 for 1 stock split of the Company’s common stock, to be effected pursuant to the issuance of additional shares as a stock dividend. The stock split was subject to shareholder approval of an increase in the Company’s authorized share capital at the Company’s 2006 Annual General Meeting. On June 9, 2006, shareholders at the Company’s 2006 Annual General Meeting approved an increase in the authorized share capital by 500 million shares of common stock. Stock certificates representing one additional share for each share held were delivered on July 24, 2006 (payment date) to all shareholders of record at the close of business on July 10, 2006 (record date). All share and per share amounts in these condensed consolidated financial statements and related notes have been retroactively adjusted to reflect the stock split for all periods presented.

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 except for the effect of the restatements as discussed in Note 1, necessary to fairly state the Company’s financial position as of October 28, 2006, the results of its operations for the three and nine months ended October 28, 2006 and October 29, 2005, respectively and its cash flows for the nine months ended October 28, 2006 and October 29, 2005, respectively. 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 Annual Report on Form 10-K for the year ended January 27, 2007 filed concurrently with this Form 10-Q. The results of operations for the three and nine months ended October 28, 2006 are not necessarily indicative of the results that may be expected for any other interim period or for the full fiscal year.

**Principles of consolidation**

The unaudited interim condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. The functional currency of the Company and its significant subsidiaries is the United States dollar.

**Use of estimates**

The preparation of unaudited interim condensed consolidated financial statements in conformity with generally accepted accounting principles in the United States (“GAAP”) requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to uncollectible receivables, the useful lives of long-lived assets including property and equipment, investment fair values, goodwill and other intangible assets, income taxes, and contingencies. In addition, the Company uses assumptions when employing the Black-Scholes option valuation model to calculate the fair value of stock-based awards granted. The Company bases its estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, when these carrying values are not readily available from other sources. Actual results may differ from these estimates.

**Revenue recognition**

The Company accounts for its revenues under the provisions of Staff Accounting Bulletin (“SAB”) No. 104, “Revenue Recognition in Financial Statements.” Under this provision, the Company recognizes revenues when there is persuasive evidence of an arrangement, delivery has occurred, the fee is fixed or determinable, and collection is reasonably assured.

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 and price protection is deferred until the distributors sell the product to end customers. The Company’s sales to direct customers are made primarily pursuant to standard purchase orders for delivery of products. The Company generally allows customers to cancel or change purchase orders with limited notice prior to the scheduled shipment dates and from time to time it also may request a customer to accept a shipment of product before the original requested delivery date, in which case revenue is not recognized until there is written

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confirmation from the customer accepting early shipment, delivery has occurred, the fee is fixed or determinable, and collection is reasonably assured. 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. Under these development agreements product revenue is recognized under the proportionate performance method. Revenue is recognized as related costs to complete the contract are incurred. These costs are included in research and development expense.

The provisions of EITF Issue No. 00-21 apply to sales arrangements with multiple arrangements that include a combination of hardware, software and /or services. For multiple element arrangements, revenue is allocated to the separate elements based on fair value. If an arrangement includes undelivered elements that are not essential to the functionality of the delivered elements, the Company defers the fair value of the undelivered elements and the residual revenue is allocated to the delivered elements. If the undelivered elements are essential to the functionality of the delivered elements, no revenue is recognized. Undelivered elements typically are software warranty and maintenance services.

In arrangements that include a combination of hardware and software products that are also sold separately, where software is more than incidental and essential to the functionality of the product being sold, the Company follows the guidance in EITF Issue No. 03-05, “Applicability of AICPA Statement of Position 97-2 to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software,” accounts for the entire arrangement as a sale of software and software-related items and follows the revenue recognition criteria in SOP No. 97-2, “Software Revenue Recognition,” and related interpretations.

Revenue from licensed software is recognized when persuasive evidence of an arrangement exists and delivery has occurred, provided that the fee is fixed and determinable and collectibility is probable. Revenue from post-contract customer support and any other future deliverables is deferred and earned over the support period or as contract elements are delivered.

**Research and development and other**

Research and development and other costs consist primarily of $148.9 million and $81.1 million of research and development costs for the three months ended October 28, 2006 and October 29, 2005, respectively, excluding costs related to patent investigation and filings for the three months ended October 28, 2006 and October 29, 2005 which were $4.0 million and $1.9 million, respectively.

Research and development and other costs consist primarily of $425.7 million and $244.0 million of research and development costs for the nine months ended October 28, 2006 and October 29, 2005, respectively, excluding costs related to patent investigation and filings for the nine months ended October 28, 2006 and October 29, 2005 which were $9.1 million and $5.1 million, respectively. Research and development and other costs are expensed as incurred.

**Inventories**

Inventories are 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.

**Warranty accrual**

The Company’s products are generally subject to warranty, which provides for the estimated future costs of repair, replacement or customer accommodation upon shipment of the product in the accompanying statements of operations. The Company’s products typically carry a standard 90-day warranty with certain exceptions in which the warranty period can range from one to five years. The warranty accrual is estimated based on historical claims compared to historical revenues and assumes that the Company will have to replace products subject to a claim. For new products, the Company uses a historical percentage for the appropriate class of product.

**Stock-based compensation**

Effective from January 29, 2006, the Company adopted FASB Statement of Financial Accounting Standards No. 123 (revised 2004), “Share Based Payment” (“SFAS 123R”). SFAS 123R requires the measurement and recognition of compensation expense for all share-based awards to employees and directors, including employee stock options, restricted stock units and employee stock purchase rights based on estimated fair values. SFAS 123R supersedes previous accounting guidance under Accounting Principles Board Opinion No. 25 “Accounting for Stock Issued to Employees” (“APB 25”) and related interpretations and amends SFAS No. 95, “Statement of Cash Flows.” Under SFAS 123R, the benefits of tax deductions in excess of recognized compensation cost has to be reported as a financing cash flow, rather than as an operating cash flow. This may reduce future net cash flows from operations and increase future net financing cash flows. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (“SAB 107”), which provides guidance regarding the interaction of SFAS 123R and certain SEC rules and regulations. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R.

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Prior to January 29, 2006, the Company accounted for its stock based compensation plans using the intrinsic value method under the provisions of APB 25 and related guidance, under the accelerated method of amortization.

The Company adopted SFAS 123R using the modified prospective method. Under the modified prospective method, results of operations include compensation costs of unvested options granted prior to January 29, 2006, and options granted subsequent to that date. For grants prior to January 29, 2006, the Company amortizes stock-based compensation expense under the accelerated method. For grants from January 29, 2006, the Company amortizes stock-based compensation expense ratably over the vest term.

***Cumulative Effect of Change in Accounting Principle***

The adoption of SFAS 123R resulted in a cumulative benefit from change in auditing principle of $8.8 million net of tax as of the year ended January 27, 2007, as restated, reflecting the net cumulative impact of estimated forfeitures that were previously not included in the determination of historic stock based compensation expense in periods prior to January 28, 2006.

As a result of the adoption of SFAS 123R, stock-based compensation increased from $9.6 million and $48.8 million in the three and nine months ended October 29, 2005, respectively to $42.1 million and $146.5 million in the three and nine months ended October 28, 2006, respectively. Stock-based compensation of $0.7 million was capitalized in inventory as of October 28, 2006. There was no stock-based compensation cost included in inventory as of January 28, 2006. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R.

Prior to the adoption of SFAS 123R, the Company presented deferred compensation as a separate component of shareholders’ equity. In accordance with the provisions of SFAS 123R, on January 29, 2006, unamortized deferred compensation totaling $62.0 million on that date was eliminated with a corresponding reduction in additional paid-in capital.

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 123(R)-3, “Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards” (FSP 123R-3). We have elected to adopt the alternative transition method provided in the FSP 123R-3 for calculating the tax effects of stock-based compensation pursuant to SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the APIC pool related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123R.

**Note 3. Supplemental Financial Information**

**Available-for-sale investments (in thousands)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  | **October 28, 2006** | | | | |  |  |  |  |
|  | **Amortized** | | |  | **Gross** | |  | **Gross** | | **Estimated** | | |  |
|  | **Unrealized** | | | **Unrealized** | | |  |
|  |  | **Cost** | |  | **Gains** | |  | **Losses** | | **Fair Value** | | |  |
| Corporate debt securities | $ | 3,588 |  | $ | — |  | $ | (70) |  | $ | 3,518 |  |  |
| Auction rate securities |  | 7,935 |  |  | — | |  | — | |  | 7,935 |  |  |
| U.S. Federal, State, county and municipal debt securities |  | 25,253 |  |  | — | |  | (475) | |  | 24,778 |  |  |
| Short-term investments | $ | 36,776 |  | $ | — |  | $ | (545 | ) | $ | 36,231 |  |  |

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|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **January 28, 2006** | | | | |  |  |  |  |
|  | **Amortized** | | |  |  | **Gross** |  |  | **Gross** | | **Estimated** | | |  |
|  |  | **Unrealized** | |  | **Unrealized** | | |  |
|  |  | **Cost** | |  |  | **Gains** |  |  | **Losses** | | **Fair Value** | | |  |
| Corporate debt securities | $ | 33,662 |  |  | $ | — |  | $ | (551) |  | $ | 33,111 |  |  |
| Auction rate securities |  | 438,615 |  |  |  | — |  |  | — | |  | 438,615 |  |  |
| U.S. Federal, State, county and municipal debt |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| securities |  | 107,414 |  |  |  | — |  |  | (1,592) | |  | 105,822 |  |  |
|  |  | 579,691 |  |  |  | — |  |  | (2,143) |  |  | 577,548 |  |  |
| Less amounts classified as cash equivalents |  | (4,957) | |  |  | — |  |  | — | |  | (4,957) | |  |
| Short-term investments | $ | 574,734 |  |  | $ | — |  | $ | (2,143 | ) | $ | 572,591 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |



Auction rate securities are securities that are structured with short-term reset dates of generally less than 90 days but with legally stated maturities in excess of 90 days. At the end of the reset period, investors can sell or continue to hold the securities at par. These securities are classified in the table below based on their legal stated maturity dates.

The contractual maturities of available-for-sale debt securities classified as short-term investments at October 28, 2006 are presented in the following table (in thousands):

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Amortized** | | |  | **Estimated** | | |
|  |  |  | **Cost** | |  | **Fair Value** | | |
| Due in one year or less |  | $ | 5,077 |  |  | $ | 5,022 |  |
| Due between one and five years |  |  | 23,763 |  |  |  | 23,274 |  |
| Due over five years |  |  | 7,936 |  |  |  | 7,935 |  |
|  |  | $ | 36,776 |  |  | $ | 36,231 |  |
|  |  |  |  |  |  |  |  |  |

Included in the Company’s available-for-sale investments are fixed income securities. As market yields increase, those securities with a lower yield-at-cost show a mark-to-market unrealized loss. All unrealized losses are primarily due to changes in interest rates and bond yields. Investments are reviewed periodically to identify possible other-than-temporary impairment. When evaluating the investments, the Company reviews factors such as the length of time and extent to which fair value has been below cost basis and the Company’s ability and intent to hold the investment for a period of time which may be sufficient for anticipated recovery in market value. The Company has the intent and ability to hold these securities for a reasonable period of time sufficient for a forecasted recovery of fair value up to (or beyond) the initial cost of the investment. The Company expects to realize the full value of all of these investments upon maturity or sale. The following table shows the investments’ gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position (in thousands):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  | **October 28, 2006** | | | | | | | |  |  |  |  |  |  |  |  |  |
|  |  |  | **Less than 12 months** | | | | |  |  | **12 months or more** | | | | | | | |  |  | **Total** | | |  |  |  |  |
|  |  |  | **Fair** | |  | **Unrealized** |  |  |  | **Fair** | |  |  |  | **Unrealized** | |  |  |  | **Fair** | |  | **Unrealized** |  |  |  |
|  |  |  | **Value** | |  | **Losses** | |  |  | **Value** | |  |  |  | **Losses** | | |  |  | **Value** | |  | **Losses** | |  |  |
| Corporate debt securities | | $ | — |  | $ | — |  | $ |  | 3,518 | |  |  | $ | (70) | |  |  | $ | 3,518 |  | $ | (70) |  |  |  |
| U.S. Federal, State, county and municipal debt | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| securities | |  | — | |  | — | |  |  | 24,778 | |  |  |  | (475) | | |  |  | 24,778 |  |  | (475) | |  |  |
| Total temporarily impaired securities | | $ | — |  | $ | — |  | $ |  | 28,296 | |  |  | $ | (545 | | ) |  | $ | 28,296 |  | $ | (545 | ) |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  | **January 28, 2006** | | | | | | | |  |  |  |  |  |  |  |  |  |
|  |  |  | **Less than 12 months** | | | | |  |  | **12 months or more** | | | | | | | |  |  | **Total** | | |  |  |  |  |
|  |  |  | **Fair** | |  | **Unrealized** |  |  |  | **Fair** | |  |  |  | **Unrealized** | |  |  |  | **Fair** | |  | **Unrealized** |  |  |  |
|  |  |  | **Value** | |  | **Losses** | |  |  | **Value** | |  |  |  | **Losses** | | |  |  | **Value** | |  | **Losses** | |  |  |
| Corporate debt securities | | $ | — |  | $ | — |  | $ |  | 28,154 | |  |  | $ | (551) | |  |  | $ | 28,154 |  | $ | (551) |  |  |  |
| U.S. Federal, State, county and municipal debt | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| securities | |  | 4,998 |  |  | (24) | |  |  | 100,824 | |  |  |  | (1,568) | | |  |  | 105,822 |  |  | (1,592) | |  |  |
| Total temporarily impaired securities | | $ | 4,998 |  | $ | (24 | ) | $ |  | 128,978 | |  |  | $ | (2,119 | | ) |  | $ | 133,976 |  | $ | (2,143 | ) |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  | 22 |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| **Inventories (in thousands)** | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  | **October 28,** | | |  | **January 28,** | | | | |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  | **2006** |  |  |  |  | **2006** |  |  |  |  |  |  |  |  |  |  |  |
|  | Work-in-process |  |  |  |  |  |  |  | $ | 90,172 |  |  | $ |  | 96,110 |  |  |  |  |  |  |  |  |  |  |  |
|  | Finished goods |  |  |  |  |  |  |  |  | 137,700 |  | 115,264 | | | |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  | $ 227,872 | |  |  | $ 211,374 | | |  |  |  |  |  |  |  |  |  |  |  |
| **Prepaid expenses and other current assets (in thousands)** | | | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  | **October 28,** | | |  | **January 28,** | | | | |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  | **2006** |  |  |  |  | **2006** |  |  |  |  |  |  |  |  |  |  |  |
|  | Prepayments for foundry capacity |  |  |  |  |  |  |  | $ | 37,820 |  |  | $ |  | 62,120 |  |  |  |  |  |  |  |  |  |  |  |
|  | Receivable from foundry |  |  |  |  |  |  |  |  | 22,649 |  |  |  |  | 19,512 |  |  |  |  |  |  |  |  |  |  |  |
|  | Other |  |  |  |  |  |  |  |  | 43,010 |  |  |  |  | 22,675 |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  | $ 103,479 | |  |  | $ 104,307 | | |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |



**Property and equipment (in thousands)**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **October 28,** | | **January 28,** | |
|  | **2006** |  | **2006** |  |
| **Property and equipment:** |  |  |  |  |
| Machinery and equipment | $ 200,355 |  | $ 142,320 |  |
| Computer software | 131,660 |  | 108,032 |  |
| Furniture and fixtures | 17,268 |  | 10,588 |  |
| Leasehold improvements | 10,709 |  | 9,292 |  |
| Buildings | 40,709 |  | 8,727 |  |
| Building improvements | 10,648 |  | 24,747 |  |
| Land | 51,500 |  | 51,500 |  |
| Construction in progress | 101,082 |  | 56,311 |  |
|  | 563,931 |  | 411,517 |  |
| Less: Accumulated depreciation and amortization | (197,200) | | (150,596) | |
|  | $ 366,731 |  | $ 260,921 |  |
|  |  |  |  |  |

**Purchased intangible assets (in thousands)**

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **As of October 28, 2006** | | | | | | |  |  |  | **As of January 28, 2006** | | | | | |  |  |  |
|  |  |  | **Gross** |  | **Accumulated** | | |  |  | **Net** |  |  | **Gross** |  | **Accumulated** | | |  | **Net** |  |  |
|  |  |  | **Carrying** |  |  |  | **Carrying** |  |  | **Carrying** |  |  | **Carrying** | |  |
|  |  |  | **Amount** |  | **Amortization** | | |  |  | **Amount** |  |  | **Amount** |  | **Amortization** | | |  | **Amount** | |  |
| Purchased |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| technology | $ | | 507,900 | $ | | (443,300) | | $ | | 64,600 | $ | | 437,415 | $ | | (400,980) | | $ | 36,435 |  |  |
| Core |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| technology |  |  | 71,900 |  |  | (13,892) | |  |  | 58,008 |  |  | 26,400 |  |  | (2,031) | |  | 24,369 |  |  |
| Trade name |  |  | 100 |  |  | (100) | |  |  | — |  |  | 100 |  |  | (100) | |  | — | |  |
| Supply contract |  |  | 900 |  |  | (155) | |  |  | 745 |  |  | — |  |  | — | |  | — | |  |
| Customer |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| contracts |  |  | 122,200 |  |  | (21,211) | |  |  | 100,989 |  |  | 54,400 |  |  | (3,231) | |  | 51,169 |  |  |
| Total intangible |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | $ | 703,000 | $ | | (478,658) | | $ | | 224,342 | $ | | 518,315 | $ | | (406,342) | | $ | 111,973 |  |  |
| assets |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

The increase in goodwill during third quarter of fiscal 2007 of $15.2 million was due to goodwill from the acquisitions of the UTStarcom Business (of $7.3 million) and the Avago Business (of $7.9 million).

The increase in purchased intangible assets during the nine months ended October 28, 2006 was from the acquisitions of the semiconductor division of UTStarcom, Inc., Avago Technologies Limited and other companies (see Note 4).

Identified intangible assets consist of purchased technology, core technology, supply contract and customer contracts and related relationships. Purchased technologies are amortized on a straight-line basis over their estimated useful lives ranging from one to five years. Core technologies are amortized on a straight-line basis over their estimated useful lives ranging from one to six years. The supply contract is amortized on a straight-line basis over its estimated useful life of four years. Customer contracts and related relationships are amortized on a straight-line basis over their estimated useful lives ranging from four to six years. The aggregate

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amortization expense of identified intangible assets was $27.4 million in the third quarter of fiscal 2007, $19.8 million in the third of quarter of fiscal 2006, $72.2 million in the first nine months of fiscal 2007 and $59.3 million in the first nine months of fiscal 2006. The estimated total amortization expenses of acquired intangible assets is $19.2 million for the remaining three months of fiscal 2007, $72.8 million for fiscal 2008, $66.9 million for 2009, $40.9 million for fiscal 2010, $18.1 million for fiscal 2011, $5.7 million for fiscal 2012, $0.7 million for fiscal 2013 and $0.1 million for fiscal 2014.

**Other long-term liabilities (in thousands)**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **October 28,** | |  | **January 28,** | | |  |
|  |  |  | **2006** |  |  | **2006** |  |  |
|  |  |  |  |  |  |  |  |  |
| Long-term facilities consolidation charge $ | | 2,362 | $ | | 2,896 |  |  |
|  | Accrued severance | | 16,992 |  |  | 13,083 |  |  |
|  | Long-term leased asset under | |  |  |  |  |  |  |
|  | construction | | 13,000 |  |  | 6,000 |  |  |
|  | Other | | 3,347 |  |  | 2,892 |  |  |
|  |  | $ | 35,701 |  | $ | 24,871 |  |  |
|  |  |  |  |  |  |  |  |  |

**Net income per share**

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

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | **Nine Months Ended** | | | |
|  |  | **October 28,** | | **October 29,** |  | **October 28,** | | **October 29,** |  |
|  | **2006** | |  | **2005** |  | **2006** |  | **2005** |  |
|  |  |  |  | **(restated)** |  |  |  | **(restated)** |  |
| Numerator: |  |  |  |  |  |  |  |  |  |
| Income before change in accounting principle |  | $ 6,046 |  | $ 83,355 |  | $ 119,644 |  | $ 184,401 |  |

Net income



Denominator:

Weighted average shares of common stock outstanding Weighted average shares — basic



* 6,046 $ 83,355 $ 128,490 $ 184,401



|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| 587,348 |  | 567,310 |  | 585,728 |  | 562,243 |
| 587,348 |  | 567,310 |  | 585,728 |  | 562,243 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Effect of dilutive securities-Warrants |  |  | 1,572 |  |  | 1,685 |  |  | 1,685 |  |  | 1,646 |  |
| Contingently issuable shares |  |  | — |  |  | — | |  | — | |  | 455 |  |
| Common stock options and other |  |  | 39,184 |  |  | 63,429 |  |  | 46,305 |  |  | 62,329 |  |
| Weighted average shares — diluted |  |  | 628,104 |  |  | 632,424 |  |  | 633,718 |  |  | 626,673 |  |
| Income before change in accounting principle; |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Basic | $ | | 0.01 | $ | | 0.15 |  | $ | 0.20 |  | $ | 0.33 |  |
| Diluted | $ | | 0.01 | $ | | 0.13 |  | $ | 0.19 |  | $ | 0.29 |  |
| Net income per share; |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Basic | $ | | 0.01 | $ | | 0.15 |  | $ | 0.22 |  | $ | 0.33 |  |
| Diluted | $ | | 0.01 | $ | | 0.13 |  | $ | 0.20 |  | $ | 0.29 |  |
|  |  |  |  | 24 | |  |  |  |  |  |  |  |  |



Options to purchase 36,136,943 shares at a weighted average exercise price of $24.39 have been excluded from the computation of diluted net income per share for the three months ended October 28, 2006 using the treasury method calculation. Options to purchase 654,263 common shares at a weighted average exercise price of $23.05 have been excluded from the computation of diluted net income per share for the three months ended October 29, 2005 using the treasury stock method calculation.

Options to purchase 30,467,554 common shares at a weighted average exercise price of $24.41 have been excluded from the computation of diluted net income per share for the nine months ended October 28, 2006 using the treasury stock method calculation. Options to purchase 640,959 common shares at a weighted average exercise price of $22.26 have been excluded from the computation of diluted net income per share for the nine months ended October 29, 2005 using the treasury stock method calculation.

**Comprehensive income (in thousands)**

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | |  | **Nine Months Ended** | | | |
|  | **October 28,** | |  | **October 29,** | |  | **October 28,** | | **October 29,** |  |
|  |  | **2006** |  |  | **2005** | **2006** | |  | **2005** |  |
|  |  |  |  | **(restated)** | |  |  |  | **(restated)** |  |
| Net income | $ | 6,046 | $ | | 83,355 | $ 128,490 | |  | $ 184,401 |  |
| Other comprehensive loss: |  |  |  |  |  |  |  |  |  |  |
| Unrealized gain (loss) on available-for-sale investments |  |  |  |  |  |  |  |  |  |  |
| and other, net of tax |  | 1,157 |  |  | 475 | 1,657 | |  | (400) | |
| Total comprehensive income | $ | 7,203 |  | $ | 83,830 |  | $ 130,147 |  | $ 184,001 |  |
|  |  |  |  |  |  |  |  |  |  |  |

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 and other, net of tax.

**Note 4. Acquisitions**

The Company acquired the hard disk and tape drive controller semiconductor business of QLogic Corporation (“QLogic Business”) during the third quarter of fiscal 2006, the semiconductor division of UTStarcom, Inc (“UTStarcom Business”) in the first quarter of fiscal 2007, and the printer semiconductor division of Avago Technologies Limited (“Avago Business”) and assets of another business from an unrelated party during the second quarter of fiscal 2007.

QLogic Business

The Company acquired the QLogic Business on November 4, 2005. The QLogic Business designs and supplies controller chips for data storage peripherals, such as hard disk and tape drives. The QLogic Business provides controller chip products which the Company believes will be able to provide complementary products to its customers in the hard disk market while improving its ability to address the overall data storage market. These factors contributed to a purchase price that was in excess of the fair value of the QLogic Business net tangible and intangible assets acquired. The Company recorded goodwill, which is not deductible for tax purposes, in connection with this transaction.

Under terms of the agreement, the Company issued a combination of $184.0 million in cash and 1,960,998 shares of its common stock valued at $45.6 million for total consideration of $229.6 million. The agreement provides for $12.0 million of the consideration to be placed in escrow for up to one year from the closing date to secure QLogic’s obligations under certain representation and warranty provisions.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| The purchase price of the QLogic Business of $232.5 million was determined as follows (in thousands): | |  |  |  |
|  |  |  |  |  |
| Cash | $ 184,032 |  |  |
|  | Value of Marvell common stock issued | 45,583 |  |  |
|  | Transaction costs | 2,920 |  |  |
|  | Total purchase price | $ 232,535 |  |  |
|  |  |  |  |  |

The value of the 1,960,998 shares of the Company’s common stock issued was determined based on the average price of the Company’s common stock over a 5-day period including the two days before and after August 29, 2005 (the announcement date), or $23.25 per share.

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Under the purchase method of accounting, the total purchase price was allocated to the QLogic Business’ net tangible and intangible assets based on their fair values as of the date of the completion of the acquisition as follows (in thousands):

|  |  |  |  |
| --- | --- | --- | --- |
| Net tangible assets acquired | $ | 25,073 |  |
| Amortizable intangible assets: |  |  |  |
| Existing technology |  | 42,700 |  |
| Core technology |  | 26,400 |  |
| Customer relationships |  | 54,200 |  |
| In-process technology |  | 4,300 |  |
| Goodwill |  | 79,862 |  |
| Total purchase price allocation | $ | 232,535 |  |
|  |  |  |  |

The Company acquired tangible assets of approximately $25.1 million consisting of inventory and fixed assets, net of assumed liabilities and was recorded at its estimated fair value. The amortizable intangible assets of $123.3 million were determined based on valuation techniques such as discounted cash flows and weighted average cost of capital methods used in the high technology industry using assumptions and estimates from management. The amortizable intangible assets acquired and their respective estimated remaining lives, over which each asset will be amortized on a straight-line basis over useful lives ranging from one to four years are:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Estimated** | | **Estimated Fair** | | |  |
|  | **Remaining** | |  |
|  | **Useful Life** | |  | **Value** | |  |
|  | **(in years)** |  | **(in thousands)** | |  |  |
| Existing technology | 1 to 2 | | $ | 42,700 |  |  |
| Core technology | 3 |  |  | 26,400 |  |  |
| Customer relationships | 4 |  |  | 54,200 |  |  |
| In-process research and development | N/A | |  | 4,300 |  |  |
| Total intangible assets acquired |  |  | $ | 127,600 |  |  |
|  |  |  |  |  |  |  |

Existing technology comprised products that have reached technological feasibility and includes the fibre channel hard disk controller (“HDC”), Small Computer System Interface (“SCSI”) HDC and the tape drive products of the hard disk and tape drive controller business of QLogic. The core technology represents technology that is embedded in the existing technology that was separately valued. Customer relationships represent future projected revenues that are derived from sales of future versions of existing products that will be sold to existing customers.

Of the total purchase price, $4.3 million was allocated to in-process research and development (“IPRD”) based upon the fair values of assets acquired and was charged to expense in the fourth quarter of fiscal 2006. The QLogic Business was developing new products that had not reached technological feasibility and which had no alternative use and therefore was immediately written-off. The projects in process consisted of a product based on a combined SCSI HDC and fibre channel HDC that would help customers transition from a SCSI market. The values assigned to IPRD were determined by considering the importance of products under development to the overall development plan, estimating costs to develop the purchased IPRD into commercially viable products, estimating the resulting net cash flows from the projects when completed and discounting the net cash flows to their present value. The fair values of IPRD were determined using the income approach, which discounts expected future cash flows to present value. The discount rates used in the present value calculations were derived from a weighted-average cost of capital analysis, adjusted to reflect additional risks related to the product’s development and success as well as the product’s stage of completion. A discount rate of 21.0% was used for IPRD. At the time of the acquisition, the project was approximately 25.0% complete with aggregate costs to complete of $2.7 million. The project was canceled in January 2006.

The weighted average useful lives of acquired intangibles from the QLogic Business are 1.2 years for developed technology, 3.0 years for core technology and 4.0 years for customer relationships.

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The results of operations of the QLogic Business have been included in the Company’s consolidated statements of operations since the acquisition completion date of November 4, 2005. The following unaudited pro forma information presents a summary of the results of operations of the Company assuming the acquisition of the QLogic Business occurred at the beginning of the period presented (in thousands, except for per share amounts):

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months** |  |  | **Nine Months** | |
|  | **Ended October 29,** | |  | **Ended October 29,** | | |
|  |  | **2005** |  |  | **2005** |  |
|  |  | **(restated)** |  |  | **(restated)** |  |
| Net revenue | $ | 471,218 | $ | | 1,307,934 |  |
| Net income | $ | 89,525 | $ | | 196,689 |  |
| Basic net income per share | $ | 0.16 | $ | | 0.35 |  |
| Diluted net income per share | $ | 0.14 | $ | | 0.31 |  |

UTStarcom Business

The Company acquired the UTStarcom Business on February 16, 2006. The UTStarcom Business focuses on the design and development of personal handyphone systems (PHS) and next generation cellular communications technology. The primary reasons for the acquisition of the semiconductor division of UTStarcom were to strengthen and augment its software engineering workforce and enhance its technological capabilities for emerging cellular strategies, obtain an established product being utilized in wireless communications technology, reduce the time required to develop new products and bring them to market for next generation cellular technology and to complement the Company’s existing wireless offerings. These factors contributed to a purchase price

that was in excess of the fair value of the UTStarcom Business net tangible and intangible assets acquired. The Company recorded goodwill, which is not deductible for tax purposes, in connection with this transaction.

Under the terms of the agreement, the Company paid $24.0 million in cash. In the third quarter of fiscal 2007, the Company recorded additional purchase consideration of $16.0 million upon the achievement of the contingent milestones as defined in the purchase agreement. A liability of approximately $8.7 million was preliminarily recorded, representing the excess of the fair value of net tangible and intangible assets acquired over the purchase price. As a result of the contingent consideration, additional goodwill of $7.3 million was recorded.

The purchase price of the acquisition was $40.8 million, including the contingent consideration of $16.0 million recognized during the third quarter of fiscal 2007, and was determined as follows (in thousands):

|  |  |  |
| --- | --- | --- |
| Cash | $ 40,008 |  |
| Transaction costs | 792 |  |
| Total purchase price | $ 40,800 |  |
|  |  |  |

Under the purchase method of accounting, the total purchase price (including the contingent consideration recognized of $16.0 million) was allocated to net tangible and intangible assets based on their fair values as of the date of the completion of the acquisition as follows (in thousands):

|  |  |  |  |
| --- | --- | --- | --- |
| Inventories | $ | 2,097 |  |
| Fixed assets |  | 611 |  |
|  |  | 2,708 |  |
| Amortizable intangible assets: |  |  |  |
| Existing technology |  | 11,900 |  |
| Core technology |  | 4,100 |  |
| Supply contract |  | 900 |  |
| Customer relationships |  | 13,900 |  |
| Goodwill |  | 7,292 |  |
| Total purchase price allocation | $ | 40,800 |  |
|  |  |  |  |

The amortizable intangible assets of $30.8 million were determined based on valuation techniques such as discounted cash flows and weighted average cost of capital methods used in the high technology industry using assumptions and estimates from

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management. The amortizable intangible assets acquired and their respective estimated remaining lives, over which each asset will be amortized on a straight-line basis over useful lives ranging from three to four years are:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Estimated** | | **Estimated Fair** | | |  |
|  | **Remaining** | |  |
|  | **Useful Life** | |  | **Value** | |  |
|  | **(in years)** |  | **(in thousands)** | |  |  |
| Existing technology | 3 |  | $ | 11,900 |  |  |
| Core technology | 4 |  |  | 4,100 |  |  |
| Supply contract | 4 |  |  | 900 |  |  |
| Customer contracts | 4 |  |  | 13,900 |  |  |
| Total intangible assets acquired |  |  | $ | 30,800 |  |  |
|  |  |  |  |  |  |  |

The existing technology represents personal handyphone systems technology and other technology that UTStarcom has developed. Core technology represents the combination of processes, patents, and trade secrets that are the building blocks for current and planned new products. Customer relationships represent future projected revenue that will be derived from sales of future versions of existing products that will be sold to existing customers. The value determined for the supply contract with UTStarcom represents the fair value of estimated revenues and net operating cash flows to be derived from the supply contract for the duration of the five-year contract.

The weighted average useful lives of acquired intangibles from the UTStarcom Business are 3.0 years for developed technology, 4.0 years for core technology, 4.0 years for customer relationships and 4.0 year for the supply contract.

Avago Business

The Company acquired the Avago Business on May 1, 2006. The Avago Business focuses on the design and development of system-on-chip and system level solutions for both inkjet and laser jet printer systems. The primary purpose and benefits of the acquisition were to obtain, accelerate and strengthen the Company’s entry into the printer market, leverage its portfolio of complementary technology, obtain important printer systems level knowledge and strengthen the Company’s relationship with the only customer of the products. These factors contributed to a purchase price that was in excess of the fair value of the Avago Business net tangible and intangible assets acquired. The Company recorded goodwill, which is not deductible for tax purposes, in connection with this transaction.

Under the terms of the agreement, the Company paid $249.6 million in cash and may pay up to an additional $35.0 million in cash if certain defined milestones are achieved. The purchase price of the acquisition, including the contingent consideration recognized of $10.0 million, was $263.0 million and was determined as follows (in thousands):

|  |  |  |
| --- | --- | --- |
| Cash | $ 259,591 |  |
| Estimated transaction costs | 3,388 |  |
| Total estimated purchase price | $ 262,979 |  |
|  |  |  |

In the third quarter of fiscal 2007, the Company recorded additional purchase consideration of $10.0 million upon the achievement of certain levels of revenue of the past year. The remaining contingent consideration of up to $25.0 million is still outstanding and may result in the recognition of additional purchase consideration in the future. The remaining contingent consideration is based on the achievement of a certain level of revenue over a one year period ending October 2007. Additionally, in the third quarter of fiscal 2007, the Company recorded a cash consideration adjustment of $1.9 million relating to inventory acquired at the acquisition date, resulting in a corresponding reduction in goodwill.

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Under the purchase method of accounting, the total purchase price (including the contingent consideration recognized of $10.0 million) was allocated to net tangible and intangible assets based on their fair values as of the date of completion of the acquisition, as adjusted, as follows (in thousands):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | Accounts receivable | $ | | 1,871 |  |
|  | Current assets |  |  | 1,442 |  |
|  | Deferred tax asset |  |  | 925 |  |
|  | Inventories |  |  | 23,896 |  |
|  | Fixed assets |  |  | 14,322 |  |
|  | Other current assets |  |  | 2,750 |  |
|  | Accrued liabilities |  |  | (12,541) | |
|  | Accrued employee benefits |  |  | (3,998) | |
|  |  |  |  | 28,667 |  |
|  | Amortizable intangible assets: |  |  |  |  |
|  | Existing technology |  |  | 55,800 |  |
|  | Core technology |  |  | 40,200 |  |
|  | Customer relationships |  |  | 53,400 |  |
|  | Goodwill |  |  | 84,912 |  |
|  | Total purchase price allocation |  | $ | 262,979 |  |
|  |  |  |  |  |  |

The amortizable intangible assets of $149.4 million were determined based on valuation techniques such as discounted cash flows and weighted average cost of capital methods used in the high technology industry using assumptions and estimates from management. The amortizable intangible assets acquired and their respective estimated remaining lives, over which each asset will be amortized on a straight-line basis over useful lives ranging from three to six years are:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Estimated** | | **Estimated Fair** | | |  |
|  | **Remaining** | |  |
|  | **Useful Life** | |  | **Value** | |  |
|  | **(in years)** |  | **(in thousands)** | |  |  |
| Existing technology | 3 to 4 | | $ | 55,800 |  |  |
| Core technology | 3 to 6 | |  | 40,200 |  |  |
| Customer contracts | 5 |  |  | 53,400 |  |  |
| Total intangible assets acquired |  |  | $ | 149,400 |  |  |
|  |  |  |  |  |  |  |

The existing technology represents personal laser jet, laser jet systems technology and other technology that the Avago Business has developed. Core technology represents the combination of processes, patents, and trade secrets that are the building blocks for current and planned new products. Customer relationships represent future projected revenue that will be derived from sales of future versions of existing products that will be sold to existing customers.

The weighted average useful lives of acquired intangibles from the Avago Business are 3.2 years for developed technology, 4.9 years for core technology and 5.0 years for customer relationships.

The results of operations of the UTStarcom Business and Avago Business have been included in the Company’s consolidated statements of operations since their respective acquisition completion date of February 16, 2006 and May 1, 2006. The following unaudited pro forma information presents a summary of the results of operations of the Company assuming the acquisitions of the UTStarcom Business and Avago Business occurred at the beginning of the period presented (in thousands, except for per share amounts):

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Nine Months** | | | **Three Months** | | | **Nine Months** | | |  |
|  |  | **Ended** | |  | **Ended** | |  |
|  |  | **October 28,** | |  | **October 29,** | | **Ended October** | | |  |
|  |  | **2006** |  |  | **2005** |  |  | **29, 2005** |  |  |
|  |  |  |  |  | **(restated)** |  |  | **(restated)** |  |  |
| Net revenue | $ | 1,653,579 |  | $ | 458,775 |  | $ | 1,277,141 |  |  |
| Net income | $ | 104,734 |  | $ | 66,063 |  | $ | 129,978 |  |  |
| Basic net income per share | $ | 0.18 |  | $ | 0.12 |  | $ | 0.23 |  |  |
| Diluted net income per share | $ | 0.17 |  | $ | 0.10 |  | $ | 0.21 |  |  |
|  |  | 29 |  |  |  |  |  |  |  |  |



Other acquisition

During the second quarter of fiscal 2007, the Company completed the acquisition of the assets of a division of an unrelated company for a purchase price of $7.3 million. Under the purchase method of accounting, the total purchase price was allocated to net tangible and intangible assets based on their fair values as of the date of the completion of the respective acquisitions. The Company recorded acquired net tangible assets of $0.4 million, amortizable intangible assets of $2.9 million and goodwill of $4.0 million. The intangible assets are being amortized over their useful lives ranging from one to six years.

**Note 5. Facilities Consolidation Charge**

During fiscal 2003, the Company recorded a total of $19.6 million of charges associated with costs of consolidation of its facilities (“2003 facilities consolidation”) of which $6.0 million related to non-cash charges. As of October 28, 2006, cash payments of $10.5 million, net of sublease income, had been made in connection with these charges. Approximately $3.0 million is accrued for the facilities consolidation charge as of October 28, 2006, of which

$0.6 million represents the current portion and is included in accrued liabilities. The long-term portion totaling $2.4 million is payable through 2010, and is included in other long-term liabilities.

Activities of accrued losses related to the 2003 facilities consolidation during the nine months ended October 28, 2006 were as follows (in thousands):

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  |  | **Nine Months** | | |
|  |  |  |  | **Ended** | |
|  |  |  | **October 28,** | | |
|  |  |  |  | **2006** |  |
|  | Beginning balance |  | $ | 3,578 |  |
|  | Net cash payments |  |  | (574) | |
|  | Non-cash charges |  |  | — | |
|  | Ending balance |  | $ | 3,004 |  |
|  |  |  |  |  |  |

**Note 6. Recent Accounting Pronouncements**

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 123(R)-3, “Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards” (FSP 123R-3). We have elected to adopt the alternative transition method provided in the FSP 123R-3 for calculating the tax effects of stock-based compensation pursuant to SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the APIC pool related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123R.

In June 2006, the FASB ratified the Emerging Issues Task Force (EITF) consensus on EITF Issue No. 06-2, “Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43” (“EITF 06-2”). EITF 06-2 requires companies to accrue the cost of such compensated absences over the requisite service period. The Company currently accrues the cost of compensated absences for sabbatical programs when the eligible employee completes the requisite service period. The Company is required to apply the provisions of EITF 06-2 at the beginning of fiscal 2008. EITF 06-02 allows for adoption through retrospective application to all prior periods or through a cumulative effect adjustment to retained earnings if it is impracticable to determine the period-specific effects of the change on prior periods presented. The Company is currently evaluating the financial impact of this guidance and the method of adoption which will be used.

In July 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109” (FIN 48), which clarifies the accounting for uncertainty in income tax positions. This Interpretation requires that the Company recognize in its financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of fiscal 2008, with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company has evaluated the impact of adopting FIN 48 and determined that there is no material impact on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (“SFAS 157”), Fair Value Measurements. The statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 157 on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (“SAB 108”). SAB 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. The Company adopted SAB 108 at the end of fiscal 2007. The adoption did not have a material impact on our financial position and results of operations.

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In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115” which is effective for fiscal years beginning after November 15, 2007. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The Company is currently evaluating the potential impact of this statement.

**Note 7. Commitments and Contingencies**

***Warranty Obligations***

The following table presents changes in the warranty accrual included in accrued liabilities during the three and nine months ended October 28, 2006 and

October 29, 2005 (in thousands):

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Three Months Ended** | | | **Nine Months Ended** | |
| **October 28,** | **October 29,** |  | **October 28,** | **October 29,** |
| **2006** | **2005** |  | **2006** | **2005** |



|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Warranty accrual (included in accrued |  |  |  |  |  |
| liabilities): |  |  |  |  |  |
| Beginning balance | $ 3,983 | $ 3,181 | $ 3,914 | $ | 1,571 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Warranties issued |  | — | |  |  | 705 |  |  | 339 |  |  | 2,647 |  |
| Settlements | (215) | | |  |  | (83) | |  | (485) | |  | (415) | |
| Ending balance |  | $ 3,768 |  |  | $ | 3,803 |  | $ | 3,768 |  | $ | 3,803 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |

***Purchase Commitments***

The Company’s manufacturing relationships with its foundries allow for the cancellation of all outstanding purchase orders, but require repayment of all expenses incurred through the date of cancellation. As of October 28, 2006, foundries had incurred approximately $134.7 million of manufacturing expenses on the Company’s outstanding purchase orders. As of October 28, 2006, the Company also had approximately $75.3 million of other outstanding non-cancelable purchase orders for capital purchase obligations.

On February 28, 2005 and as amended on March 31, 2005, the Company entered into an agreement with a foundry to reserve and secure foundry fabrication capacity for a fixed number of wafers at agreed upon prices for a period of five and a half years beginning on October 1, 2005. In return, the Company agreed to pay the foundry $174.2 million over a period of eighteen months. The amendment extends the term of the agreement and the agreed-upon pricing terms until December 31, 2015. As of October 28, 2006, payments totaling $174.2 million (included in prepaid expenses and other current assets and other non current assets) have been made and approximately $74.9 million of the prepayment has been utilized as of October 28, 2006. At October 28, 2006, there were no more remaining commitments under the agreement.

***Contingencies***

*IPO Securities Litigation.* On July 31, 2001, a putative class action suit was filed against two investment banks that participated in the underwriting ofthe Company‘s initial public offering, or IPO, on June 29, 2000. That lawsuit, which did not name Marvell or any of the Company’s 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 Marvell and two of the Company’s officers, one of whom is also a director. Relying on many of the same allegations contained in the initial complaint in which we were 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. Defendants in the consolidated proceedings moved to dismiss the actions. In February 2003, the trial court granted the motions in part and denied them in part, thus allowing the case to proceed against the underwriters and the Company as to alleged violations of section 11 of the Securities Act of 1933 and section 10(b) of the Securities Exchange Act of 1934. Claims against the individual officers have been voluntarily dismissed with prejudice by agreement with plaintiffs. On June 26, 2003, the plaintiffs announced that a settlement among plaintiffs, the issuer defendants and their directors and officers, and their insurers has been structured, a part of which provides that the insurers for all issuer defendants would guarantee up

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to $1 billion to investors who are class members, depending upon plaintiffs’ success against non-settling parties. The Company’s board of directors has approved the proposed settlement, which if approved by the court would result in the plaintiffs’ dismissing the case against the Company and granting releases that extend to all of its officers and directors. Definitive settlement documentation was completed in early June 2004 and first presented to the court on June 14, 2004. On February 15, 2005, the court issued an opinion preliminarily approving the proposed settlement, contingent upon certain modifications being made to one aspect of the proposed settlement — the proposed “bar order.” The court ruled that it had no authority to deviate from the wording of the Private Securities Litigation Reform Act of 1995 and that any bar order that may issue should the proposed settlement be finally approved must be limited to the express wording of 15 U.S.C. section 78u-4(f)(7)(A). On May 2, 2005 the issuer defendants and plaintiffs jointly submitted an amendment to the settlement agreement conforming the language of the settlement agreement with the court’s February 15, 2005 ruling regarding the bar order. The court on August 31, 2005 issued an order preliminarily approving the settlement and setting a public hearing on its fairness for April 24, 2006 due to difficulties in mailing the required notice to class members. A final settlement approval hearing on the proposed issuer settlement was held on April 24, 2006. The court took the matter under submission. Meanwhile the consolidated case against the underwriters has proceeded. On October 2004, the district court certified a class. On December 5, 2006, however, the United States Court of Appeals for the Second Circuit reversed, holding that a class could not be certified. The Second Circuit’s holding, while directly affecting only the underwriters, raises some doubt as to whether the settlement class contemplated by the proposed issuer settlement would be approved in its present form. On January 5, 2007, plaintiffs petitioned the Second Circuit for rehearing of the Second Circuit’s decision. On April 6, 2007, the Second Circuit denied the petition. At a status conference on April 23, 2007, the district court suggested that the issuers’ settlement could not be approved in its present form, given the Second Circuit’s ruling. not yet ruling on the matter, the district court has suggested that the parties will likely withdraw and seek to reformulate the current settlement in light of the Second Circuit ruling.

*Jasmine Networks Litigation.* On September 12, 2001, Jasmine Networks, Inc. (“Jasmine”) filed a lawsuit in the Santa Clara County Superior Courtalleging claims against three officers and the Company for improperly obtaining and using information and technologies during the course of the negotiations with the Company’s personnel regarding the potential acquisition of certain Jasmine assets by the Company. The lawsuit claims that the Company’s 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 the Company are without merit and the Company intends to defend all claims vigorously.

On June 21, 2005, the Company filed a cross complaint in the above disclosed action in the Santa Clara County Superior Court asserting claims against Jasmine and unnamed Jasmine officers and employees. The cross complaint was later amended to name two individual officers of Jasmine. On May 15, 2007, the Company filed a second amended cross complaint to add additional causes of action for declaratory relief against Jasmine. Among other actions, the cross complaint alleges that Jasmine and its personnel engaged in fraud in connection with their effort to sell to the Company technology that Jasmine and its personnel wrongfully obtained from a third party in violation of such third party’s rights. The cross complaint seeks declaratory judgment that the Company’s technology does not incorporate any of Jasmine’s alleged technology. The cross complaint seeks further declaratory judgment that Jasmine and its personnel misappropriated certain aspects of Jasmine’s alleged technology. The Company intends to prosecute the cross complaint against Jasmine and its personnel vigorously, including, but not limited to, filing certain dispositive motions regarding the ownership of the technology which is the subject of the cross complaint.

*CSIRO Litigation.* In 2004, Australia’s Commonwealth Scientific and Industrial Research Organisation (“CSIRO”) sent notice letters to a number of Wi-Fi System manufacturers regarding CSIRO’s patent, U.S. Patent No. 5,487,069 as it relates to IEEE 802.11a and 802.11g wireless standards. In May 2005, a group of system manufacturers, including customers of our 802.11a or 802.11g wireless LAN products, filed an action in the United States District Court for the Northern District of California seeking a declaratory judgment against CSIRO that the plaintiff manufacturers’ products employing the IEEE 802.11a or 802.11g wireless standards do not infringe CSIRO’s patent, U.S. Patent No. 5,487,069. In September 2006, CSIRO filed an answer and counterclaims alleging that plaintiffs’ products that employ those wireless standards infringe the CSIRO patent and seeking damages, including enhanced damages and attorneys’ fees and costs, and an injunction against sales of infringing products. In December 2006, the district court granted CSIRO’s motion to transfer the case to the United States District Court for the Eastern District of Texas, where CSIRO had brought a similar lawsuit against another company. As a result of CSIRO’s counterclaims for patent infringement, a customer of the Company has sought indemnification from it. Also in December 2006, CSIRO filed suit in the United States District Court for the Eastern District of Texas against several manufacturers and suppliers of wireless products, including customers of the Company’s 802.11a or 802.11g wireless LAN products. The complaint alleges that the manufacture, use and sale of wireless products compliant with the IEEE 802.11a or 802.11g wireless standards infringes on the CSIRO patent. As a result of CSIRO’s claim for patent infringement, another customer of the Company has sought indemnification from it. In response to these demands for indemnification, the Company has acknowledged the demands and incurred costs in response to them.

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On May 4, 2007, the Company filed an action in the United States District Court for the Eastern District of Texas seeking a declaratory judgment against CSIRO that the CSIRO patent is invalid and unenforceable and that the Company and its customers do not infringe the CSIRO patent. The complaint also seeks damages and a license for the Company and its customers on reasonable and non-discriminatory terms in the event the Company’s 802.11a/g wireless LAN products are found to infringe and the CSIRO patent is found to be valid and enforceable. CSIRO has not yet responded to the complaint.

*Shareholder Derivative Litigation.* Between July 7, 2006 and August 2, 2006, three purported shareholder derivative actions were filed in the UnitedStates District Court for the Northern District of California. Each of these lawsuits names the Company as a nominal defendant and a number of the Company’s current and former directors and officers as defendants. Each lawsuit seeks to recover damages purportedly sustained by the Company in connection with its option granting processes, and seeks certain corporate governance and internal control changes. Pursuant to orders of the court dated August 17 and October 17, 2006, the three actions were consolidated as a single action, entitled *In re Marvell Technology Group Ltd. Derivative Litigation*. The plaintiffs filed an amended and consolidated complaint on November 1, 2006. On January 16, 2007, the Company filed a motion to dismiss the consolidated complaint for lack of standing or, in the alternative, stay proceedings. Pursuant to stipulations among the parties and orders of the court, our motion is currently scheduled to be heard on November 2, 2007.

On February 12, 2007, a new purported derivative action was filed in the United States District Court for the Northern District of California. Like *In re* *Marvell Technology Group Ltd. Derivative Litigation*, this lawsuit names the Company as a nominal defendant and a number of our current and formerdirectors and officers as defendants. It seeks to recover damages purportedly sustained by the Company in connection with its option granting processes, and seeks certain corporate governance and internal control changes. On May 1, 2007, the court entered an order consolidating this lawsuit with *In re Marvell* *Technology Group Ltd. Derivative Litigation*.

On May 29, 2007, the court entered an order staying discovery in this matter pending resolution of the Company’s motion to dismiss.

*Securities Litigation*. Between October 5, 2006 and November 13, 2006, four putative class actions were filed in the United States District Court for theNorthern District of California against the Company and certain of its officers and directors. The complaints allege that the Company and certain of its officers and directors violated the federal securities laws by making false and misleading statements and omissions relating to the grants of stock options. The complaints seek, on behalf of persons who purchased our common stock during the period from October 3, 2001 to October 3, 2006, unspecified damages, interest, and costs and expenses, including attorneys’ fees and disbursements. Pursuant to an order of the court dated February 2, 2007, these four putative class actions were consolidated as a single action entitled *In re Marvell Technology Group Ltd. Securities Litigation*. By an order of the court dated February 28, 2007, the plaintiffs must file a consolidated complaint no later than 45 days after the Company files restated financial statements with the SEC.

*SEC and United States Attorney Inquiries.* In July 2006, the Company received a letter of informal inquiry from the Securities and ExchangeCommission (“SEC”) requesting certain documents relating to the Company’s stock option grants and practices. The Company also received a grand jury subpoena from the office of the United States Attorney for the Northern District of California requesting substantially similar documents. On April 20, 2007, the Company was informed that the SEC is now conducting a formal investigation in this matter. On June 8, 2007, the Company received a document subpoena from the SEC. The Company has cooperated with the SEC and the United States Attorney regarding these matters and intends to continue to do so. The Company cannot predict the outcome of these investigations.

*General.* The Company is also party to other legal proceedings and claims arising in the normal course of business.

The legal proceedings and claims described above could result in substantial costs and could divert the attention and resources of the Company’s management. Although the legal responsibility and financial impact with respect to these proceedings and claims 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. However, litigation is subject to inherent uncertainties and unfavorable rulings could occur. An unfavorable ruling in litigation could require the Company to pay damages or one-time license fees or royalty payments, which could adversely impact gross margins in future periods, or could prevent the Company from manufacturing or selling some of its products or limit or restrict the type of work that employees involved in such litigation may perform for the Company. There can be no assurance that these matters will be resolved in a manner that is not adverse to the Company’s business, financial condition, results of operations or cash flows.

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**Note 8. Stock-Based Compensation**

***Stock Plans***

In April 1995, the Company adopted the 1995 Stock Option Plan (the “Option Plan”). The Option Plan, as amended, had 324,289,786 shares of common stock reserved for issuance thereunder as of October 28, 2006. Options granted under the Option Plan generally have a term of ten years and generally must be issued at prices not less than 100% and 85% for incentive and nonqualified stock options, respectively, of the fair market value of the stock on the date of grant. Incentive stock options granted to shareholders who own greater than 10% of the outstanding stock are for periods not to exceed five years and must be issued at prices not less than 110% of the fair market value of the stock on the date of grant. The options generally vest 20% one year after the vesting commencement date, and the remaining shares vest one-sixtieth per month over the remaining forty-eight months. Options granted under the Option Plan prior to March 1, 2000 may be exercised prior to vesting. The Company has the right to repurchase such shares at their original purchase price if the optionee is terminated from service prior to vesting. Such right expires as the options vest over a five-year period. Options granted under the Option Plan subsequent to March 1, 2000 may only be exercised upon or after vesting.

In August 1997, the Company adopted the 1997 Directors’ Stock Option Plan (the “Directors’ Plan”). The Directors’ Plan had 3,600,000 shares of common stock reserved thereunder as of October 28, 2006. Under the Directors’ Plan, an outside director is granted 30,000 options upon appointment to the Board of Directors. These options vest 20% one year after the vesting commencement date and remaining shares vest one-sixtieth per month over the remaining forty-eight months. An outside director is also granted 6,000 options on the date of each annual meeting of the shareholders. These options vest one-twelfth per month over twelve months after the fourth anniversary of the vesting commencement date. Options granted under the Directors’ Plan may be exercised prior to vesting. The Company has the right to repurchase such shares at their original purchase price if the director is terminated or resigns from the Board of Directors prior to vesting. Such right expires as the options vest over a five-year period.

***Employee Stock Purchase Plan***

In June 2000, the Company adopted the 2000 Employee Stock Purchase Plan (the “Purchase Plan”). The Purchase Plan had 33,871,612 shares of common stock reserve for issuance thereunder as of October 28, 2006. Under the Purchase Plan, employees are granted the right to purchase shares of common stock at a price per share that is 85% of the lesser of the fair market value of the shares at (i) the participant’s entry date into the two-year offering period, or (ii) the end of each six-month purchase period within the offering period. Participants purchase stock using payroll deductions, which may not exceed 20% of their total cash compensation. Offering and purchase periods begin on December 1 and June 1 of each year. For the three and nine months ended October 28, 2006, the stock-based compensation expense related to the activity under the Purchase Plan was $0 and $8.6 million, respectively. The Company issued 895,170 shares under the Purchase Plan in the nine months ended October 28, 2006. As of October 28, 2006, there was no unrecognized compensation cost related to the Purchase Plan which will be recognized over the next two years.

Stock option activity under the Company’s stock option plans for the nine months ended October 28, 2006 is summarized below (in thousands, except per share amounts):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  | **Weighted** | | **Weighted** |  |  |  |  |  |  |  |
|  |  |  |  | **Average** |  |  |  |  | **Restricted** | |  |
|  | **Options** | |  | **Average** | | **Remaining** |  |  | **Aggregate** |  |  |
|  |  | **Exercise** | | **Contractual** |  |  |  | **Stock** | |  |
|  | **Outstanding** | |  | **Price** | | **Term** |  | **Intrinsic Value** | |  | **Outstanding** | |  |
|  | **(In thousands)** |  |  |  |  |  |  | **(In thousands)** | |  | **(In thousands)** |  |  |
| Balance at January 28, 2006 | 94,244 |  | $ | 9.88 |  |  |  |  |  |  | — | |  |
| Options granted | 17,569 |  | $ | 28.35 |  |  |  |  |  | 4 | |  |  |
| Options forfeited/canceled/expired | (4,306) | | $ | 15.06 |  |  |  |  |  |  | — | |  |
| Options exercised | (3,716) | | $ | 6.03 |  |  |  |  |  |  | — | |  |
| Balance at October 28, 2006 | 103,791 |  | $ | 12.93 |  |  |  |  |  |  | 4 |  |  |
| Vested or expected to vest at October | 98,904 |  |  |  |  |  | $ | | 723,961 |  | 4 |  |  |
| 28, 2006 |  | $ | 12.50 |  | 6.7 years |  |  |
| Exercisable at October 28, 2006 | 37,887 |  | $ | 7.30 |  | 5.4 years |  | $ | 401,627 |  |  |  |  |
|  |  |  |  | 34 | |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |



Included in the preceding table are 1,690,000 shares of option granted to certain officers at an exercise price of $24.80 during the second quarter of fiscal 2007 that will become exercisable only upon the achievement of specified annual earnings per share targets through fiscal 2010.

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the aggregate difference between the closing stock price of the Company’s common stock on October 27, 2006 of $17.65 and the exercise price for in-the-money options) that would have been received by the option holders if all options had been exercised on October 28, 2006. The total intrinsic value of options exercised in the three and nine months ended October 28, 2006 was $4.1 million and $76.1 million, respectively. Cash received from option exercises for the nine months ended October 28, 2006 was $22.4 million.

Included in the preceding table is activity related to the nonvested portion of the stock based arrangements as follows:

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Nonvested** | |  |  | **Weighted** | | **Nonvested** |  |  | **Weighted** | |  |
|  |  |  | **Average** | | **Restricted** |  |  | **Average** | |  |
|  | **Options** | |  | **Grant Date Fair** | | | **Stock Units** |  |  | **Grant Date** | |  |
|  | **Outstanding** | |  |  | **Value** | | **Outstanding** |  |  | **Fair Value** | |  |
| Balance at January 28, 2006 | 71,813 |  |  | $ | 6.39 |  | — |  | $ | — |  |  |
| Granted | 17,568 |  | $ | | 14.87 |  | 144 | $ | | 32.12 |  |  |
| Vested | (11,670) | | $ | | 5.79 |  | — | $ | | — | |  |
| Canceled/Forfeited | (4,288) | | $ | | 8.80 |  | — | $ | | — | |  |
| Balance at October 28, 2006 | 73,423 |  |  | $ | 8.37 |  | 144 |  | $ | 32.12 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |

As of October 28, 2006, there was $410.5 million of unrecognized compensation cost related to unvested stock options which is expected to be recognized over a weighted average period of 1.6 years. The Company’s current practice is to issue new shares to satisfy share option exercises.

Under applicable securities laws, the Company suspended all stock option exercise transactions under its Stock Option Plan effective on the close of business on September 7, 2006. On September 8, 2006, management communicated the trading suspension, which was expected to last until the Company filed its delinquent SEC reports, to all option holders. As a result, the exercisability of all outstanding options, including vested awards held by certain separated employees, was modified. Incremental compensation costs, representing the excess of the fair value of the modified award over the fair value of the original award immediately before the filing of the Company’s delinquent SEC reports, on affected awards will be recognized in the second half of fiscal 2008.

In December 2006, the options granted to five officers and directors of the Company were reformed to reflect higher exercise prices. There was no incremental compensation cost resulting from the modification.

Total tax benefit attributable to options exercised in the nine months ended October 28, 2006 was $0.9 million. The excess tax benefits from stock-based compensation of $0.9 million as reported on the condensed consolidated statement of cash flows in financing activities represents the reduction, in income taxes otherwise payable during the period, attributable to the actual gross tax benefits in excess of the expected tax benefits for options exercised in current and prior periods.

***Stock Award Activity***

In the first nine months of fiscal 2007, the Company granted 140,000 restricted stock awards to its employees under the 1995 Stock Option Plan. Such awards generally vest over a period of five years from the date of grant. The restricted stock awards have the voting rights of common stock and the shares underlying the restricted are considered issued and outstanding. The Company expenses the value of the restricted stock awards determined based on the fair market value of the shares at the date of grant, ratably over the period during which the restrictions lapse. The grant of restricted stock awards is deducted from the shares available for grant under the Company’s stock option plan. Restricted stock activity under the Company’s stock option plans for the nine months ended October 28, 2006 is summarized below (in thousands, except per share amounts):

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | **Weighted** | |  |
|  |  |  | **Restricted Stock** |  |  | **Average** | |  |
|  |  |  |  |  | **Grant Date** | |  |
|  |  |  | **Outstanding** |  |  | **Fair Value** | |  |
|  |  |  |  |  |  |  |  |  |
| Balance at January 28, 2006 |  | — | $ | | — | |  |
|  | Restricted stock granted | 140 | |  |  | 32.21 |  |  |
|  | Restricted stock forfeited |  | — |  |  | — | |  |
|  | Restricted stock vested |  | — |  |  | — | |  |
|  | Balance at October 28, 2006 |  | 140 | $ | | 32.21 |  |  |
|  |  | 35 |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |



No restricted stock awards vested during the nine months ended October 28, 2006. Based on the closing price of the Company’s stock of $17.65, on October 27, 2006, the total pretax intrinsic value of all outstanding restricted stock was $2.5 million.

The following table presents details of stock-based compensation expenses by functional line item (in thousands):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Three Months Ended** | | | |  |  | **Nine Months Ended** | | | | |
|  |  | **October 28,** | | | **October 29,** | |  | **October 28,** | |  | **October 29,** | |  |
|  |  |  | **2006** |  |  | **2005** |  |  | **2006** |  |  | **2005** |  |
|  |  |  |  |  | **(restated)** | |  |  |  |  | **(restated)** | |  |
| Cost of goods sold | $ | | 2,602 |  | $ | 503 | $ | | 8,497 | $ | | 2,849 |  |
| Research and development |  |  | 26,322 |  |  | 4,878 |  |  | 93,003 |  |  | 24,682 |  |
| Selling and marketing |  |  | 6,502 |  |  | 1,415 |  |  | 23,198 |  |  | 6,655 |  |
| General and administrative |  |  | 6,702 |  |  | 2,771 |  |  | 21,796 |  |  | 14,608 |  |
|  |  | $ | 42,128 |  | $ | 9,567 |  | $ | 146,494 |  | $ | 48,794 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |

The following assumptions were used for each respective period to calculate the weighted average fair value of each option award on the date of grant using the Black-Scholes option pricing model:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Stock Option Plans** | | | | **ESPP** | | |  |  |
|  | **Three Months Ended** | | |  | **Three Months Ended** | | | |  |
|  | **October 28,** | | **October 29,** |  | **October 28,** | | | **October 29,** |  |
|  | **2006** |  | **2005** |  | **2006** |  |  | **2005** |  |
|  |  |  | **(restated)** |  |  |  |  |  |  |
| Volatility | — | | 61% | | 41% | |  | 73% | |
| Expected life (in |  |  |  |  |  |  |  |  |  |
| years) | — | | 4.0 |  | 1.3 |  |  | 1.3 |  |
| Risk-free interest rate | — | | 4.2% | | 5.0% | |  | 3.3% | |
| Dividend yield | — | | — | | — | | | — | |
|  | **Stock Option Plans** | | | | **ESPP** | | |  |  |
|  | **Nine Months Ended** | | |  | **Nine Months Ended** | | | |  |
|  | **October 28,** | | **October 29,** |  | **October 28,** | | | **October 29,** |  |
|  | **2006** |  | **2005** |  | **2006** |  |  | **2005** |  |
|  |  |  | **(restated)** |  |  |  |  |  |  |
| Volatility | 59% | | 70% | | 41% | |  | 73% | |
| Expected life (in |  |  |  |  |  |  |  |  |  |
| years) | 4.7 |  | 4.4 |  | 1.3 |  |  | 1.3 |  |
| Risk-free interest rate | 4.7% | | 4.0% | | 5.0% | |  | 3.3% | |
| Dividend yield | — | | — | | — | | | — | |

In refining estimates used in the adoption of SFAS 123R, the Company established the expected term for employee options and awards, as well as expected forfeiture rates, based on the historical settlement experience and after giving consideration to vesting schedules. Assumptions for option exercises and pre-vesting terminations of options were stratified by employee groups with sufficiently distinct behavior patterns.

Expected volatility under SFAS 123R was developed based on the average of Marvell’s historical daily stock price volatility and average implied volatility.

SFAS 123R also requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. From January 29, 2006, stock-based compensation expense was recorded net of estimated forfeitures such that expense was recorded only for those stock-based awards that are expected to vest. Previously under APB 25, previously recognized expense was reversed for the portion of awards forfeited prior to vesting as and when forfeitures occurred.

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No options were granted in the three month period ended October 28, 2006. The weighted average fair value per share of the options granted in the three month period ended October 29, 2005 was $10.81. The weighted average fair values per share of the options granted in the nine month period ended October 28, 2006 and October 29, 2005 was $15.13 and $10.54, respectively.

The Company has granted performance based options to executives contingent upon achieving pro forma earnings per share targets (EPS). Pro forma EPS will be calculated by adjusting diluted net income per share under generally accepted accounting principles (GAAP EPS) for the impact of (i) non-cash stock-based compensation charges by adding to GAAP EPS non-cash stock-based compensation expense recognized under SFAS 123R, and (ii) non-cash charges associated with purchase accounting, including purchase accounting adjustments for inventory and other write-off related expenses by adding to GAAP EPS amortization and write-off of acquired intangible assets and other and acquired in-process research and development. Share options were granted at the fair market value on the date of grant and fully vest upon achievement of these earnings per share targets within a four-year period. The contractual lives of the options are 10 years from the date of grant. The fair value of the each performance option grant that is expected to vest under these conditions was estimated on the date of grant using the same option valuation model for options granted under the Company’s Option Plan. If such goals are not met, no compensation expense is recognized and any recognized compensation expense is reversed.

Prior to the adoption of SFAS 123R, the Company provided disclosures required under SFAS 123. The following table illustrates the effect on loss and net loss per share, net of tax effects for the first quarter of fiscal 2006 as if the Company had applied the fair value recognition provisions of SFAS 123 to stock based awards (in thousands, except for per share data):

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Three Months** | | |  | **Nine Months** | | |
|  |  |  |  | **Ended** | |  |  | **Ended** | |
|  |  |  |  | **October 29,** | |  |  | **October 29,** | |
|  |  |  |  | **2005** |  |  |  | **2005** |  |
|  |  |  |  | **(restated)** |  |  |  | **(restated)** |  |
|  | Net income: |  |  |  |  |  |  |  |  |
|  | As reported | $ | | 83,355 |  | $ | | 184,401 |  |
|  | Adjustments: |  |  |  |  |  |  |  |  |
|  | Stock-based employee compensation expense included in reported |  |  |  |  |  |  |  |  |
|  | net income, net of tax effects |  |  | 9,567 |  |  |  | 48,794 |  |
|  | Stock-based employee compensation expense determined under |  |  |  |  |  |  |  |  |
|  | fair value based method for all awards, net of tax effects |  |  | (46,435) | |  |  | (135,125) | |
|  | Pro forma |  | $ | 46,487 |  |  | $ | 98,070 |  |
|  | Basic net income per share: |  |  |  |  |  |  |  |  |
|  | As reported | $ | | 0.15 |  | $ | | 0.33 |  |
|  | Pro forma | $ | | 0.08 |  | $ | | 0.17 |  |
|  | Diluted net income per share: |  |  |  |  |  |  |  |  |
|  | As reported | $ | | 0.13 |  | $ | | 0.29 |  |
|  | Pro forma | $ | | 0.07 |  | $ | | 0.16 |  |

**Note 9. Related Party Transactions**

During the third quarters of fiscal 2007 and 2006, the Company incurred approximately $1,000 and $0.2 million, respectively of expenses from an unrelated third-party entity, ACM Aviation, Inc. (“ACM”) for charter aircraft services provided to MSI for Estopia Air LLC (“Estopia Air”). During the first nine months of fiscal 2007 and 2006, the Company incurred approximately $0.5 million and $0.6 million, respectively, of expenses from ACM, for charter aircraft services provided to MSI. The aircraft provided by ACM to the Company for such services is owned by Estopia Air. The Company’s President and Chief Executive Officer, Dr. Sehat Sutardja and the Company’s Executive Vice President and Chief Operating Officer, Weili Dai, through their control and ownership of Estopia Air, own the aircraft provided by ACM. The expenses incurred were the result of the Company’s use of the aircraft for business travel purposes. The cost of such usage was determined based on market prices.

On February 19, 2005, the Company, through its subsidiaries MSI and Marvell Asia Pte. Ltd. (“MAPL”), entered into a development agreement with MagnetoX Inc. (“MagnetoX”). The development agreement is substantially on similar terms as other development agreements with other parties. The Company did not recognize any revenue from the development agreement or product revenue during the first nine months of fiscal 2007. Total revenue expected to be recognized from the development agreement is $1.0 million. Herbert Chang, one of the Company’s directors, is a shareholder of MagnetoX and its Chairman of the Board, President and Chief Executive Officer.

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Estopia LLC (“Estopia”) is also a shareholder of MagnetoX. Dr. Sehat Sutardja and Weili Dai, through their ownership and control of Estopia, are indirect shareholders of MagnetoX.

On August 19, 2005, the Company, through its subsidiaries MSI and Marvell International Ltd., entered into a License and Manufacturing Services Agreement (the “License Agreement”) with C2 Microsystems, Inc. (“C2Micro”). The License Agreement is on substantially similar terms as other license and manufacturing services agreements with other third parties. The Company did not recognize any revenue from C2Micro during the third quarter of fiscal 2007 and 2006, respectively. The Company recognized $0.3 million of revenue from the License Agreement with C2 Microsystems during the first nine months of fiscal 2007. Dr. Sehat Sutardja and Weili Dai, through their ownership and control of Estopia, are indirect shareholders of C2Micro. The Company had recorded a receivable of $154,000 and deferred revenue of $42,000 from C2Micro as of October 28, 2006. Herbert Chang, through his ownership and control of C-Squared venture entities, is also an indirect shareholder of C2Micro. Dr. Pantas Sutardja, the Company’s Chief Technology Officer, is also a shareholder of C2Micro.

**Note 10. Subsequent Events**

On November 8, 2006, the Company completed its acquisition of the communications and applications business of Intel Corporation (“ICAP Business”) and paid $600.0 million in cash upon closing of the transaction. The Company recorded a one-time charge for purchased in-process research and development expenses related to the acquisition of $77.8 million in the fourth fiscal quarter of fiscal 2007. In addition to the asset purchase, Marvell and the third party agree to enter into certain additional agreements, including a supply agreement. Under the terms of the agreement the Company has committed to purchase and Intel has agreed to supply a minimum number of wafers at fixed prices. If at the end of any fiscal quarter for Intel, there is a shortfall between the quantity of supply ordered by the Company and the quantities of supply required under the supply agreement commitment, Intel will invoice the Company for the shortfall and will deliver the corresponding quantity upon receipt of payment from the Company. The agreement requires the Company to prepay for certain wafers six months in advance of delivery and requires it to issue non cancellable purchase orders at least six months in advance of requested delivery dates for all purchases under the supply agreement.

In November 2006, the Company borrowed $400.0 million from a group of lenders in the form of term loans to partially finance the acquisition of the ICAP Business. Amounts borrowed under the credit agreement bear interest at the higher of the lender’s prime rate or 0.5% per annum above the Federal Funds Effective Rate, as defined in the agreement, plus a 1% margin. In the case of Eurodollar loans, amounts borrowed bear interest at a rate equal to Adjusted LIBOR plus 2% margin. Such margins are subject to reductions or increases depending on the Company’s credit rating. The credit agreement also contains customary covenants, including financial covenants. The Company may repay the term loans at any time without premium or penalty. The Company must also prepay the term loans depending on certain specified events. Certain of the Company’s subsidiaries have guaranteed the obligations under the credit agreement. In connection with the credit agreement, the Company and three of its subsidiaries entered into pledge agreements with the lender to which each such entity has granted the lender a security interest in the equity interests held by such entity in certain affiliates.

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

*The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding our expectations, beliefs, intentions or strategies regarding the future. Words such as “anticipates,” “expects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “allows,” “can” and similar expressions identify such forward-looking statements. These are statements that relate to future periods and include statements relating to our anticipation that the rate of new orders and shipments will vary signifcantly from quarter to quarter; industry trends; our anticipation that the total amount of sales through distributors will increase in future periods; our expectation that a significant percentage of our sales will continue to come from direct sales to key customers; our expectations regarding the number of days in inventory, inventory levels, and levels of accounts receivable;*

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*our expectations regarding competition; our intention to reduce product costs to offset decreases in average selling prices; our continued efforts relating to the protection of our intellectual property; our expectations regarding the amount of customer concentration in the future; the amount of our future sales in Asia; our intention to continue to invest significant resources for research and development; our expected results, cash flows, and expenses, including those related to sales and marketing, research and development and general and administrative; our intention to complete acquired in-process research and development projects; our intention to make acquisitions, investments, strategic alliances and joint ventures; our expectations regarding revenue, sources of revenue and make-up of revenue; our expectations regarding the impact of legal proceedings and claims; our expectations regarding the adequacy of our capital resources to meet our capital needs; our expectations regarding the growth in business and operations; our expectations regarding our compliance with SEC periodic reporting requirements and NASDAQ listing requirements; our expectations regarding the impact of the restatement of our financial statements in connection with the internal review of our historical stock option granting; our plans regarding remedition of 2007 material weakness and expectations regarding the effectiveness of those remediation efforts; our plan regarding dividends; our plan regarding forward exchange contracts; and the effect of recent accounting pronouncements and changes in taxation rules. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements. Factors that could cause actual results to differ materially from those predicted, include but are not limited to, the impact of international conflict and continued economic volatility in either domestic or foreign markets; our dependence upon the hard disk drive industry which is highly cyclical; our ability to scale our operations in response to changes in demand for existing or new products and services; our maintenance of an effective system of internal controls; our dependence on a small number of customers; our ability to develop new and enhanced products; our success in integrating businesses we acquire and the impact such acquisitions may have on our operating results; our ability to estimate customer demand accurately; the success of our strategic relationships with customers; our reliance on independent foundries and subcontractors for the manufacture, assembly and testing of our products; our ability to manage future growth; the development and evolution of markets for our integrated circuits; our ability to protect our intellectual property; the impact of any change in our application of the United States federal income tax laws and the loss of any beneficial tax treatment that we currently enjoy; the impact of changes in international financial and regulatory conditions; the impact of changes in management; the risk that other remediation efforts will be insufficient to address our material weaknesses in internal controls and the outcome of pending or future litigation and legal proceedings. Additional factors, which could cause actual results to differ materially, include those set forth in the following discussion, as well as the risks discussed in Item 1A, “Risk Factors.” These forward-looking statements speak only as of the date hereof. Unless required by law, we undertake no obligation to update publicly any forward-looking statements.*

**Overview**

We are a leading global semiconductor provider of high-performance analog, mixed-signal, digital signal processing and embedded microprocessor integrated circuits. Our diverse product portfolio includes switching, transceiver, wireless, PC connectivity, gateways, communications controller and storage and power management solutions that serve diverse applications used in business enterprises, consumer electronics and emerging markets. 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. (now Marvell Semiconductor Israel Ltd, or MSIL) in a stock-for-stock transaction for aggregate consideration of approximately $2.5 billion. MSIL develops high-performance internetworking and switching products for the broadband communications market. In June 2003, we acquired RADLAN Computer Communications Ltd. (RADLAN), a leading provider of embedded networking software, for aggregate consideration to date of approximately $134.7 million. In November 2005, we acquired the hard disk and tape drive controller business of QLogic Corporation for approximately $232.5 million. The acquired business designs and supplies controller chips for data storage peripherals, such as hard disk and tape drives. In February 2006, we acquired the semiconductor design business of UTStarcom, Inc. for $40.8 million. The semiconductor design business of UTStarcom designs and supplies chipsets for cellular phone applications. In May 2006, we acquired the printer semiconductor business of Avago Technologies Limited for $263.0 million and potential additional earnout payments. This business designs and develops system-on-chip and system level solutions for both inkjet and laser jet printer systems. In November 2006, we completed the acquisition of the communications and application processor business of Intel Corporation for $600.0 million. The communications and application processor business of Intel designs and develops cellular baseband processors for multi-mode, multi-band wireless handheld devices such as handsets, PDAs and smartphones.

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We offer our customers a wide range of high-performance analog, mixed-signal, digital signal processing and embedded microprocessor integrated circuits. Our products can be utilized in a wide array of enterprise applications including hard disk drives, high-speed networking equipment, PCs, wireless local area network solutions (WLAN) for small office/home office and residential gateway solutions, and consumer applications such as cell phones, printers, digital cameras, MP3 devices, speakers, game consoles and PDAs.

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 and shipment will vary significantly from quarter to quarter. Consequently, if anticipated sales and shipments in any quarter do not occur when expected, expenses and inventory levels could be disproportionately high, and our operating results for that quarter and future quarters may be adversely affected.

Our fiscal year is the 52- or 53-week period ending on the Saturday closest to January 31. In a 52-week year, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal year 2006 comprised 52 weeks.

**Restatement Adjustments - Stock Based Compensation**

***Background***

On about May 23, 2006, our Chief Executive Officer initiated a review of our past stock option granting practices. Then on May 25, 2006, the Board appointed a committee, chaired by and consisting solely of an independent and disinterested member of the Audit Committee who had no prior involvement in the stock option process, to conduct the internal review of our historical stock option practices and related accounting matters. This committee retained outside legal counsel at the time to assist with this internal review. In June and July 2006, this committee identified various stock option grants as having been potentially selected with the benefit of hindsight. During this time we were also named as a nominal defendant, and a number of our current and former directors and officers were named as defendants, in purported shareholder derivative actions.

During this time, we were informed that our outside legal counsel at the time could not represent both the independent committee and us, particularly if that independent committee was going to evaluate and address matters raised by the derivative actions. Our Board met on July 19, 2006 and appointed a successor special committee, titled the Special Committee Regarding Derivative Litigation, to assume responsibility for the stock option review and to evaluate and address matters raised by the derivative action (the “Special Committee”). The same independent director continued as the sole member of the Special Committee and, after consideration of a number of firms, selected new, independent counsel to represent the Special Committee. The Special Committee subsequently retained a second independent law firm (collectively “Independent Counsel”). Independent Counsel retained forensic accounting experts to assist in the internal review.

The Special Committee reported its preliminary findings on quantitative issues to the Audit Committee and the Board on September 28, 2006. Based on the report of the Special Committee, and upon the recommendation of management and the Audit Committee, the Board concluded on October 2, 2006, that we would need to restate our historical financial statements to record additional non-cash charges for stock-based compensation expense related to past option grants and that the historical financial statements and all earnings press releases and similar communications issued by us relating to periods beginning on or after our initial public offering in June 2000 should no longer be relied upon. We reported these conclusions in a current report on Form 8-K filed on the same day.

On February 7, 2007, the former General Counsel of our U.S. subsidiary, Marvell Semiconductor, Inc. (“MSI”), who was a subject of the internal review, raised allegations regarding the independence of the sole member of the Special Committee. Our Audit Committee thereafter formed a subcommittee consisting of the Chairman of the Audit Committee to investigate the matter. The subcommittee appointed a former federal judge to serve as independent reviewer for the subcommittee who in turn retained independent counsel. Although the independent reviewer made no findings as to the truth of the allegations themselves and expressed substantial doubt regarding their credibility, he nevertheless concluded that the independent director should step down from the Special Committee to ensure compliance with the stringent independence standards developed by courts reviewing the independence of special litigation committees formed to assess the merits of shareholder derivative litigation. The subcommittee also found that the

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General Counsel violated our Code of Ethics and Business Conduct for not reporting the allegations timely. The subcommittee accepted the findings of the independent reviewer. We have since terminated the General Counsel for the violation. On March 30, 2007, the independent director resigned from the Special Committee and the Board appointed two independent non-director members to the Special Committee to continue the review of our historical stock option practices and related accounting matters, which action is permitted under our bye-laws. As a result, the Special Committee thereafter comprised two non-directors.

On April 27, 2007, the Special Committee reported its findings to the Board of Directors and to the Implementation Committee, which consists of three independent members of the Board. The Implementation Committee was formed by the Board on April 26, 2007 to make such decisions and take such action as the committee determines to be appropriate in light of the Special Committee’s findings and recommendations. On May 8, 2007, we disclosed on Form 8-K the completion of the independent review.

*Findings of the Special Committee*

From our initial public offering through June 9, 2006 (the “Relevant Period”), option grants awarded to employees who were not then executive officers, as defined in Section 16 of the Securities Exchange Act of 1934, as amended (“Section 16 Officers”), were awarded either by the Board of Directors or the Stock Option Committee of the Board. The Stock Option Committee was formed by the Board of Directors in December 2000 and consisted of the Chief Executive Officer and the former Executive Vice President and Chief Operating Officer. Pursuant to authority delegated by the Board of Directors under Marvell’s 1995 Stock Option Plan, the Stock Option Committee was empowered to act jointly. The Stock Option Committee awarded all grants to non-executive employees after its formation until June 9, 2006.

The Special Committee concluded that only one member of the Stock Option Committee was actively involved in the grant approval process. Of the 59 minutes of meetings of the Stock Option Committee, all of which were prepared by or under the direction of the former General Counsel of MSI, only the first set of minutes were separately prepared for each member’s signature and signed by each of them; subsequently the minutes were only prepared for one member to sign and only one member signed those minutes. Additionally, the Special Committee determined that the Stock Option Committee conducted no meetings with respect to option grants and that minutes reflecting such meetings were false.

The Special Committee determined that in a substantial number of instances grant dates were chosen with the benefit of hindsight, so as to provide exercise prices lower than the fair market value on the actual measurement date.

In addition to the foregoing, the review determined that false documentation supporting new hires was employed to reflect start dates that preceded the actual first day of employment, and to reflect secondary grant authorizations as if they occurred on dates prior to the original grant date, which facilitated giving the employees favorable prices.

From our initial public offering in June 2000 through February 28, 2002, grants to our former Chief Financial Officer were awarded only by the Stock Option Committee. The Stock Option Committee was not advised that it lacked the authority to make such awards. Furthermore, the first award made to our former Chief Financial Officer by the Executive Compensation Committee dated October 16, 2002 was backdated and the Special Committee found that the former General Counsel misled the Executive Compensation Committee with respect to the facts and circumstances surrounding the grant, including the grant date.

During the Relevant Period, option grants to Section 16 Officers and members of the Board of Directors were approved by the Board of Directors or the Executive Compensation Committee or made pursuant to the Automatic Director Grant Program under the 1997 Directors’ Stock Option Plan. In the absence of a meeting, grant approvals by the Executive Compensation Committee were documented via written consents, which were dated “as of” a specified date but signed at a later time. The Executive Compensation Committee comprised three to four independent members of the Board over the Relevant Period. The Special Committee found that current board members who had served or are serving on the Executive Compensation Committee had not engaged in impropriety or intentional backdating with the benefit of hindsight.

The Special Committee found evidence of recommendations made by representatives of Human Resources and Finance and our external auditors between 2000 and 2004 to grant options on fixed grant dates. In August 2004, we implemented revisions to our stock option grant processes and procedures for new hire and secondary grants that generally followed a fixed grant date schedule.

For the period from our initial public offering in June 2000 through June 2006, the Special Committee found a systemic failure in controls over the stock option process, and that corporate documents, including our SEC filings on Form 10-K and Form 10-Q and proxy statements, were false in relation to the accounting and related disclosure covering stock option matters.

The Special Committee found that certain individuals had varying degrees of responsibility for the lack of controls and the inappropriate grant practices.

As to the following individuals, the Special Committee concluded among other things:

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Matthew Gloss, MSI’s corporate counsel from April 2000 until February 2001 and thereafter its Vice President and subsequently, General Counsel until his termination in March 2007, failed to properly advise upper management, including Dr. Sutardja and Ms. Dai, about their responsibilities and duties regarding stock options and other financial filings. The minutes of the Stock Option Committee were prepared by or at the direction of Matthew Gloss. Mr. Gloss was also found to have misled the Executive Compensation Committee by creating false minutes and unanimous written consents including in one instance adding or directing the addition of a grant date to a unanimous written consent after that unanimous written consent was were executed, or by creating minutes that were incomplete, inaccurate or misleading. He also failed to establish proper controls over the stock option process despite being on notice of various control problems.

George A. Hervey, Marvell’s Vice President and Chief Financial Officer throughout the Relevant Period until his resignation in May 2007, failed to properly advise upper management, including Dr. Sutardja and Ms. Dai, about their responsibilities and duties regarding stock options and other financial filings. Mr. Hervey also was found to have been aware of awarding options to two employees prior to their start date. He also failed to establish a system of proper controls despite being on notice of repeated concerns raised by others regarding the stock option process. He signed inaccurate external documents, including our SEC filings and financial statements.

Weili Dai, Marvell’s former Board member, who served as our Executive Vice President and General Manager of the Communications Business Group from 1999 to April 2006 and thereafter also as our Chief Operating Officer until she resigned from such positions in May 2007, played a central role in all Stock Option Committee grants. Ms. Dai participated in the selection of grant dates with the benefit of hindsight and signed false minutes and other employee related corporate documents. The Special Committee also found that she failed to establish proper internal controls and failed to exercise proper review and inquiry as an officer. Certain individuals involved in the process said that they did not feel able to provide her with frank advice. She signed inaccurate external documents, including 10-K’s and proxy statements. She did not personally benefit from any of the grants she approved.

Dr. Sehat Sutardja, Marvell’s Chairman of the Board, President and Chief Executive Officer, was found to have had a limited role in the stock option process and to have participated in only a few instances in awards with incorrect measurement dates with respect to which he had received no or inadequate advice. He signed inaccurate external documents, including our SEC filings, financial statements, and proxy statements. The Special Committee found that he failed to establish proper internal controls and that certain individuals involved in the process to some extent did not feel able to provide him with frank advice. He did not personally benefit from any of the grants he approved.

*Remediation*

With respect to the following employees, the Special Committee made recommendations and Marvell’s Implementation Committee has implemented or is in the process of implementing the following remedial steps:

Marvell accepted the resignation of George A. Hervey on May 2, 2007. All unvested stock options previously awarded to him were cancelled.

The Implementation Committee of our Board of Directors determined, contrary to the recommendation of the Special Committee that Ms. Dai have no continuing role with the Company, that retaining the services of Ms. Dai in a substantially reduced capacity as Director of Strategic Marketing and Business Development, an individual contributor in a non-managerial role, and under the auspices of the Implementation Committee better serves the interests of all shareholders. Ms. Dai will have no authority to undertake any decisions affecting internal controls or financial matters of the Company. The Implementation Committee will provide periodic compliance updates to our Board of Directors on Ms. Dai’s activities. Additionally, all of Ms. Dai’s outstanding options that were unvested as of May 6, 2007 have been cancelled and the exercisability of already vested options have been limited, notwithstanding her continued employment.

Dr. Sehat Sutardja will remain as Chief Executive Officer and as a member of the Board, but will step down as Chairman of the Board in favor of a non-executive Chairman. Dr. Sutardja agreed to reduce the number of shares received in his December 26, 2003 option grant by 500,000 pre-split shares (2,000,000 post-split shares), which is the amount of underlying shares mistakenly awarded by the Executive Compensation Committee in excess of that authorized under the applicable stock option plan.

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In April 2007, the Stock Option Committee was formally dissolved; however, it ceased to function during June 2006 and has granted no options since that time. Currently, the Executive Compensation Committee, comprising two independent Board members, holds periodic meetings to approve equity award grants. The process requires that any proposed equity awards be reviewed in advance by the Human Resources, Legal, Finance and Internal Audit Departments, and requires communication of the details of proposed equity awards to committee members prior to each monthly meeting, as well as awarding recipients promptly after the meeting. Equity awards are priced and valued based upon the closing price of our common stock on the date of the meeting. Decisions of the committee meeting are documented by minutes. Additionally, the Executive Compensation Committee adopted a policy regarding the granting of equity-based compensation awards. Following the Special Committee’s recommendations, we are conducting a search for a new Chief Operating Officer, Chief Financial Officer, General Counsel and Vice President of Compliance. Additionally, the Board’s Governance Committee is conducting a search for three new independent directors to fill existing vacancies. One of these independent directors will succeed Dr. Sutardja as Chairman of the Board.

***Pre-tax Financial Impact of the Equity Award Review***

Approximately 74% of shares granted during the Relevant Period were backdated or resulted in additional accounting charges. Of these re-measured grants, the stock prices on the original grant date were lower than the prices on the appropriate measurement dates for 97% of such shares. Substantially all options granted (99% of shares granted during the Relevant Period) have been evaluated for appropriate re-measurement dates under APB 25.

The types of grant discrepancies uncovered by the internal review (by both the Special Committee and management) and the additional pre-tax stock-compensation expense arising from these adjustments, quantified under APB 25 for periods through fiscal 2006, are summarized as follows (in thousands):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Cumulative** | |  | **Year Ended** | | | **Year Ended** | | | **Year Ended** | | | **Year Ended** | | |  | **Year Ended** | | | **Year Ended** | | |  |
|  |  |  | **through** |  |  | **January 27,** | | |  |
|  |  | **January 28,** | |  | **January 28,** | | | **January 29,** | | | **January 31,** | | | **February 1,** | | |  | **February 2,** | | |  | **2001 and** | |  |
|  |  |  | **2006** |  |  | **2006** |  |  | **2005** |  |  | **2004** |  |  | **2003** |  |  |  | **2002** |  |  | **prior** | |  |
| Board of Director |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Grants (a) | $ | | 1 | $ | | 1 |  | $ | — | | $ | — | | $ | — | | $ | | — | | $ | — | |  |
| Officer Grants (b) |  |  | 19,577 |  |  | 6,317 |  |  | 12,023 |  |  | 836 |  |  | 270 |  |  |  | 127 |  |  | 4 |  |  |
| Re-priced Officer |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Grants (c) |  |  | 39,658 |  |  | 24,827 |  |  | 9,888 |  |  | 4,943 |  |  | — | |  |  | — | |  | — | |  |
| New Hire Grants — |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| effective hire |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| dates (d) |  |  | 19,879 |  |  | 249 |  |  | 1,530 |  |  | 2,729 |  |  | 4,754 |  |  |  | 7,278 |  |  | 3,339 |  |  |
| Other New Hire (e) |  |  | 49,876 |  |  | 5,313 |  |  | 13,235 |  |  | 13,437 |  |  | 10,322 |  |  |  | 7,061 |  |  | 508 |  |  |
| Secondary Grants (e) |  |  | 18,165 |  |  | 2,360 |  |  | 3,713 |  |  | 3,016 |  |  | 4,432 |  |  |  | 3,975 |  |  | 669 |  |  |
| Re-priced New Hire |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Grants (f) |  |  | 100,575 |  |  | 49,798 |  |  | 23,727 |  |  | 25,254 |  |  | (1,885) | |  |  | 3,681 |  |  | - |  |  |
| Evergreen Grants (g) |  |  | 60,838 |  |  | 9,870 |  |  | 11,082 |  |  | 12,634 |  |  | 17,911 |  |  |  | 9,312 |  |  | 29 |  |  |
| Non-employee Grants |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| \* (h) |  |  | 8,800 |  |  | 121 |  |  | 486 |  |  | 1,166 |  |  | (264) | |  |  | 1,884 |  |  | 5,407 |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Termination related | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| charges (i) | | 10,006 |  | — | | — | | — | | — |  | — | |  | 10,006 |  |
|  | $ | 327,375 |  | $ 98,856 |  | $ 75,684 |  | $ 64,015 |  | $ 35,540 |  | $ 33,318 |  | $ | 19,962 |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |



* The restated financial statements include charges for non-employee grants of $1,062,000 for fiscal 2000, $139,000 for fiscal 1999, $41,000 for fiscal 1998, $12,000 for fiscal 1997 and $1,000 for fiscal 1996.

1. *Board of Director Grants:* Non-employee directors receive initial and annual grants in their capacity as directors. A grant of43



24,000 shares to a non-employee director, issued on an annual general meeting date in accordance with the terms of his appointment letter, was outside the 1997 Directors’ Stock Option Plan and therefore, required approval from the Board. The Board approval was obtained at a later date. For accounting purposes, the grant was re-measured based on our stock price at the date of the Board’s ratification.

In December 2006, the terms of this option were reformed to reflect the revised stock option exercise price.

1. *Officer Grants:* During the Relevant Period, we granted options on 13 different dates (including the Re-priced Officer Grants) to the then-Section 16Officers — Dr. Sehat Sutardja, Weili Dai, Dr. Pantas Sutardja and George Hervey. We recorded additional compensation costs for one grant on December 26, 2003 (which represented 75% of options granted) for three of the Officers who were also our founders (“Founder Officers”) and six grants (which represented 96% of options granted) for George Hervey. For accounting purposes, the grant of 12,640,000 shares to the Founder Officers was re-measured based on the stock price at the date the Executive Compensation Committee meeting occurred to approve the grants. Grants to George Hervey totaling 1,279,892 shares of options originally priced at the “as of” dates of the written consents have been re-measured to the last documented date of approval received from members of the Executive Compensation Committee.

In December 2006, the terms of the options deemed to have been issued at a discount were reformed to reflect the revised stock option exercise prices for all affected Section 16 Officer grants. Of these 5.4 million reformed options, we received from the Officers the incremental exercise prices for the portion of these options which had previously been exercised totaling $9.6 million. The reformation of these options did not result in incremental compensation cost in the fourth quarter of fiscal 2007.

The amounts above do not include $7.5 million in unrecognized stock-based compensation that will be recorded in the second quarter of fiscal 2008 in connection with the cancellation of certain officer grants to Dr. Sehat Sutardja and Weili Dai.

1. *Re-priced Officer Grants:* The minutes of the May 22, 2002 Executive Compensation Committee meeting reflect the Executive CompensationCommittee’s approval of a grant to the Founder Officers totaling 1.6 million shares, to be effective on the execution of a unanimous written consent. In June 2002, the Executive Compensation Committee members executed a unanimous written consent dated June 6, 2002 and effective as of May 22,

2002. The Special Committee found that on September 10, 2002 after the former General Counsel had a discussion with two of the Founder Officers who indicated that the setting of the price as of May 22, 2002 was inaccurate, the grant was repriced to the fair market value on June 6, 2002. The Special Committee found that the former General Counsel had misled the Executive Compensation Committee as to the reasons for the change. The Special Committee further found that the amendment was falsely characterized as a documentation error rather than a grant modification. While the affected options were not considered to be issued at a discount on the date of the modification, these shares were subject to variable accounting until our adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123R”) at the beginning of fiscal 2007.

1. *New Hire Grants – effective hire dates:* The internal review identified that 4,669,200 options to 30 new hire recipients which required revision to reflecta later date of effective employment. In all cases, the stock price on the original grant date was lower than the price on the appropriate measurement date. For accounting purposes, the new hire start dates had to be reconstructed through payroll records and evaluated to determine appropriate re-measurement dates.
2. *Other New Hire and Secondary Grants:* In addition to grants issued to new hires at the commencement of their employment, we occasionally issuesecondary grants to employees for outstanding performance, retention or other discretionary reasons outside of the annual performance review cycle. During the Relevant Period, we granted new hire and secondary options on 86 different dates, excluding assumption of acquisition-related options. These dates included grants made from August 2004 onwards when a fixed grant date schedule was set on the first Friday of each month. As a result of the internal review, we recorded additional compensation costs for grants relating to 37 different grant dates, impacting approximately two-thirds of our new hire and secondary grants (totaling 48,708,478 options). The original grant date with respect to a such grant preceded the appropriate measurement date and in substantially all instances, the stock price on the former date was lower than the price on the appropriate measurement date. Generally, the terms of new hire grants, except for their exercise prices, are stated in employee offer letters which are acknowledged by employees. For new hire grants, re-measurement dates were determined based on the first instance when the Stock Option Committee grant date was picked. For secondary grants, as there was no other reliable documentation available to support the measurement date, we applied the date the grant was submitted to stock administration for processing, which typically indicated the conclusion of the grant process. The last date of submission was used unless the submitted change was proven to be purely administrative in nature and unrelated to the terms of the grant. Absent such submission documentation, we used the date the grant entry was created in our option database, as this was the most objectively verifiable date when the terms of the grant were known, in accordance with the SEC Chief Accountant’s letter issued on September 19, 2006, outlining the SEC staff’s interpretation of specific accounting guidance for registrants under APB 25.

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1. *Re-priced New Hire Grants:* Of the new hire grants in the Relevant Period, grant prices were re-set for a segment of grants on three grant dates.Consequently, affected awards totaling 6,224,200 options were subject to variable accounting until our adoption of SFAS 123R. The re-pricing resulted from the Stock Option Committee’s originally designated grant date being modified to a later grant date.
2. *Evergreen Grants:* During the Relevant Period, there were eight Evergreen grant dates. Substantially all employees are entitled to these grants forretention purposes. There were two Evergreen grant dates in both fiscal 2003 and 2004. There was evidence of amendments to the recipients and for the number of options subsequent to the grant date. In all cases, the definitive lists of award recipients grant date could not be reasonably determined until after the original grant date, impacting 54,702,828 options. Consequently, all Evergreen grants were re-measured on subsequent dates when the granting process was considered to be finalized. For purposes of the restatement, we used the date the grant was submitted to stock administration for processing, which typically indicated the conclusion of the grant process. The last date of submission was used unless the submitted change was proven to be purely administrative in nature and unrelated to the terms of the grant. Absent this supporting documentation, the date the grant entry was created in our option database was used. In substantially all instances, the stock price on the former date was lower than the price on the appropriate measurement date. The last Evergreen grant (totaling 7,215,056 options) occurred during fiscal 2007 and the effects on the restatement were included in the restated fair value of the affected grants under SFAS 123R, increasing the grant date fair value of affected options by $0.31 per share.
3. *Non-employee Grants:* Since our inception, 3,819,000 options were granted to 13 recipients who were not employees or directors. These grants wereerroneously accounted for under APB 25 as if they had been made to employees. Of these, four recipients that were granted a total of 1,483,000 options subsequently became employees or directors. As a result, the affected awards were accounted for as non-employee grants under EITF 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services, which resulted in the application of variable accounting on these options until exercised or cancelled. Options held by consultants who became employees or directors have been accounted for under FASB Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, which addresses a change in grantee status.
4. *Termination-related charges:* With respect to option grants to an employee, the post-service exercise period for 605,332 vested stock options waseffectively extended by an unpaid leave of absence arrangement which appears to have lacked substance. We applied APB 25 as if the leave of absence arrangement was a constructive modification extending the exercise period of vested awards. We recorded $10.0 million in additional deferred compensation charges in fiscal 2001.

Notwithstanding the foregoing, the lack of conclusive evidence in the case of certain grants required our management to apply significant judgment in establishing revised measurement dates. We determined that the total cumulative, pre-tax, non-cash, stock-based compensation expense resulting from revised measurement dates under APB 25 was $327.4 million for periods through fiscal 2006. There was no impact on revenue. We adopted SFAS 123R at the beginning of fiscal 2007.

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*Tax Impact of the Equity Award Review and Other*

The majority of the additional $327.4 million stock option compensation is expensed on the financial statements of the entities located in tax jurisdictions having a lower tax rate than that of the U.S. The tax benefits associated with all but $12.0 million of the $327.4 million total expense is reocrded in Bermuda at zero percent tax rate. The $12.0 million of compensation expense and associated tax benefits have resulted in a cumulative deferred tax asset of $2.5 million as of January 2006 and a deferred provision benefit of $4.8 million. The tax impact of the adjustments arising from the equity award review is summarized as follows (in thousands):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Cumulative** | | |  | **Year Ended** | | | **Year Ended** | | | **Year Ended** | | | **Year Ended** | | |  | **Year Ended** | | | **Year Ended** | | |  |
|  |  |  | **through** | |  |  |  |
|  |  | **January 28,** | | |  | **January 28,** | | | **January 29,** | | | **January 31,** | | | **February 1,** | | |  | **February 2,** | | | **January 27,** | | |  |
|  |  |  | **2006** |  |  |  | **2006** |  |  | **2005** |  |  | **2004** |  |  | **2003** |  |  |  | **2002** |  |  | **2001** |  |  |
| Operating costs and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| expenses - Payroll tax |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| \*(a) | $ | | 7,628 |  | $ | | 4,384 |  | $ | 2,306 |  | $ | 921 |  | $ | 17 |  | $ | | — | | $ | — | |  |
| Provision for income tax |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| – Deferred Income |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Tax Benefit (b) |  |  | (4,806) | |  |  | (1,822) | |  | (1,150) | |  | (1,170) | |  | (405) | |  |  | (259) | |  | — | |  |
| Provision for income tax |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| – Section 162(m) and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| utilization of deferred |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| tax assets \*\* (c) |  |  | 27,206 |  |  |  | 27,206 |  |  | — | |  | — | |  | — | |  |  | — | |  | — | |  |
| Tax impact of the |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| equity awarded | $ | | 30,028 |  | $ | | 29,768 |  | $ | 1,156 |  | $ | (249) | | $ | (388) | | $ | | (259) | | $ | — | |  |
| review |  |  |  |  |
| Reduction to deferred |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| tax asset for | $ | | 5,275 |  | $ | | 3,249 |  | $ | 2,026 |  |  | — | |  | — | |  |  | — | |  | — | |  |
| exemption benefit (d) |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |



* $3.0 million of additional employer and employee withholding taxes relating to exercises of affected options, including penalty and interest, and $24.2 million of Section 409A expenses of employee’s, including penalties and interest was also recorded in fiscal 2007.

\*\* $4.9 million of penalty and interest associated with section 162(m) liability was also recorded in fiscal 2007.

1. *Payroll Tax -* The revised federal and state measurement dates for certain stock options as discussed in this filing may result in adverse federal and statetax consequences to holders of those options under IRC Section 409A which was enacted in 2004 to impose certain restrictions on deferred compensation arrangements. The adverse tax consequences are that Section 409A may subject the option holder of the re-measured retroactively priced stock options to a penalty tax and interest on the exercise of the options vesting after December 31, 2004. In addition to similar penalty taxes and interest under California and other state income tax laws upon the exercise of the option grant will apply.

* *Exercised options*. The option grants had been originally issued as incentive stock options. Due to the re-measurement caused by the re-pricing, theyhave become non-statutory stock options. We have accrued employment taxes for the exercise in each of the years due to the conversion of the options from incentive to non-statutory. Included in the restated results through fiscal 2006 are additional employer and employee withholding taxes relating to exercises of affected options totaling $7.6 million, including penalties and interest. The amounts represent additional compensation expense and have been classified in their respective functional categories. On a calendar year basis the amounts total: calendar 2003 of $0.8 million, calendar 2004 of $1.9 million, calendar 2005 of $3.7 million, and calendar 2006 of $4.2 million. The above table reflects the amounts on a fiscal year basis. The full amount of compensation, taxes, interest and penalties has been accrued as reflected above as well as in fiscal 2007. The total amount accrued through fiscal 2007 is $10.6 million.
* *Section 409A*

We have informed employees who exercised options in 2006 that any additional tax costs accruing to such employees from Section 409A, ISO disqualification, and employment taxes will be reimbursed by us and grossed up.

For the Section 409A affected options exercised during calendar year 2006, the IRS issued guidelines that would allow employers to enter into a global settlement of Section 409A issues on behalf of their employees. California and other states have offered a similar program. This liability does not appear in the above table, but has been accured in fiscal year 2007 as explained in the remainder of this section.

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Because all holders of re-measured stock options issued generally were not involved in or aware of the retroactive pricing, the Board of Directors approved our plan to deal with the adverse tax consequences that may be incurred by the holders of the re-measured options in the fourth quarter of fiscal 2007. Therefore, we recorded in the last quarter of fiscal 2007 Section 409A expenses for the adverse tax consequences of the re-measured options exercised during calendar year 2006 of approximately $24.2 million, including estimated penalties and interest. The amount represents additional compensation expense and has been classified in the respective functional categories. We have sent timely notices to the IRS and the California Franchise Tax Board that we have elected to participate in these programs.

* + *Unexercised options*. The IRS has provided taxpayers with the following two ways of correcting unexercised discounted stock options: 1) setting afixed exercise date; or 2) increasing the exercise price of the option up to the fair market price on the date of grant. We are actively evaluating these options. The discount associated with unexercised stock options outstanding as of January 27, 2007 amounted to $51.7 million. We have not determined the tax consequences associated with these potential future remedies.

1. *Deferred Tax Asset for Stock Based Compensation:* We recorded adjustments for the creation of additional deferred tax asset for stock basedcompensation that is deductible at later periods for U.S. income tax purposes on our balance sheets for year end dates of each of fiscal 2002 through fiscal 2006. As a result, additional benefits for income tax arising from stock based compensation was recognized in fiscal 2006 of $1.8 million, fiscal 2005 of $1.1 million, fiscal 2004 of $1.2 million, fiscal 2003 of $0.4 million and fiscal 2002 of $0.3 million. The total gross stock-based compensation cost that results in a deferred tax benefit is $12.0 million of the total expense of $327.4 million.

In addition, we evaluated the impact of the restatement on our global tax provision. Our parent company and its subsidiaries file tax returns in multiple tax jurisdictions around the world. In the U.S. jurisdiction one of our subsidiaries claims a tax deduction relative to stock options with regard to the U.S. distributor business. In accordance with FAS 123R for this jurisdiction where the deduction is claimed during fiscal 2007, we have recorded a deferred tax asset totaling $3.5 million at January 27, 2007, to reflect future tax deductions to the extent we believe such asset is recoverable.

1. *Income Tax - Section 162(m) and utilization of deferred tax assets:* We have accrued for the current and deferred tax impact of $104.5 million of non-deductible officer compensation related to Internal Revenue Section 162(m) (“Section 162(m)”) in fiscal 2006. Section 162(m) limits the deductibility of compensation in excess of one million dollars, but exempts stock option comensation where the option was issued at fair market value on the date of grant. We have determined that $104.5 million of executive compensation in fiscal 2006 does not meet the exclusion criteria under Section 162(m), under existing IRS interpretations, and have therefore accrued $21.8 million of current tax expense and $5.4 million of deferred tax expense associated with the utilization of net operating losses. We have accrued the penalty and interest totaling $4.9 million associated with this liability in fiscal 2007.
2. *Other:* We recorded adjustments to correct an overstatement of deferred tax asset related to the Singapore entity. The original deferred tax asset had notreflected the benefit of the Pioneer status of this entity.

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***Accumulated Deficit Impact of Equity Award Review and Other Tax Adjustments***

The table below reflects the breakdown by year of the cumulative adjustment to retained earnings. Our consolidated financial statements for periods through fiscal 2006 included in previously filed periodic reports with the SEC for such periods have not been amended. The consolidated financial statements, included in this Form 10-Q, have been restated as follows (in thousands):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Cumulative** |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Section** | | | **effect of** |  |  |  |  |  |
|  |  |  |  |  | **Estimated** | | | **Additional** | | | **Additional** | | | **change in** |  |  |  |  |  |
|  |  | **Stock-based** | |  | **162(m) and** | | | **accounting** |  |  | **Total** | |  |
|  |  |  | **additional** | | | **deferred** | | | **deferred** | | | **utilization** | | | **principle,** |  |  |  |
|  | **compensation** | | |  | **payroll tax** | | | **income tax** | | | **income tax** | | | **of deferred** | | | **net of tax** |  |  | **Adjustments,** | |  |
|  |  | **expense** | |  | **expense** | | | **benefit** | | | **provision** | | | **tax assets** | | | **effect** |  |  | **net of tax** | |  |
| Fiscal 2000 and prior \* | $ | 1,255 |  | $ | — |  | $ | — |  | $ | — |  | $ | — |  | $ | — |  | $ | 1,255 |  |  |
| Fiscal 2001 |  | 18,707 |  |  | — | | | — | | | — | | | — | | | — |  |  | 18,707 |  |  |
| Fiscal 2002 |  | 33,318 |  |  | — | | | (259) | |  | — | | | — | | | — |  |  | 33,059 |  |  |
| Fiscal 2003 |  | 35,540 |  |  | 17 |  |  | (405) | |  | — | | | — | | | — |  |  | 35,152 |  |  |
| Fiscal 2004 |  | 64,015 |  |  | 921 |  |  | (1,170) | |  | — | | | — | | | — |  |  | 63,766 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Cumulative effect at |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| January 31, 2004 |  |  |  |  |  | 152,835 |  |  |  | 938 |  |  | (1,834) | |  |  | — |  |  | — | |  | — | |  | 151,939 |  |  |  |  |  |
|  |  | **Net income** | | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **Net income** | |  |
|  |  | **as reported** | | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | **as restated** | |  |
| Fiscal 2005 | $ | 141,661 |  |  |  | 75,684 |  |  |  | 2,306 |  |  | (1,150) | |  |  | 2,026 |  |  | — | |  | — | |  | 78,866 |  | $ | 62,795 |  |  |
| Fiscal 2006: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  | — | |  |  |  |  |  |  |  |
| Three months ended |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| April 30, 2005 |  |  |  |  |  | 8,719 |  |  |  | 866 |  |  | — | |  |  | — |  |  | — | |  | — | |  | 9,585 |  |  |  |  |  |
| Three months ended |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| July 30, 2005 |  |  |  |  |  | 29,120 |  |  |  | 1,083 |  |  | — | |  |  | — |  |  | — | |  | — | |  | 30,203 |  |  |  |  |  |
| Three months ended |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| October 29, 2005 |  |  |  |  |  | 9,102 |  |  |  | 589 |  |  | — | |  |  | — |  |  | — | |  | — | |  | 9,691 |  |  |  |  |  |
| Three months ended |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| January 28, 2006 |  |  |  |  |  | 51,915 |  |  |  | 1,846 |  |  | (1,822) | |  |  | 3,249 |  |  | 27,206 |  |  | — | |  | 82,394 |  |  |  |  |  |
| Total for Fiscal 2006 |  | 331,363 |  |  |  | 98,856 |  |  |  | 4,384 |  |  | (1,822) |  |  |  | 3,249 |  |  | 27,206 |  |  | — |  |  | 131,873 |  |  | 199,490 |  |  |
| Cumulative effect at |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| January 28, 2006 |  |  |  |  |  | 327,375 |  |  |  | 7,628 |  |  | (4,806) | |  |  | 5,275 |  |  | 27,206 |  |  | — | |  | 362,678 |  |  |  |  |  |
| Three months ended |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| April 29, 2006 |  | 75,297 |  |  |  | 4,225 |  |  |  | 2,170 |  |  | (3,325) | |  |  | — |  |  | 3,510 |  |  | (8,846) | |  | (2,266) | |  | 77,563 |  |  |
| Cumulative effect at |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | | | $ | 331,600 |  | $ | | 9,798 |  | $ | (8,131) | | $ | | 5,275 | $ | | 30,716 |  | $ | (8,846) | | $ | 360,412 |  |  |  |  |  |
| April 29, 2006 |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |



* Comprised $1,062,000 for fiscal 2000, $139,000 for fiscal 1999, $41,000 for fiscal 1998, $12,000 for fiscal 1997 and $1,000 for fiscal 1996.

The restatement adjustments decreased previously reported basic net income per share by $0.24 and $0.14 for fiscal 2006 and 2005, respectively and diluted net income per share by $0.20 and $0.13 for fiscal 2006 and fiscal 2005, respectively.

***Cashflows Impact of Equity Award Review***

The additional payable for payroll taxes associated with these stock option grants of approximately $10.6 million, additional Section 409A expenses for the adverse tax consequences of the re-measured options exercised during calendar year 2006 of approximately $24.2 million, and Section 162(m) liabilities of $26.5 million for cumulative period from fiscal 2001 through 2007, represents future cash outflow totaling $61.3 million.

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The following tables present the impact of the financial statement adjustments on the previously reported Consolidated Statement of Operations for the three and nine months ended October 29, 2005:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended October 29, 2005** | | | | | | |  |  | **Nine Months Ended October 29, 2005** | | | | | | |  |  |
|  |  | **As** |  |  |  |  |  | **As** |  |  | **As** |  |  |  |  |  | **As** | |  |
|  |  | **Previously** |  | **Adjustments** | | |  |  |  | **Previously** |  | **Adjustments** | | |  |  |
|  |  | **Reported** |  |  | **Restated** |  |  | **Reported** |  |  | **Restated** | |  |
|  |  |  |  |  |  | **(In thousands, except per share amounts)** | | | | | | | |  |  |  |  |  |  |
| Net revenue | $ | 426,026 | $ | | — | | $ | 426,026 | $ | | 1,181,250 | $ | | — | | $ | 1,181,250 |  |  |
| Operating costs and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| expenses: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Cost of goods sold |  | 197,077 |  |  | 503(A) | |  | 197,580 |  |  | 555,967 |  |  | 2,849(A) | |  | 558,816 |  |  |
| Research and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| development |  | 77,689 |  |  | 5,354(A) | |  | 83,043 |  |  | 222,751 |  |  | 26,347(A) | |  | 249,098 |  |  |
| Selling and marketing |  | 21,634 |  |  | 1,495(A) | |  | 23,129 |  |  | 63,898 |  |  | 7,392(A) | |  | 71,290 |  |  |
| General and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| administrative |  | 9,029 |  |  | 2,804(A) | |  | 11,833 |  |  | 24,107 |  |  | 14,744(A) | |  | 38,851 |  |  |
| Amortization of stock- |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| based compensation |  | 465 |  |  | (465)(A) | |  | — |  |  | 1,853 |  |  | (1,853)(A) | |  | — | |  |
| Amortization and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| write-off of goodwill |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| and acquired |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| intangible assets and |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| other |  | 19,746 |  |  | — | |  | 19,746 |  |  | 59,258 |  |  | — | |  | 59,258 |  |  |
| Total operating costs |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| and expenses |  | 325,640 |  |  | 9,691 |  |  | 335,331 |  |  | 927,834 |  |  | 49,479 |  |  | 977,313 |  |  |
| Operating income (loss) |  | 100,386 |  |  | (9,691) |  |  | 90,695 |  |  | 253,416 |  |  | (49,479) |  |  | 203,937 |  |  |
| Interest and other income, |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| net |  | 5,244 |  |  | — | |  | 5,244 |  |  | 13,240 |  |  | — | |  | 13,240 |  |  |
| Income (loss) before |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| income taxes |  | 105,630 |  |  | (9,691) | |  | 95,939 |  |  | 266,656 |  |  | (49,479) | |  | 217,177 |  |  |
| Provision for income |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| taxes |  | 12,584 |  |  | — | |  | 12,584 |  |  | 32,776 |  |  | — | |  | 32,776 |  |  |
| Net income (loss) | $ | 93,046 |  | $ | (9,691) |  | $ | 83,355 |  | $ | 233,880 |  | $ | (49,479 | ) | $ | 184,401 |  |  |
| Basic net income (loss) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| per share | $ | 0.16 | $ | | (0.01) | | $ | 0.15 | $ | | 0.42 | $ | | (0.09) | | $ | 0.33 |  |  |
| Diluted net income (loss) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| per share | $ | 0.15 | $ | | (0.02) | | $ | 0.13 | $ | | 0.37 | $ | | (0.08) | | $ | 0.29 |  |  |
| Weighted average shares |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| — basic |  | 567,310 |  |  |  |  |  | 567,310 |  |  | 562,243 |  |  |  |  |  | 562,243 |  |  |
| Weighted average shares |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| — diluted |  | 632,424 |  |  |  |  |  | 632,424 |  |  | 626,673 |  |  |  |  |  | 626,673 |  |  |



(A). Adjustments for additional stock-based compensation expense pursuant to APB 25 and reclassification of previously reported stock-based compensation expenses to the respective functional cost and expense line items.

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The following tables present the impact of the financial statement adjustments on the previously reported Consolidated Balance Sheets as of January 28, 2006:

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | **January 28, 2006** | |  |  |  |  |
|  |  |  |  | **As** | |  |  |  |  | **As** | |  |
|  |  |  |  | **Previously** | |  | **Adjustments** | |  |  |
|  |  |  |  | **Reported** | |  |  | **Restated** | |  |
|  |  |  |  | **(In thousands, except per share amounts)** | | | | | |  |  |  |
|  | **ASSETS** |  |  |  |  |  |  |  |  |  |  |  |
|  | Current assets: |  |  |  |  |  |  |  |  |  |  |  |
|  | Cash and cash equivalents | $ | | 348,431 |  | $ | — | | $ | 348,431 |  |  |
|  | Short-term investments |  |  | 572,591 |  |  | — | |  | 572,591 |  |  |
|  | Accounts receivable, net of allowance of $3,132 |  |  | 245,164 |  |  | — | |  | 245,164 |  |  |
|  | Inventories |  |  | 211,374 |  |  | — | |  | 211,374 |  |  |
|  | Prepaid expenses and other current assets |  |  | 104,307 |  |  | — | |  | 104,307 |  |  |
|  | Deferred income taxes |  |  | 18,007 |  |  | (14,062)(B) | |  | 3,945 |  |  |
|  | Total current assets |  |  | 1,499,874 |  |  | (14,062) |  |  | 1,485,812 |  |  |
|  | Property and equipment, net |  |  | 260,921 |  |  | — | |  | 260,921 |  |  |
|  | Goodwill |  |  | 1,558,209 |  |  | — | |  | 1,558,209 |  |  |
|  | Acquired intangible assets, net |  |  | 111,973 |  |  | — | |  | 111,973 |  |  |
|  | Other non-current assets |  |  | 82,312 |  |  | 5,279(B) | |  | 87,591 |  |  |
|  | Total assets |  | $ | 3,513,289 |  | $ | (8,783) |  | $ | 3,504,506 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |
| **LIABILITIES AND SHAREHOLDERS’ EQUITY** |  |  |  |  |  |  |  |  |  |  |  |
|  | Current liabilities: |  |  |  |  |  |  |  |  |  |  |  |
|  | Accounts payable | $ | | 196,606 |  | $ | — | | $ | 196,606 |  |  |
|  | Accrued liabilities |  |  | 34,905 |  |  | — | |  | 34,905 |  |  |
|  | Accrued employee compensation |  |  | 51,549 |  |  | 7,628(C) | |  | 59,177 |  |  |
|  | Income taxes payable |  |  | 3,352 |  |  | 21,042(B) | |  | 24,394 |  |  |
|  | Deferred income |  |  | 29,773 |  |  | — | |  | 29,773 |  |  |
|  | Current portion of capital lease obligations |  |  | 16,563 |  |  | — | |  | 16,563 |  |  |
|  | Total current liabilities |  |  | 332,748 |  |  | 28,670 |  |  | 361,418 |  |  |
|  | Capital lease obligations, net of current portion |  |  | 24,447 |  |  | — | |  | 24,447 |  |  |
|  | Non-current income taxes payable |  |  | 85,126 |  |  | 1,419(B) | |  | 86,545 |  |  |
|  | Other long-term liabilities |  |  | 24,871 |  |  | — | |  | 24,871 |  |  |
|  | Total liabilities |  |  | 467,192 |  |  | 30,089 |  |  | 497,281 |  |  |
|  | Shareholders’ equity: |  |  |  |  |  |  |  |  |  |  |  |
|  | Preferred stock, $0.002 par value; 8,000 shares authorized; no shares issued and |  |  |  |  |  |  |  |  |  |  |  |
|  | outstanding |  |  | — | |  | — | |  | — | |  |
|  | Common stock, $0.002 par value; 992,000 shares authorized; 582,776 shares issued |  |  |  |  |  |  |  |  |  |  |  |
|  | and outstanding |  |  | 1,165 |  |  | — | |  | 1,165 |  |  |
|  | Additional paid-in capital |  |  | 3,249,587 |  |  | 384,652(A) | |  | 3,634,239 |  |  |
|  | Deferred stock-based compensation |  |  | (1,141) | |  | (60,846)(A) | |  | (61,987) | |  |
|  | Accumulated other comprehensive loss |  |  | (1,759) | |  | — | |  | (1,759) | |  |
|  | Accumulated deficit |  |  | (201,755) | |  | (362,678) | |  | (564,433) | |  |
|  | Total shareholders’ equity |  |  | 3,046,097 |  |  | (38,872) |  |  | 3,007,225 |  |  |
|  | Total liabilities and shareholders’ equity |  | $ | 3,513,289 |  | $ | (8,783 | ) | $ | 3,504,506 |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |



(A). Adjustments for additional stock-based compensation expense pursuant to APB 25, net of tax benefit from employee stock transactions.

(B). Adjustments to deferred tax assets arising from the stock-based compensation charge.

(C). Adjustments for additional payroll taxes.

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The following tables present the impact of the financial statement adjustments on the previously reported Statements of Cash Flows for three and nine months ended October 29, 2005:

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Nine Months Ended October 29, 2005** | | | | |  |  |
|  |  | **As** |  |  |  | **As** | |  |
|  |  | **Previously** |  | **Adjustments** |  |  |
|  |  | **Reported** |  |  | **Restated** | |  |
|  |  |  | **(In thousands)** | |  |  |  |  |
| **Cash flows from operating activities:** |  |  |  |  |  |  |  |  |
| Net income | $ | 233,880 | $ | (49,479) | $ | 184,401 |  |  |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |  |  |  |  |  |  |
| Depreciation and amortization |  | 41,840 |  | — |  | 41,840 |  |  |

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Stock-based compensation |  | 1,853 |  |  |  | 46,941(A) | |  | 48,794 |  |
| Amortization of acquired intangible assets |  | 59,258 |  |  |  | — | |  | 59,258 |  |
| Changes in assets and liabilities, net of acquisition: |  |  |  |  |  |  |  |  |  |  |
| Accounts receivable |  | (52,383) | |  |  | — | |  | (52,383) | |
| Inventories |  | (21,040) | |  |  | — | |  | (21,040) | |
| Prepaid expenses and other assets |  | (105,044) | |  |  | — | |  | (105,044) | |
| Accounts payable |  | 60,441 |  |  |  | — | |  | 60,441 |  |
| Accrued liabilities and other |  | 3,358 |  |  |  | — | |  | 3,358 |  |
| Accrued employee compensation |  | 2,363 |  |  |  | 2,538(B) | |  | 4,901 |  |
| Income taxes payable |  | 29,562 |  |  |  | — | |  | 29,562 |  |
| Deferred income |  | 9,854 |  |  |  | — | |  | 9,854 |  |
| Net cash provided by operating activities |  | 263,942 |  |  |  | — |  |  | 263,942 |  |
| **Cash flows from investing activities:** |  |  |  |  |  |  |  |  |  |  |
| Purchases of short-term investments |  | (490,811) | |  |  | — | |  | (490,811) | |
| Sales and maturities of short-term investments |  | 533,876 |  |  |  | — | |  | 533,876 |  |
| Purchases of property and equipment |  | (62,309) | |  |  | — | |  | (62,309) | |
| Net cash provided by (used in) investing activities |  | (19,244) |  |  |  | — |  |  | (19,244) |  |
| **Cash flows from financing activities:** |  |  |  |  |  |  |  |  |  |  |
| Proceeds from the issuance of common stock |  | 65,732 |  |  |  | — | |  | 65,732 |  |
| Principal payments on capital lease obligations |  | (12,042) | |  |  | — | |  | (12,042) | |
| Net cash provided by financing activities |  | 53,690 |  |  |  | — |  |  | 53,690 |  |
| Net increase (decrease) in cash and cash equivalents |  | 298,388 |  |  |  | — |  |  | 298,388 |  |
| Cash and cash equivalents at beginning of period |  | 166,471 |  |  |  | — | |  | 166,471 |  |
| Cash and cash equivalents at end of period | $ | 464,859 |  |  | $ | — |  | $ | 464,859 |  |
|  |  |  |  |  |  |  |  |  |  |  |



(A). Adjustments for additional stock-based compensation expense pursuant to APB. 25.

(B). Adjustments for additional payroll tax.

**Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 and Estimates” 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 27, 2007, as filed concurrently with this Form 10-Q with the U.S. Securities and Exchange Commission. There have been no material changes in any of our accounting policies during fiscal 2007.

*Stock-Based Compensation.* Effective January 29, 2006, we adopted FASB Statement of Financial Accounting Standards No. 123 (revised 2004), “ShareBased Payment” (“SFAS 123R”). SFAS 123R requires the measurement and recognition of compensation expense for all share-based awards to employees and directors, including employee stock options, restricted stock units and employee

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stock purchase rights based on estimated fair values. SFAS 123R supersedes previous accounting guidance under Accounting Principles Board Opinion No. 25 “Accounting for Stock Issued to Employees” (“APB 25”) and related interpretations and amends SFAS No.95, “Statement of Cash Flows.” Under SFAS 123R, the benefits of tax deductions in excess of recognized compensation cost has to be reported as a financing cash flow, rather than as an operating cash flow. This may reduce future net cash flows from operations and increase future net financing cash flows. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (“SAB 107”), which provides guidance regarding the interaction of SFAS 123R and certain SEC rules and regulations. We have applied the provisions of SAB 107 in our adoption of SFAS 123R.

Prior to January 29, 2006, we accounted for our stock based compensation plans using the intrinsic value method under the provisions of APB 25 and related guidance, under the accelerated method of amortization. We adopted SFAS 123R using the modified prospective method. Under the modified prospective method, our results of operations include compensation costs of unvested options granted prior to January 29, 2006, and options granted subsequent to that date. For grants prior to January 29, 2006, we amortize stock-based compensation expense under the accelerated method. For grants from January 29, 2006, we amortize stock-based compensation expense ratably over the expected term.

As a result of the adoption of SFAS 123R, our stock-based compensation increased from $9.6 million and $48.8 million in the three and nine months ended October 29, 2005, respectively, to $42.1 million and $146.5 million in the three and nine months ended October 28, 2006, respectively. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R.

SFAS 123R requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods. We have estimated the fair value of each award as of the date of grant using the Black-Scholes option pricing model, which was developed for use in estimating the value of traded options that have no vesting restrictions and that are freely transferable. The Black-Scholes model considers, among other factors, the expected life of the award and the expected volatility of our stock price. Although the Black-Scholes model meets the requirements of SFAS 123R and SAB 107, the fair values generated by the model may not be indicative of the actual fair values of our awards as it does not consider other factors important to those share-based payment awards, such as continued employment, periodic vesting requirements, and limited transferability.

SFAS 123R also requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. From January 29, 2006, stock-based compensation expense was recorded net of estimated forfeitures such that expense was recorded only for those stock-based awards that are expected to vest. Previously under APB 25, previously recognized expense was reversed for the portion of awards forfeited prior to vesting as and when forfeitures occurred.

Prior to the adoption of SFAS 123R, we presented deferred compensation as a separate component of shareholders’ equity. In accordance with the provisions of SFAS 123R, on January 29, 2006, we eliminated unamortized deferred compensation totaling $62.0 million on that date with a corresponding reduction in additional paid-in capital.

*Accounting for Income Taxes.* To prepare our consolidated financial statements, we estimate our income taxes in each of the jurisdictions in which weoperate. This process involves estimating our actual tax exposure together with assessing temporary differences resulting from the differing treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income and, to the extent we believe that recovery is not likely, we must establish a valuation allowance.

Significant management judgment is required in determining current and long-term tax payable, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. We have recorded a valuation allowance against our net deferred tax assets due to uncertainties related to our ability to realize some of our deferred tax assets before the underlying tax attributes expire primarily related to our ability to utilize research and development tax credits and certain acquired net operating losses. The valuation allowance determination is based on an evaluation of all available positive and negative evidence in determining our estimates of taxable income in the jurisdictions in which we operate and the period over which our deferred tax assets will be recoverable.

As a multinational corporation, we conduct our business in many countries and are subject to taxation in many jurisdictions. The taxation of our business is subject to the application of multiple and sometimes conflicting tax laws and regulations as well as multinational tax conventions. The application of tax laws and regulations is subject to legal and factual interpretation, judgment and

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uncertainty. Tax laws themselves are subject to change as a result of changes in fiscal policy, changes in legislation, and the evolution of regulations and court rulings. Consequently, taxing authorities may impose tax assessments or judgments against us that could materially impact our tax liability and/or our effective income tax rate.

In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to record additional income tax expense or establish an additional valuation allowance, which could materially impact our financial position and results of operations.

**Results of Operations**

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

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | **Nine Months Ended** | | | |
|  |  | **October 28,** | | **October 29,** |  | **October 28,** | | **October 29,** |  |
|  |  | **2006** |  | **2005** |  | **2006** |  | **2005** |  |
|  |  |  |  | **(restated)** |  |  |  | **(restated)** |  |
|  | Net revenue | 100.0% | | 100.0% | | 100.0% | | 100.0% | |
|  | Operating costs and expenses: |  |  |  |  |  |  |  |  |
|  | Cost of goods sold | 49.2 |  | 46.4 |  | 48.0 |  | 47.3 |  |
|  | Research and development | 29.4 |  | 19.5 |  | 26.9 |  | 21.1 |  |
|  | Selling and marketing | 7.3 |  | 5.4 |  | 7.2 |  | 6.0 |  |
|  | General and administrative | 7.8 |  | 2.8 |  | 4.9 |  | 3.3 |  |
|  | Amortization of acquired intangible assets | 5.2 |  | 4.6 |  | 4.4 |  | 5.0 |  |
|  | Total operating costs and expenses | 98.9 |  | 78.7 |  | 91.4 |  | 82.7 |  |
|  | Operating income | 1.1 |  | 21.3 |  | 8.6 |  | 17.3 |  |
|  | Interest and other income, net | 1.3 |  | 1.2 |  | 1.0 |  | 1.1 |  |
|  | Income before income taxes | 2.4 |  | 22.5 |  | 9.6 |  | 18.4 |  |
|  | Provision for income taxes | 1.2 |  | 3.0 |  | 2.1 |  | 2.8 |  |
|  | Income before change in accounting principle | 1.2 |  | 19.5 |  | 7.5 |  | 15.6 |  |
|  | Cumulative effect of change in accounting |  |  |  |  |  |  |  |  |
|  | principle, net of tax effect | — | | — | | 0.5 |  | — | |
|  | Net income | 1.2 | % | 19.5 | % | 8.0 | % | 15.6 | % |
|  |  |  |  |  |  |  |  |  |  |

**Three and Nine Months Ended October 28, 2006 and October 29, 2005**

*Net Revenue*

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Three Months Ended** | | | | **Percent** | | **Nine Months Ended** | | | | **Percent** | |  |
|  |  |  | **October 28,** |  | **October 29,** |  | **October 28,** |  | **October 29,** |  |  |
|  |  |  | **2006** |  | **2005** |  | **Change** |  | **2006** |  | **2005** |  | **Change** |  |  |
|  | Net revenue |  | $ 520,398 |  | $ 426,026 |  | 22.2% | | $ 1,615,579 |  | $ 1,181,250 |  | 36.8% | |  |

Net revenue consists primarily of product revenue from sales of our semiconductor devices, and to a much lesser extent, development revenue derived from development contracts with our customers. Net revenue is gross revenue, net of accruals for estimated sales returns and allowances. The increase in net revenue in the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006 reflected an increase in volume shipments of our storage System-on-Chips, or SOCs, which increased $31.7 million, printer semiconductor solutions and wireless products, which increased $25.0 million, and hard disk drive

controller products, which increased $15.9 million. The increases in net revenue in the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006 reflected a significant increase in volume shipments of our storage SOCs, which increased $196.7 million, printer semiconductor solutions and wireless products, which increased $102.1 million, hard disk drive controller products, which increased $63.5 million, and switching products, which increased $44.6 million. The increases in net revenue were primarily due to increased acceptance of our storage SOC products and increased market share gains in the PC desktop segment with our storage SOC products. The increase in net revenue for the printer semiconductor solutions and wireless products were due to the incremental revenue from the acquisition of the printer semiconductor business of Avago Technologies Limited. The increase in net revenue for our switching products was due to increased acceptance of our switching products. Revenue derived from development contracts increased in absolute dollars during the third quarter and first nine months of fiscal 2007 as compared to the third quarter and first nine months of fiscal 2006, but represented less than 10% of net revenue for each period.

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We expect that revenue for fiscal 2007 will increase from the level of revenue we reported in fiscal 2006 due to increases in shipments and volume production of our storage SOCs into the PC desktop segment and consumer storage electronics. Also, we expect additional growth in fiscal 2007 compared to fiscal 2006 due to increases in shipments of our WLAN products from new design wins, our Gigabit Ethernet products as well as incremental revenue from the products acquired from QLogic, Intel and Avago Technologies and UTStarcom.

Historically, a relatively small number of customers have accounted for a significant portion of our revenue. For the three months ended October 28, 2006, three customers each represented more than 10% of our net revenue, for a combined total of 42% of our net revenue. For the nine months ended October 28, 2006, four customers each represented more than 10% of our net revenue, for a combined total of 51% of our net revenue. For the three and nine months ended October 29, 2005, three customers each represented more than 10% of our net revenue. For the three and nine months ended October 29, 2005, three customers combined for a total of 45% of our net revenue. In addition, no distributor accounted for more than 10% of our net revenue in the three and nine months ended October 28, 2006 but one distributor accounted for approximately 12% and 11% of our net revenue in the three and nine months ended October 29, 2005.

Because we sell our products to many OEM manufacturers who have manufacturing operations located in Asia, a significant percentage of our sales are made to customers located outside of the United States. Sales to customers located in Asia represented 94% of our net revenue for the three months ended October 28, 2006 and October 29, 2005. Sales to customers located in Asia represented 93% and 94% of our net revenue for the nine months ended October 28, 2006 and October 29, 2005, respectively. The rest of our sales are to customers located in the United States and other geographic regions. We expect that a significant portion of our revenue will continue to be represented by sales to our customers in Asia. Substantially all of our sales to date have been denominated in United States dollars.

*Cost of Goods Sold*

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Three Months Ended** | | | | **Percent** | | **Nine Months Ended** | | | | | **Percent** | |  |
|  | **October 28,** | | **October 29,** |  | **October 28,** | |  | **October 29,** |  |  |
|  | **2006** |  | **2005** |  | **Change** | | **2006** |  | **2005** | |  | **Change** | |  |
|  |  |  | **(restated)** |  |  |  |  |  |  | **(restated)** |  |  |  |  |
| Cost of goods sold | $ 256,090 |  | $ 197,580 |  | 29.6% $ 775,398 | | |  | $ 558,816 | |  | 38.8% | |  |
| % of net revenue | 49.2% | | 46.4% | |  |  | 48.0% | | 47.3% | | |  |  |  |
| Gross margin | 50.8% | | 53.6% | |  |  | 52.0% | | 52.7% | | |  |  |  |

Cost of goods sold consists primarily of the costs of manufacturing, assembly and test of integrated circuit devices and related overhead costs, product warranty costs, royalties and compensation and associated costs relating to manufacturing support, logistics and quality assurance personnel, including stock-based compensation costs. Gross margin is calculated as net revenue less cost of goods sold as a percentage of net revenue. The decrease in gross margin percentage for the three months ended October 28, 2006 compared to the three months ended October 29, 2005 was primarily due to higher inventory excess and obsolescence provision of $6.0 million, increased stock-based compensation costs of $2.1 million, product costs associated with inventory that was acquired from our acquisitions and higher royalties of $1.7 million. Partially offsetting the decrease in gross margins were manufacturing efficiencies and product cost savings resulting from the benefits of decreased foundry pricing. The increase in excess and obsolescence provision was due to the mix and quantities of products on hand. The increase in stock-based compensation expense was a result of our adoption of SFAS 123R. The increase in royalties in the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006 was due to higher sales of products that integrated licensed technology. The decrease in gross margin percentage in the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006 was due to higher inventory obsolescence provision of $10.3 million, increased stock-based compensation costs of $5.6 million, products costs associated with inventory that was acquired from our acquisitions and higher royalties of $5.8 million. The costs associated with contracted development work are included in research and development expense. Our gross margins may fluctuate in future periods due to, among other things, changes in the mix of products sold, the timing of production ramps of new products, increased pricing pressures from our customers and competitors, particularly in the consumer product markets that we are targeting, charges for obsolete or potentially excess inventory, changes in the costs charged by our manufacturing and test subcontractors and changes in the amount of development revenue recognized.

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  | 54 |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | *Research and Development and Other* |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  |  | **Three Months Ended** | | | | **Percent** | | **Nine Months Ended** | | | | | **Percent** | | |  |
|  |  | **October 28,** | | **October 29,** |  | **October 28,** | |  | **October 29,** |  |  |
|  |  | **2006** |  | **2005** |  | **Change** | | **2006** |  | **2005** | |  | **Change** | | |  |
|  |  |  |  | **(restated)** |  |  |  |  |  |  | **(restated)** |  |  |  |  |  |
|  | Research and development and other | $ 152,939 |  | $ 83,043 |  | 84.2% $ 434,812 | | |  | $ 249,098 | |  | 74.6% | |  |  |
|  | % of net revenue | 29.4% | | 19.5% | |  |  | 26.9% | | 21.1% | | |  |  |  |  |



Research and development expense consists primarily of compensation and associated costs relating to development personnel, including stock-based compensation expenses, prototype costs, depreciation and amortization expense, and allocated occupancy costs for these operations. The increase in research

and development expense in absolute dollars in the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006 was primarily due to the net hiring of additional development personnel, including personnel related to our acquisitions of the hard disk and tape drive controller business of QLogic Corporation in November 2005, the semiconductor division of UTStarcom, Inc. in February 2006 and the printer semiconductor division of Avago Technologies Limited in May 2006, which resulted in an increase in salary and related costs of $29.2 million. In addition, research and development expenses increased due to stock-based compensation expenses of $21.4 million as a result of our adoption of SFAS 123R. Additionally, we incurred increased costs for depreciation and amortization expense of $5.2 million arising from purchases of property, equipment and technology licenses, increased costs of $3.0 million for prototype and related product tape-out costs for new product initiatives, increased costs of $2.1 million for patent related fees to protect newly developed intellectual property, and increased costs of $1.3 million for evaluation boards and supplies arising from an increase in new product initiatives, and other allocated expenses of $1.4 million related to our expanding operations. Research and development related costs for the three month period ended October 28, 2006 was $148.9 million, as compared to $81.1 million for the three month period ended October 29, 2005, an increase of $67.8 million or 83.4%.

The increase in research and development expense in absolute dollars in the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006 was primarily due to stock-based compensation expenses of $68.3 million as a result of our adoption of SFAS 123R. In addition, research and development expenses increased due to the net hiring of additional development personnel, including personnel related to our acquisitions of the hard disk and tape drive controller business of QLogic Corporation in November 2005, the semiconductor division of UTStarcom, Inc. in February 2006 and the printer semiconductor business of Avago Technologies Limited in May 2006, which contributed to an increase in salary and related costs of $72.3 million. Additionally, we incurred increased costs for depreciation and amortization expense of $10.0 million arising from purchases of property, equipment and technology licenses, increased costs of $9.6 million for prototype and related product tape-out costs for new product initiatives, increased costs of $3.9 million for patent related fees to protect newly developed intellectual property and increased costs of $5.0 million for evaluation boards and supplies arising from an increase in new product initiatives, and other allocated expenses of $2.8 million related to our expanding operations. Research and development related costs for the nine month period ended October 28, 2006, was $425.7 million, as compared to $244.0 million for the nine month period ended October 29, 2005, an increase of $181.7, million or 74.5%.

We expect that research and development expense will increase in absolute dollars in future periods as we continue to devote resources to develop new products, migrate to lower process geometries, meet the changing requirements of our customers, expand into new markets and technologies and hire additional personnel, including those from our acquisitions.

*Selling and Marketing*

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Three Months Ended** | | | | **Percent** | | **Nine Months Ended** | | | | | **Percent** | |  |
|  | **October 28,** | | **October 29,** |  | **October 28,** | |  | **October 29,** |  |  |
|  | **2006** |  | **2005** |  | **Change** | | **2006** |  | **2005** | |  | **Change** | |  |
|  |  |  | **(restated)** |  |  |  |  |  |  | **(restated)** |  |  |  |  |
| Selling and marketing | $ 37,875 |  | $ 23,129 |  | 63.8% $ 116,004 | | |  | $ 71,290 | |  | 62.7% | |  |
| % of net revenue | 7.3% | | 5.4% | |  |  | 7.2% | | 6.0% | | |  |  |  |

Selling and marketing expense consists primarily of compensation and associated costs relating to sales and marketing personnel, including stock-based compensation expenses, sales commissions, promotional and other marketing expenses, and allocated occupancy costs for these operations. The increase in selling and marketing expense in absolute dollars in the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006 was primarily due to stock-based compensation expenses of $5.1 million as a result of our adoption of SFAS 123R. In addition, selling and marketing expenses increased due to the net hiring of additional sales and marketing personnel, which resulted in an increase in salary and related costs of $3.9 million. Additionally, we incurred other variable sales and marketing costs of $2.8 million related to expanding our sales and marketing activities as we broadened our customer and product base and increased commission costs of $0.4 million due to the increase in sales.

The increase in selling and marketing expense in absolute dollars in the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006 was primarily due to stock-based compensation expenses of $16.5 million as a result of our adoption of SFAS 123R. In addition, selling and marketing expenses increased due to the net hiring of additional sales and marketing personnel, which contributed to an increase in salary and related costs of $11.8 million. Additionally, we incurred other variable sales and marketing costs of $8.4 million related to expanding our sales and marketing activities as we broadened our customer and product base and increased commission costs of $2.7 million due to the increase in sales.

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We expect that selling and marketing expense will increase in absolute dollars in future periods as we hire additional sales and marketing personnel and expand our sales and marketing efforts into product markets such as consumer applications for our wireless and storage products.

*General and Administrative*

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|  | **Three Months Ended** | | | | **Percent** | | **Nine Months Ended** | | | | | **Percent** | |  |
|  | **October 28,** | | **October 29,** |  | **October 28,** | |  | **October 29,** |  |  |
|  | **2006** |  | **2005** |  | **Change** | | **2006** |  | **2005** | |  | **Change** | |  |
|  |  |  | **(restated)** |  |  |  |  |  |  | **(restated)** |  |  |  |  |
| General and administrative | $ 40,427 |  | $ 11,833 |  | 241.6% $ 78,674 | | |  | $ 38,851 | |  | 102.5% | |  |
| % of net revenue | 7.8% | | 2.8% | |  |  | 4.9% | | 3.3% | | |  |  |  |

General and administrative expense consists primarily of compensation and associated costs relating to general and administrative personnel, including stock-based compensation expenses, fees for professional services and allocated occupancy costs for these operations. The increase in absolute dollars in general and administrative expense in the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006 was primarily due to higher professional fees of $20.9 million due to attorney and other professional fees associated with our on-going internal review by a special committee of the Board of Directors relating to our historical stock option practices and related accounting. General and administrative expenses also increased due to stock-based compensation expenses of $3.9 million as a result of our adoption of SFAS 123R. In addition, general and administrative expense increased due to the net hiring of additional administrative personnel, which resulted in an increase in salary and related costs of $2.1 million.

The increase in absolute dollars in general administrative expense in the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006 was primarily due to higher professional fees of $24.7 million due to attorney and other professional fees associated with our on-going internal review by a special committee of the Board of Directors relating to our historical stock option practices and related accounting. General and administrative expenses also

increased due to stock-based compensation expenses of $7.2 million as a result of our adoption of SFAS 123R. In addition, general and administrative expense increased due to the net hiring of additional administrative personnel, which contributed to an increase in salaries and related costs of $3.7 million.

*Amortization of Acquired Intangible Assets*

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
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|  |  | **Three Months Ended** | | | | | **Percent** | | **Nine Months Ended** | | | | **Percent** | |  |
|  |  | **October 28,** | |  | **October 29,** |  | **October 28,** | | **October 29,** |  |  |
|  | **2006** | |  | **2005** | |  | **Change** | | **2006** |  | **2005** |  | **Change** | |  |
| Amortization of acquired intangible |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| assets | $ 27,405 | |  | $ 19,746 | |  | 38.8% $ 72,161 | | |  | $ 59,258 |  | 21.8% | |  |
| % of net revenue | 5.2% | | | 4.6% | | |  |  | 4.4% | | 5.0% | |  |  |  |

In connection with various acquisitions, we have recorded acquired intangible assets which are being amortized over their estimated economic lives of one to six years. The increase in amortization of acquired intangible assets in the third quarter and first nine months of fiscal 2007 compared to the third quarter and first nine months of fiscal 2006 was due to additional amortization of intangible assets from new acquisitions partially offset by the absence of amortization of acquired intangible assets from the acquisition of Galileo Technology Ltd. which were fully amortized at the end of fiscal 2006.

*Interest and Other Income, net*

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | | **Percent** | | **Nine Months Ended** | | | | | **Percent** | |  |
|  | **October 28,** | | | **October 29,** | |  | **October 28,** | |  | **October 29,** |  |  |
|  |  | **2006** |  |  | **2005** |  | **Change** |  | **2006** |  |  | **2005** |  | **Change** |  |  |
| Interest and other income, net | $ | 6,845 |  | $ | 5,244 |  | 30.5% | | $ 15,552 |  |  | $ 13,240 |  | 17.5% | |  |
| % of net revenue |  | 1.3% | |  | 1.2% | |  |  | 1.0% | | 1.1% | | |  |  |  |

Interest and other income, net consists primarily of interest earned on cash, cash equivalents and short-term investment balances, offset by interest paid on capital lease obligations. The increase in interest and other income, net for the third quarter of fiscal 2007 compared to the third quarter of fiscal 2006 was primarily due to higher interest income due to higher yields on our investments in the

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third quarter of fiscal 2007 compared to the third quarter of fiscal 2006. The increase in interest and other income, net for the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006 was primarily due to higher interest income due to higher yields on our investments during the nine months of fiscal 2007, partially offset by a $5.0 million charge for a reserve recorded in the second quarter of fiscal 2007 for an advance payment to a company which subsequently filed for bankruptcy. The combined cash and short-term investment balances as of October 28, 2006 decreased compared to the cash and short-term investment balance as of October 29, 2005 due to the payments for acquisitions in the first nine months of fiscal 2007.

*Provision for Income Taxes*

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | **Three Months Ended** | | | | | **Percent** | | **Nine Months Ended** | | | | **Percent** | |  |
|  |  | **October 28,** | |  | **October 29,** |  | **October 28,** | | **October 29,** |  |  |
|  | **2006** | |  | **2005** | |  | **Change** | | **2006** |  | **2005** |  | **Change** | |  |
|  |  |  |  |  | **(restated)** |  |  |  |  |  | **(restated)** |  |  |  |  |
| Provision for income taxes | $ 6,461 | |  | $ 12,584 | |  | (48.7)% $ 34,438 | | |  | $ 32,776 |  | 5.1% | |  |
| % of net revenue | 1.2% | | | 3.0% | | |  |  | 2.1% | | 2.8% | |  |  |  |

Our effective tax rate was 51.7% and 22.4% for the three and nine months ended October 28, 2006 compared to 13.1% and 15.1 for the three and nine months ended October 29, 2005. The effective tax rates for October 28, 2006 were affected by expenses not deductible for income tax purposes, such as the impact of adopting SFAS 123R and nondeductible acquisition related expenses and for October 29, 2005, the effective tax rates were affected by profits earned in jurisdictions where the tax rate is other than the U.S. tax rate and by non-tax-deductible expenses, such as nondeductible acquisition related expenses and the impact of adopting SFAS 123R. At October 28, 2006, the effective tax rate increased to 10.9% due to interest and penalties arising out of nondeductible officer compensation. Also, during the three months ended October 29, 2005, the effective tax rate increased by 4.9% due to nondeductible officer compensation.

*Cumulative Effect of Change in Accounting Principle, net of Tax Effect*

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  | **Three Months Ended** | | |  |  | **Percent** | | **Six Months Ended** | | | | **Percent** | |  |
|  |  | **October 28,** | |  | **October 29,** | |  | **October 28,** | | **October 29,** |  |  |
|  |  |  | **2006** | **2005** | |  |  | **Change** | | **2006** |  | **2005** |  | **Change** | |  |
|  |  |  |  |  | **(restated)** | |  |  |  |  |  | **(restated)** |  |  |  |  |
| Cumulative effect of change in |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| accounting principle, net of tax effect | $ | | — | $ | | — | | —% $ 8,846 | | | | — | | 100% | |  |
| % of net income |  |  | — |  |  | — | |  |  | 0.5% | | — | |  |  |  |

During the first quarter of fiscal 2007, we recorded an adjustment for the cumulative effect of a change in accounting principle related to estimating forfeitures in our adoption of FAS 123R.

**Liquidity and Capital Resources**

Our principal source of liquidity as of October 28, 2006 consisted of $875.7 million of cash, cash equivalents and short-term investments. Since our inception, we have financed our operations through a combination of sales of equity securities, cash generated by operations and cash assumed in acquisitions.

***Net Cash Provided by Operating Activities (Restated)***

Net cash provided by operating activities was $346.5 million for the nine months ended October 28, 2006 compared to $266.2 million for the nine months ended October 28, 2005. The cash inflows from operations in the nine months of fiscal 2007 was primarily a result of our generation of income during the

period and changes in working capital. Non-cash charges in the first nine months of fiscal 2007 included $72.2 million related to amortization of acquired intangible assets, $52.5 million of depreciation and amortization expense and $146.5 million of stock-based compensation. Significant working capital changes contributing to positive cash inflow in the first nine months of fiscal 2007 included an increase of $29.1 million in income tax payable resulting from higher taxable income in the first nine months of fiscal 2007 and an increase in accrued liabilities of $13.8 million resulting primarily from accruals for contingent consideration in connection with our acquisitions. Inventory increased $10.3 million, primarily as a result of the build up of inventory to support our increasing revenue and additional inventory from our acquisitions. The number of days in inventory has increased at the end of the third quarter of fiscal 2007 to 81 days compared to 68 days at the end of the third quarter of fiscal 2006 due primarily to a higher comparable inventory balance at the end of each respective quarter. We expect the number of days in inventory to fluctuate in the range of approximately 70 to 80 days depending on our wafer starts and the inventory purchase needs of our customers as well as lead times and competitive situations in the marketplace.

Significant working capital changes offsetting positive cash flows in the first nine months of fiscal 2007 included an increase in prepaid expenses and other current assets of $51.8 million due primarily to payments made in connection with a capacity reservation agreement with a foundry. Also contributing to working capital changes offsetting positive cash flow in the first nine months of fiscal 2007 was an increase in accounts receivable of $49.1 million primarily due to higher total net revenue in the first nine months of fiscal 2007 compared to the first nine months of fiscal 2006. Although accounts receivable increased, the days sales outstanding, or DSO, metric decreased to 51 days at the end of the third quarter of fiscal 2007 from 54 days at the end of the third quarter of 2006. Many of our larger customers have regularly scheduled payment dates with some of the dates falling immediately before or after our fiscal quarter-end. As a result, our accounts receivable balance and DSO may fluctuate depending on the timing of large payments made by our customers.

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Net cash provided by operating activities was $263.9 million for the nine months ended October 29, 2005. The cash inflow from operations in the nine months of fiscal 2006 was primarily a result of our generation of income during the period and changes in working capital. Non-cash charges in the first nine months of fiscal 2006 included $59.3 million related to amortization of acquired intangible assets, $41.8 million of depreciation and amortization expense and $48.8 million of stock-based compensation expense. Significant working capital changes contributing to positive cash inflow in the first nine months of fiscal 2006 included an increase in accounts payable of $60.4 million resulting from the overall increase in activity and inventory levels, an increase in income taxes payable of $29.6 million resulting from higher taxable income in the first nine months of fiscal 2006 and an increase in deferred income of $9.9 million due to the increase in inventory levels at distributors to replenish and build up inventory for year-end sales as well as new distributors building up inventory.

Significant working capital changes offsetting positive cash flows in the first nine months of fiscal 2006 included an increase in prepaid and other assets of $105.0 million due primarily to an $83.0 million payment in connection with a capacity reservation agreement with a foundry, a $12.3 million security deposit for long-term assets under construction and a $10.6 million receivable from a foundry for reimbursements under a capacity reservation agreement. Also contributing to working capital changes offsetting positive cash flow in the first nine months of fiscal 2006 was an increase in accounts receivable of $52.4 million primarily due to higher total net revenue in the first nine months of fiscal 2006 compared to the first nine months of fiscal 2005. Inventory also increased $21.0 million, primarily as a result of additional wafer starts to meet forecasted demand and build in buffer stock to compensate for longer foundry lead times.

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 thirty to sixty day payment terms. If our sales levels were to increase as they have in prior fiscal years, 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, foundry lead times and available capacity, and competitive situations in the marketplace. Such considerations are balanced against risk of obsolescence or potentially excess inventory levels.

***Net Cash Provided by (Used in) Investing Activities***

Net cash provided by investing activities was $121.3 million for the first nine months of fiscal 2007 while net cash used in investing activities was $19.2 million for the first nine months of fiscal 2006. The net cash provided by investing activities in the first nine months of fiscal 2007 was due to proceeds from the sales and maturities of short-term investments of $804.9 million partially offset by cash paid for acquisitions of $283.0 million, purchases of short-term investments of $266.9 million and purchases of property and equipment of $121.4 million. The net cash used in investing activities in the first nine months of fiscal 2006 was due to purchases of short-term investments of $490.8 million and purchases of property and equipment of $62.3 million, partially offset by the proceeds from the sales and maturities of short-term investments of $533.9 million.

***Net Cash Provided by Financing Activities***

Net cash provided by financing activities was $23.2 million for the nine months ended October 28, 2006 and $53.6 million for the nine months ended October 29, 2005. In the first nine months of fiscal 2007 and 2006, net cash provided by financing activities was attributable to proceeds from the issuance of common stock under our stock option and employee purchase plans, partially offset by principal payments on capital lease obligations. The proceeds from the issuance of common stock were primarily due to the exercises of stock options and purchases of shares under the employee stock purchase plan. The increase in capital lease obligations was due to additional computer-aided design software licenses, which we have acquired for use in our research and development activities.

**Contractual Obligations and Commitments**

Our relationships with our foundries 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 October 28, 2006, foundries had incurred approximately $134.7 million of manufacturing expenses on our outstanding purchase orders. The purchase obligations are included in outstanding purchase commitments as of October 28, 2006.

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On February 28, 2005 and as amended on March 31, 2005, we entered into an agreement with a foundry to reserve and secure foundry fabrication capacity for a fixed number of wafers at agreed upon prices for a period of five and a half years beginning on October 1, 2005. In return, we agreed to pay the foundry $174.2 million over a period of eighteen months. The amendment extends the term of the agreement and the agreed upon pricing terms until December 31, 2015. As of October 28, 2006, payments totaling $174.2 million (included in prepaid expenses and other current assets and other non current assets) have been made and approximately $74.9 million of the prepayment has been utilized as of October 28, 2006. At October 28, 2006, there are no more remaining commitments under the agreement.

In October 2001, we entered into a lease agreement with Yahoo! Inc. to lease a building in Sunnyvale, California consisting of approximately 213,000 square feet. The lease commenced on January 1, 2002 and was amended in the third quarter of fiscal 2006 to end December 31, 2005. In February 2002, we consolidated our three existing facilities in California into this new building. The leases on two of our former facilities expired in February 2002 and June 2005, respectively, but we have an ongoing, non-cancelable lease for the remaining facility, for which we have obtained a sublease. Actual sublease income approximated the estimated sublease income, but is less than our actual lease commitment, resulting in future negative cash flow over the remaining term of the sublease of approximately $3.0 million as of October 28, 2006. At October 28, 2006, cash payments of $10.5 million, net of sublease income had been made in connection with this charge. Approximately $3.0 million is accrued for this facilities consolidation charge as of October 28, 2006 of which $0.6 million was the current portion while the long-term portion totaling $2.4 million is payable through 2010.

On November 4, 2005, we completed the acquisition of the hard disk and tape drive controller semiconductor business of QLogic Corporation. The acquisition was completed in accordance with the terms and conditions of an Asset Purchase Agreement dated August 29, 2005. Under the terms of the agreement, in exchange for certain assets and intellectual property of QLogic, we paid $180.0 million in cash and issued 1,960,998 shares of our common stock to QLogic valued at $45.6 million for consideration of $225.6 million. An additional payment of $4.0 million was made for an inventory adjustment, resulting in total cash paid of $184.0 million and total consideration of $232.5 million, including acquisition costs. Pursuant to the agreement, on the closing date, we placed a portion of the shares in escrow as security for our indemnification rights under the agreement. The shares can be held in escrow for up to 12 months from the closing date. Our shares of common stock were issued pursuant to an exemption under the Securities Act of 1933.

On February 16, 2006, we completed the acquisition of the semiconductor division of UTStarcom, Inc. for $24.0 million in cash. In the third quarter of fiscal 2007, we recorded $16.0 million of contingent consideration based on certain defined milestones being achieved in August 2006.

In April 2006, we made a deposit of $0.5 million for the purchase of land in Singapore. We plan to make additional commitments to construct a building for our Singapore office. We are still in the preliminary stages of defining the scope of the work to be performed as well as selecting contractors. As such, we have not been able to assess and determine how much we expect to incur in connection with the improvements for the building.

On May 1, 2006, we completed the acquisition of the printer semiconductor business of Avago Technologies Limited. Under the acquisition agreement, we paid $251.5 million in cash upon closing of the transaction. In the third quarter of fiscal 2007, we accrued $10.0 million of contingent consideration based on certain defined milestones being achieved in October 2006. We may pay an additional $25.0 million if defined milestones are achieved at various intervals through October 2007.

On November 8, 2006, we completed the acquisition of the communications and application processor business of Intel Corporation (“ICAP Business”) and paid $600.0 million in cash upon closing of the transaction. We recorded a one-time charge for purchased in-process research and development expenses related to the acquisition of $77.8 million in the fourth fiscal quarter of fiscal 2007. In addition to the asset purchase, we entered into certain additional agreements with Intel, including a supply agreement. Under the terms of the agreement we have committed to purchase and Intel has agreed to supply through June 2008 a minimum number of wafers at fixed prices. If at the end of any fiscal quarter for Intel, there is a shortfall between the quantity of supply ordered by us and the quantities of supply required under the supply agreement commitment, Intel will invoice us for the shortfall and will deliver the corresponding quantity upon receipt of payment from us. The supply agreement requires us to prepay for certain wafers six months in advance of delivery and requires us to issue non cancellable purchase orders at least six months in advance of requested delivery dates for all purchases under the supply agreement.

In November 2006, we borrowed $400.0 million from a group of lenders in the form of term loans to partially finance the acquisition of the ICAP Business. Amounts borrowed under the credit agreement bear interest at the higher of the lender’s prime rate or 0.5% per annum above the Federal Funds Effective Rate, as defined in the agreement, plus a 1% margin. In the case of Eurodollar

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loans, amounts borrowed bear interest at a rate equal to Adjusted LIBOR plus 2% margin. Such margins are subject to reductions or increases depending on our credit rating. The credit agreement also contains customary covenants, including financial covenants. We may repay the term loans at any time without premium or penalty. We must also prepay the term loans depending on certain specified events. Certain of our subsidiaries have guaranteed the obligations under the credit agreement. In connection with the credit agreement, the Company and three of our subsidiaries entered into pledge agreements with the lender to which each such entity has granted the lender a security interest in the equity interests held by such entity in certain affiliates.

We currently intend to fund our short and long-term capital requirements, as well as our liquidity needs, with existing cash, cash equivalents and short-term investment balances as well as cash generated by operations. We believe that our existing cash, cash equivalents and short-term investment balances will be sufficient to meet our working capital needs, capital requirements, investment requirements, including acquisitions, and commitments for at least the next twelve 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, expenditures in connection with acquisitions, costs of making improvements to facilities and increases in operating expenses, which are all subject to uncertainty. To the extent that our existing cash, cash equivalents 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. We may enter into acquisitions or strategic arrangements in the future, which could also require us to seek additional debt or equity financing, which in turn may be dilutive to our current shareholders. Additional funds may not be available on terms favorable to us or at all.

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The following table summarizes our contractual obligations as of October 28, 2006 and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  | **Payments Due by Period** | | | | | |  |  |  |  |  |  |  |  |  |
|  |  | **2007** |  |  | **2008** |  |  | **2009** |  |  | **2010** |  |  | **2011** |  |  | **There-** |  |  | **Total** | |  |
|  |  |  |  |  |  |  |  |  |  |  |  | **after** |  |  |  |
|  |  | **(remaining** |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | **three months)** | | |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Contractual |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| obligations: |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| Operating leases | $ | 2,578 |  | $ | 10,742 | $ | | 10,543 |  | $ | 7,685 | $ | | 6,799 | $ | | 31,239 | $ | | 69,586 |  |  |
| Capital lease |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| obligations |  | 5,440 |  |  | 21,751 |  |  | 12,784 |  |  | 5,539 |  |  | 2,084 |  |  | 521 |  |  | 48,119 |  |  |
| Purchase |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| commitments |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| to foundries |  | 134,741 |  |  | — |  |  | — | |  | — |  |  | — |  |  | — |  |  | 134,741 |  |  |
| Capital purchase |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| obligations |  | 75,252 |  |  | — |  |  | — | |  | — |  |  | — |  |  | — |  |  | 75,252 |  |  |
| Acquisition |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| related |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| commitments |  | 600,000 |  |  | — |  |  | — |  |  | — |  |  | — |  |  | — |  |  | 600,000 |  |  |
| Total contractual | $ | 818,011 |  | $ | 32,493 | $ | | 23,327 |  | $ | 13,224 | $ | | 8,883 | $ | | 31,760 | $ | | 927,698 |  |  |
| cash obligations |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |

Included in operating lease commitments are anticipated lease payments for two airplanes one of which is currently under construction. One plane was delivered in November 2006 and delivery of second airplane is expected in fiscal 2008. The airplanes will be used for business travel purposes and will be accounted for as operating leases once the airplanes are completed and delivered.

*Restatement Related Impacts:* The additional payable for payroll taxes associated with affected stock option grants of approximately $10.6 million,additional Section 409A expenses for the adverse tax consequences of the re-measured options exercised during calendar year 2006 of approximately $24.2 million, and Section 162(m) liabilities of $26.5 million for potential cumulative period from fiscal 2001 through 2007, represents future cash outflow totaling $61.3 million.

The IRS has provided taxpayers with the following two ways of correcting unexercised discounted stock options: (1) setting a fixed exercise date; and (2) increasing the exercise price of the option up to the fair market price on the date of grant. We are actively evaluating these options. The discount associated with unexercised stock options outstanding as of January 27, 2007 amounted to approximately $51.7 million. We have not determined the tax consequences associated with these potential future remedies.

*Prospective Capital Needs*: We believe that our existing cash, cash equivalents and marketable securities, together with cash generated from operationsand from the exercise of employee stock options, will be sufficient to cover our working capital needs, capital expenditures, investment requirements and commitments for at least the next 12 months. In the event that we may need or desire to raise additional funds to prepay our term loan obligation or consummate acquisitions of other businesses, assets, products or technologies, we could raise such funds by electing to sell equity or debt securities to the public or to selected investors, or by borrowing money from financial institutions. Our existing credit agreement however limits our ability to borrow additional funds. Certain covenants would have to be met. Additionally, we have not been in full compliance with NASDAQ Marketplace Rule 4310(c)(14) which requires us to timely file with the SEC all filings required by the Securities Exchange Act of 1934. We intend to file all required filings as soon as practicable.

However, if the SEC disagrees with the manner in which we have accounted for and reported, or not reported, the financial impact of past stock option grants, there could be further delays in filing subsequent SEC reports or other actions that might result in the delisting of our common stock from the NASDAQ Global Select Market. If we are unable to maintain compliance with the conditions for continued listing required by NASDAQ, then our shares of common stock may be subject to delisting from the NASDAQ Global Select Market. If our shares of common stock are delisted from the NASDAQ Global Select Market, they may not be eligible to trade on any national securities exchange or the over-the-counter market. If our common stock is no longer traded through a market system, the liquidity of our common stock may be greatly reduced, which could negatively affect its price.

Even if we become compliant with the NASDAQ conditions for continued listing, because one of the eligibility requirements for use of a Form S-3 filing is that an issuer must have timely filed all reports required to be filed with the SEC during the preceding twelve calendar months, we will not be able to register securities on Form S-3 and would be required to register those securities using a Form S-1 registration statement, which can be more complex, time consuming and expensive. If we elect to raise additional funds, we may not be able to obtain such funds on a timely basis or on acceptable terms, if at all. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing shareholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to our common stock.

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**Off-Balance Sheet Arrangements**

As of October 28, 2006, we did not have any material off-balance-sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

**Recent Accounting Pronouncements**

In June 2006, the FASB ratified the Emerging Issues Task Force (EITF) consensus on EITF Issue No. 06-2, “Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43” (“EITF 06-2”). EITF 06-2 requires companies to accrue the cost of such compensated absences over the requisite service period. We currently accrue the cost of compensated absences for sabbatical programs when the eligible employee completes the

requisite service period. We are required to apply the provisions of EITF 06-2 at the beginning of fiscal 2008. EITF 06-02 allows for adoption through retrospective application to all prior periods or through a cumulative effect adjustment to retained earnings if it is impracticable to determine the period-specific effects of the change on prior periods presented. We are currently evaluating the financial impact of this guidance and the method of adoption which will be used.

In July 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109” (FIN 48), which clarifies the accounting for uncertainty in income tax positions. This Interpretation requires that the Company recognize in its financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of fiscal 2008, with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company has evaluated the impact of adopting FIN 48 and determined that there is no material impact on its consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (“SFAS 157”), Fair Value Measurements. The statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of SFAS 157 on our consolidated financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108 (“SAB 108”). SAB 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. We adopted SAB 108 at the end of fiscal 2007. The adoption did not have a material impact on our financial position and results of operations.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115” which is effective for fiscal years beginning after November 15, 2007. This statement permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. We are currently evaluating the potential impact of this statement.

**Related Party Transactions**

During the third quarter of fiscal 2007 and 2006, we incurred approximately $1,000 and $0.2 million, respectively of expenses from an unrelated third-party entity, ACM Aviation, Inc. (“ACM”) for charter aircraft services provided to MSI, for Estopia Air LLC (“Estopia Air”). During the first nine months of fiscal 2007 and 2006, we incurred approximately $0.5 million and $0.6 million, respectively of expenses from ACM for charter aircraft services provided to MSI. The aircraft provided by ACM to us for such services is owned by Estopia Air. Our President and Chief Executive Officer, Dr. Sehat Sutardja, and former Executive Vice President and Chief Operating Officer, Weili Dai, through their control and ownership in Estopia Air, own the aircraft provided by ACM. The expenses were the result of our use of the aircraft for business travel purposes. The pricing was based on values determined to be market prices.

On February 19, 2005, we, through our subsidiaries MSI and Marvell Asia Pte. Ltd. (“MAPL”), entered into a development agreement with MagnetoX Inc. (“MagnetoX”). The development agreement is on substantially similar terms as other development agreements with other third parties. We did not recognize any revenue from the development agreement or product revenue during the first nine months of fiscal 2007.

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with other third parties. Herbert Chang, one of our directors, is a shareholder of MagnetoX and its Chairman and Chief Executive Officer. Estopia LLC (“Estopia”) is also a shareholder of MagnetoX. Dr. Sehat Sutardja and Weili Dai, through their ownership and control of Estopia, are indirect shareholders of MagnetoX.

On August 19, 2005, we, through our subsidiaries MSI and Marvell International Ltd., entered into a License and Manufacturing Services Agreement (the “License Agreement”) with C2 Microsystems, Inc. (“C2Micro”). The License Agreement is on substantially similar terms as other license and manufacturing services agreements with other third parties. We did not recognize any revenue from C2Micro during the third quarter of fiscal 2007 and 2006, respectively. We recognized $0.3 million of revenue from the License Agreement with C2Micro during the nine months of fiscal 2007. We had recorded a receivable of $154,000 and deferred revenue of $42,000 from C2Micro as of October 28, 2006. Dr. Sehat Sutardja and Weili Dai, through their ownership and control of Estopia, are indirect shareholders of C2Micro. Herbert Chang, through his ownership and control of C-Squared venture entities, is also an indirect shareholder of C2Micro. Dr. Pantas Sutardja, our Chief Technology Officer, is also a shareholder of C2Micro.

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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 fromour investments without significantly increasing risk. Some of the securities in which we have invested 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. Also, 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, Federal, State, county and municipal debt securities and auction rate 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 October 28, 2006 (in thousands). This table does not include money market funds because those funds are not subject to market risk. Although auction rate securities generally have legally stated maturities in excess of one year,

auction rate securities are presented below with an expected fiscal year maturity date in 2007 because such securities are structured with short-term interest reset dates of generally less than 90 days at which time we can sell or continue to hold the securities at par.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |  | **Expected Fiscal Year Maturity Date** | | | | | | | |  |  |  |  |  |  |
|  |  | **2007** |  |  | **2008** |  |  | **2009** |  |  | **2010** |  |  | **2011** |  |  | **Total** | | **Fair Value** | |  |
| Variable Rate | $ | 7,934 |  | $ | — |  | $ | — |  | $ | — |  | $ | — |  | $ | 7,934 |  | $ | 7,934 |  |
| Average Interest Rate |  | 5.28% | |  | — | |  | — | |  | — | |  | — | |  | 5.28% | |  |  |  |
| Fixed Rate | $ | — | | $ | 13,753 |  | $ | 15,088 |  | $ | — | | $ | — | | $ | 28,841 |  | $ | 28,296 |  |
| Average Interest Rate |  | — | |  | 3.43% | |  | 3.58% | |  | — | |  | — | |  | 3.51% | |  |  |  |

At any time, fluctuations in interest rates could affect interest earnings on our cash, cash equivalents, and short-term investments, or the fair value of our investment portfolio. A 10% move in interest rates as of October 28, 2006 would have an immaterial effect on our financial position, results of operations and cash flows.

*Investment Risk.* We invest in equity instruments of privately-held companies for business and strategic purposes. These investments, which totaled

$11.7 million at October 28, 2006, are included in other non-current assets in the accompanying balance sheets and are accounted for under the cost method because our ownership is less than 20% and we do not have the ability to exercise significant influence over the operations on these companies. We monitor these investments for impairment and make appropriate reductions in carrying value when an impairment is deemed to be other than temporary.

*Foreign Currency Exchange Risk.* Substantially all of our sales and the majority of our expenses to date have been denominated in United States dollars, and,as a result, we have relatively little exposure to foreign currency exchange risk. Occasionally, we will enter into short-term forward exchange contracts to hedge exposures for purchases denominated in foreign currencies such as the Singapore Dollar and the New Israeli Shekel. We do not enter into any other derivative financial instruments for trading or speculative purposes.

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

**Stock Option Review**

As discussed in Note 1 to our Consolidated Financial Statements and in our Management’s Discussion and Analysis of Financial Condition, our internal review of our stock option granting practices resulted in the restatement of certain previously filed annual and quarterly financial statements.

**Management’s Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and our interim Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934) as of October 28, 2006. Disclosure controls and procedures are designed to ensure that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to management, including the Chief Executive Officer and

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interim Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our management, including our Chief Executive Officer and interim Chief Financial Officer, has concluded that our disclosure controls and procedures were not effective as of October 28, 2006 because of the material weaknesses described below:

*Control environment.* We did not maintain an effective control environment based on criteria established in the COSO framework and commensuratewith our rapid growth and increasing complexity. Our management, including those individuals responsible for our Finance and Legal Departments, did not exercise the necessary rigor and commitment to internal control over financial reporting. Specifically, certain individuals involved in the stock option process said that they did not feel able to provide frank advice to senior management regarding controls over processing, recording and reporting of stock options transactions. This lack of an effective control environment contributed to the restatement of the consolidated financial statements of annual periods through fiscal 2006, each of the quarters of fiscal year 2006, as well as the first quarter of fiscal year 2007. Additionally, this lack of an effective control environment could result in misstatements of any of our financial statement accounts and disclosures that would result in a material misstatement to the annual or interim consolidated financial statements that would not be prevent or detected; this lack of effective control environment also contributed to the material weakness described below. Accordingly, our management has determined that this control deficiency constitutes a material weakness.

*Control over stock option granting process.* We did not maintain effective controls over the stock option granting process. Our controls, includingmonitoring controls, policies and procedures relating to the granting process were not effective. Specifically, effective controls were not maintained to ensure the validity of stock option grants and related supporting documentation and to ensure the accuracy of the measurement dates and associated accounting treatment for options granted. This lack of effective controls contributed to the restatement of the consolidated financial statements of annual periods through 2006, each of the quarters of fiscal year 2006, as well as the first quarter of fiscal year 2007. Additionally, this lack of effective controls could result in misstatements of any of our financial statement accounts and disclosures that would result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected. Accordingly, our management has determined that this control deficiency constitutes a material weakness.

*Controls over stock-based compensation expense under FASB Statement of Financial Accounting Standards No. 123 (revised 2004), “Share Based Payments” (“FAS 123(R*)”). We did not maintain effective controls over the accounting for and disclosure of our stock-based compensation expense underFAS 123(R). Our controls, including monitoring controls, policies and procedures relating to the accounting for and disclosure of stock-based compensation were not effective. Specifically, effective controls were not maintained to ensure the existence, completeness, accuracy, valuation and presentation of our stock-based compensation expense. This control deficiency resulted in audit adjustments to stock-based compensation expense for the year ended January 27, 2007. This control deficiency could also result in a misstatement to compensation expense that would result in a material misstatement to our annual or interim financial statements that would not be prevented or detected. Accordingly, our management has determined that this control deficiency constitutes a material weakness.

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**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting during the most recently completed fiscal quarter that have materially affected, on are reasonably likely to materially affect, our internal control over financial reporting.

**Implemented or Planned Remedial Actions of 2007 Material Weaknesses**

Subsequent to October 28, 2006, we implemented or plan to implement further remedial actions, specifically:

* Implemented or planned remediation efforts regarding the material weakness in internal control over financial reporting related to an ineffective control environment include the following:

We accepted the resignation of our former Vice President of Finance and Chief Financial Officer, George A. Hervey, on May 2, 2007. We also accepted Weili Dai’s resignation from her position as our Executive Vice President and Chief Operating Officer. The Implementation Committee of our Board of Directors determined, contrary to the recommendation of the Special Committee that Ms. Dai have no continuing role with the Company, that retaining the services of Ms. Dai in a reduced capacity as Director of Strategic Marketing and Business Development, an individual contributor in a non-managerial role, and under the auspices of the Implementation Committee better serves the interests of all shareholders.

Ms. Dai will have no authority to undertake any material decisions affecting internal controls or financial matters of the Company. The Implementation Committee will provide periodic compliance updates to the Board of Directors on Ms. Dai’s activities.

Dr. Sehat Sutardja will remain Chief Executive Officer and a member of the Board, but will step down as Chairman of the Board in favor of a non-executive Chairman. The Implementation Committee believes that the reconstitution of the Board of Directors, the separation of the role of Chairman of the Board from that of Chief Executive Officer and President and the hiring of key qualified senior executives in Finance, Operations and Compliance will help address the issues discussed in the material weakness relating to our control environment noted above.

Following the Special Committee’s recommendations, we are conducting a search for a new Chief Operating Officer, Chief Financial Officer, General Counsel and Vice President of Compliance. The Vice President of Compliance will report directly to the Audit Committee of the Board. Additionally, the Board’s Governance Committee is conducting a search for three new independent directors to fill existing vacancies. One of these independent directors will succeed Dr. Sutardja as Chairman of the Board.

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* Implemented or planned remediation efforts regarding the material weakness over accounting for and disclosure of our stock-based compensation expense under FAS 123R includes the changes in internal control over financial reporting as stated above along with the following:

We reviewed the accounting for and disclosure of our stock-based compensation expense process and have assessed the need for additional managerial and qualified staff resources. Once these qualified individuals are hired and training of appropriate personnel is completed, effective monitoring controls will be in place and maintained to ensure existence, completeness, accuracy, valuation and presentation of our stock-based compensation expense.

As a result of the material weaknesses described above, management, with the assistance of outside consultants, reviewed key areas within internal control over financial reporting and the related financial statement accounts and disclosure for the periods ended October 28, 2006. Based on the review performed, management did not identify any evidence that would prevent our Audit Committee or current management from approving our financial statements.

**PART II. OTHER INFORMATION**

**Item 1. *Legal Proceedings***

*IPO Securities Litigation.* On July 31, 2001, a putative class action suit was filed against two investment banks that participated in the underwriting ofour 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 we were 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. Defendants in the consolidated proceedings moved to dismiss the actions. In February 2003, the trial court granted the motions in part and denied them in part, thus allowing the case to proceed against the underwriters and us as to alleged violations of section 11 of the Securities Act of 1933 and section 10(b) of the Securities

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Exchange Act of 1934. Claims against the individual officers have been voluntarily dismissed with prejudice by agreement with plaintiffs. On June 26, 2003, the plaintiffs announced that a settlement among plaintiffs, the issuer defendants and their directors and officers, and their insurers has been structured, a part of which provides that the insurers for all issuer defendants would guarantee up to $1 billion to investors who are class members, depending upon plaintiffs’ success against non-settling parties. Our board of directors has approved the proposed settlement, which if approved by the court would result in the plaintiffs’ dismissing the case against us and granting releases that extend to all of our officers and directors. Definitive settlement documentation was completed in early June 2004 and first presented to the court on June 14, 2004. On February 15, 2005, the court issued an opinion preliminarily approving the proposed settlement, contingent upon certain modifications being made to one aspect of the proposed settlement — the proposed “bar order.” The court ruled that it had no authority to deviate from the wording of the Private Securities Litigation Reform Act of 1995 and that any bar order that may issue should the proposed settlement be finally approved must be limited to the express wording of 15 U.S.C. section 78u-4(f)(7)(A). On May 2, 2005 the issuer defendants and plaintiffs jointly submitted an amendment to the settlement agreement conforming the language of the settlement agreement with the court’s February 15, 2005 ruling regarding the bar order. The court on August 31, 2005 issued an order preliminarily approving the settlement and setting a public hearing on its fairness for April 24, 2006 due to difficulties in mailing the required notice to class members. A final settlement approval hearing on the proposed issuer settlement was held on April 24, 2006. The court took the matter under submission. Meanwhile the consolidated case against the underwriters has proceeded. On October 2004, the district court certified a class. On December 5, 2006, however, the United States Court of Appeals for the Second Circuit reversed, holding that a class could not be certified. The Second Circuit’s holding, while directly affecting only the underwriters, raises some doubt as to whether the settlement class contemplated by the proposed issuer settlement would be approved in its present form. On January 5, 2007, plaintiffs petitioned the Second Circuit for rehearing of the Second Circuit’s decision. On April 6, 2007, the Second Circuit denied the petition. At a status conference on April 23, 2007, the district court suggested that the issuers’ settlement could not be approved in its present form, given the Second Circuit’s ruling. While not yet ruling on the matter, the district court has suggested that the parties will likely withdraw and seek to reformulate the current settlement in light of the Second Circuit ruling.

*Jasmine Networks Litigation.* On September 12, 2001, Jasmine Networks, Inc. (“Jasmine”) filed a lawsuit in the Santa Clara County Superior Courtalleging claims against three officers and us for improperly obtaining and using information and technologies during the course of the negotiations with our personnel regarding the potential acquisition of certain Jasmine assets by us. The lawsuit claims that our officers improperly obtained and used such information and technologies after we signed a non-disclosure agreement with Jasmine. We believe the claims asserted against our officers and us are without merit and we intend to defend all claims vigorously.

On June 21, 2005, we filed a cross complaint in the above disclosed action in the Santa Clara County Superior Court asserting claims against Jasmine and unnamed Jasmine officers and employees. The cross complaint was later amended to name two individual officers of Jasmine. On May 15, 2007, we filed a second amended cross complaint to add additional causes of action for declaratory relief against Jasmine. Among other actions, the cross complaint alleges that Jasmine and its personnel engaged in fraud in connection with their effort to sell to us technology that Jasmine and its personnel wrongfully obtained from a third party in violation of such third party’s rights. The cross complaint seeks declaratory judgment that our technology does not incorporate any of Jasmine’s alleged technology. The cross complaint seeks further declaratory judgment that Jasmine and its personnel misappropriated certain aspects of Jasmine’s alleged technology. We intend to prosecute the cross complaint against Jasmine and its personnel vigorously, including, but not limited to, filing certain dispositive motions regarding the ownership of the technology which is the subject of the cross complaint.

*CSIRO Litigation.* In 2004, Australia’s Commonwealth Scientific and Industrial Research Organisation (“CSIRO”) sent notice letters to a number of Wi-Fi System manufacturers regarding CSIRO’s patent, U.S. Patent No. 5,487,069 as it relates to IEEE 802.11a and 802.11g wireless standards. In May 2005, a group of system manufacturers, including customers of our 802.11a or 802.11g wireless LAN products, filed an action in the United States District Court for the Northern District of California seeking a declaratory judgment against CSIRO that the plaintiff manufacturers’ products employing the IEEE 802.11a or 802.11g wireless standards do not infringe CSIRO’s patent, U.S. Patent No. 5,487,069. In September 2006, CSIRO filed an answer and counterclaims alleging that plaintiffs’ products that employ those wireless standards infringe the CSIRO patent and seeking damages, including enhanced damages and attorneys’ fees and costs, and an injunction against sales of infringing products. In December 2006, the district court granted CSIRO’s motion to transfer the case to the United States District Court for the Eastern District of Texas, where CSIRO had brought a similar lawsuit against another company. As a result of CSIRO’s counterclaims for patent infringement, a customer of ours has sought indemnification from us. Also in December 2006, CSIRO filed suit in the United States District Court for the Eastern District of Texas against several manufacturers and suppliers of wireless products, including customers of our 802.11a or 802.11g wireless LAN products. The complaint alleges that the manufacture, use and sale of wireless products compliant with the IEEE 802.11a or 802.11g wireless standards infringes on the CSIRO patent. As a result of CSIRO’s claim for patent infringement, another

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customer of ours has sought indemnification from us. In response to these demands for indemnification, we have acknowledged the demands and incurred costs in response to them.

On May 4, 2007, we filed an action in the United States District Court for the Eastern District of Texas seeking a declaratory judgment against CSIRO that the CSIRO patent is invalid and unenforceable and that we and our customers do not infringe the CSIRO patent. The complaint also seeks damages and a license for us and our customers on reasonable and non-discriminatory terms in the event our 802.11a/g wireless LAN products are found to infringe and the CSIRO patent is found to be valid and enforceable. CSIRO has not yet responded to the complaint.

*Shareholder Derivative Litigation.* Between July 7, 2006 and August 2, 2006, three purported shareholder derivative actions were filed in the UnitedStates District Court for the Northern District of California. Each of these lawsuits names us as a nominal defendant and a number of our current and former directors and officers as defendants. Each lawsuit seeks to recover damages purportedly sustained by us in connection with our option granting processes, and seeks certain corporate governance and internal control changes. Pursuant to orders of the court dated August 17 and October 17, 2006, the three actions were consolidated as a single action, entitled *In re Marvell Technology Group Ltd. Derivative Litigation*. The plaintiffs filed an amended and consolidated complaint on November 1, 2006. On January 16, 2007, we filed a motion to dismiss the consolidated complaint for lack of standing or, in the alternative, stay proceedings. Pursuant to stipulations among the parties and orders of the court, our motion is currently scheduled to be heard on November 2, 2007.

On February 12, 2007, a new purported derivative action was filed in the United States District Court for the Northern District of California. Like *In re* *Marvell Technology Group Ltd. Derivative Litigation*, this lawsuit names us as a nominal defendant and a number of our current and former directors andofficers as defendants. It seeks to recover damages purportedly sustained by us in connection with our option granting processes, and seeks certain corporate governance and internal control changes. On May 1, 2007, the court entered an order consolidating this lawsuit with *In re Marvell Technology Group Ltd.* *Derivative Litigation*.

On May 29, 2007, the court entered an order staying discovery in this matter pending resolution of our motion to dismiss.

*Securities Litigation*. Between October 5, 2006 and November 13, 2006, four putative class actions were filed in the United States District Court for theNorthern District of California against us and certain of our officers and directors. The complaints allege that we and certain of our officers and directors violated the federal securities laws by making false and misleading statements and omissions relating to the grants of stock options. The complaints seek, on behalf of persons who purchased our common stock during the period from October 3, 2001 to October 3, 2006, unspecified damages, interest, and costs and expenses, including attorneys’ fees and disbursements. Pursuant to an order of the court dated February 2, 2007, these four putative class actions were consolidated as a single action entitled *In re Marvell Technology Group Ltd. Securities Litigation*. By an order of the court dated February 28, 2007, the plaintiffs must file a consolidated complaint no later than 45 days after we file restated financial statements with the SEC.

*SEC and United States Attorney Inquiries.* In July 2006, we received a letter of informal inquiry from the Securities and Exchange Commission (“SEC”)requesting certain documents relating to our stock option grants and practices. We also received a grand jury subpoena from the office of the United States Attorney for the Northern District of California requesting substantially similar documents. On April 20, 2007, we were informed that the SEC is now conducting a formal investigation in this matter. On June 8, 2007, we received a document subpoena from the SEC. We have cooperated with the SEC and the United States Attorney regarding these matters and intend to continue to do so. We cannot predict the outcome of these investigations.

*General.* We are also party to other legal proceedings and claims arising in the normal course of business.

The legal proceedings and claims described above could result in substantial costs and could divert the attention and resources of our management. Although the legal responsibility and financial impact with respect to these proceedings and claims 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. However, litigation is subject to inherent uncertainties and unfavorable rulings could occur. An unfavorable ruling in litigation could require us to pay damages or one-time license fees or royalty payments, which could adversely impact gross margins in future periods, or could prevent us from manufacturing or selling some of our products or limit or restrict the type of work that employees involved in such litigation may perform for us. There can be no assurance that these matters will be resolved in a manner that is not adverse to our business, financial condition, results of operations or cash flows.

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**Item 1A. *Risk Factors***

In addition to the factors discussed in the “Overview” and “Liquidity and Capital Resources” sections of Item 2 “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.

***Matters related to the internal review of our historical stock option granting practices and the restatement of our financial statements may result in additional litigation, regulatory proceedings and government enforcement actions.***

Our historical stock option granting practices and the restatement of our financial statements have exposed us to greater risks associated with litigation, regulatory proceedings and government enforcement actions. For more information regarding our current litigation and related inquiries, please see the discussion included in Part II, Item 1 — “Legal Proceedings,” of this Report as well as the other risk factors related to litigation set forth in this section. We have provided the results of our internal review to the Securities and Exchange Commission (“the SEC”) and the United States Attorney’s Office for the Northern District of California, and in that regard we have responded to formal and informal requests for documents and additional information. The SEC is conducting a formal inquiry into our historical stock option granting practices and we received a grand jury subpoena from the United States Attorney’s Office for the Northern District of California requesting documents relating to our stock option granting practices. No assurance can be given regarding the outcomes of litigation, regulatory proceedings or government enforcement actions relating to our past stock option practices. The resolution of these matters will be time consuming and expensive, and may distract management from the conduct of our business. Further, if we are subject to adverse findings in litigation, regulatory proceedings or government enforcement actions, we could be required to pay damages or penalties or have other remedies imposed against us, our directors, executive officers or other officers, or employees, which could harm our reputation, business, financial condition, results of operations and cash flows.

In addition, while we believe that we have, in completing the restatement of our financial statements, made appropriate judgments in determining the correct measurement dates for our stock option grants, the SEC may disagree with the manner in which we accounted for and reported, or did not report, the corresponding financial impact. Accordingly, it is possible that we will be required to restate further our prior financial statements, amend prior filings with the SEC, or take other actions not currently contemplated.

***A number of our current and former executive officers and directors have been named as parties to several derivative action lawsuits arising from our internal option review, and there is a possibility of additional lawsuits, all of which could require significant management time and attention and result in significant legal expenses.***

We are subject to a number of lawsuits purportedly on behalf of us against certain of our current and former executive officers and board members, and we may become the subject of additional private lawsuits. Subject to certain limitations, we are obligated to indemnify our current and former directors, officers and employees in connection with the investigation of our historical stock option practices and such lawsuits. The expenses associated with these lawsuits may be significant, the amount of time to resolve these lawsuits in unpredictable and defending these lawsuits may divert management’s attention from the day-to-day operations of our business, which could have a material adverse effect on our financial condition, business, results of operations and cash flows.

***Recent changes in our management may cause uncertainty in, or be disruptive to, our business.***

We have recently experienced significant changes in our management and our board of directors. In May 2007, our former Chief Financial Officer resigned and our Executive Vice President and Chief Operating Officer, who is one of our co-founders, resigned from those positions and as a member of our board of directors and will continue in a non-management role. Also, the general counsel of our U.S. operating subsidiary was terminated in March 2007. We are conducting a search for a permanent Chief Operating Officer, Chief Financial Officer and General Counsel. We have also commenced a search for three new independent directors to fill existing vacancies on our board of directors, one of whom will succeed Dr. Sehat Sutardja as Chairman of the Board. We cannot assure you that we will find qualified candidates in a timely manner. These changes in our management and board of directors may be disruptive

to our business, and, during the transition period, there may be uncertainty among customers, investors, vendors, employees and others concerning our future direction and performance. Our future success will depend to a significant extent on the ability of our management team to work together effectively. The loss of any of our management or other key personnel could harm our ability to implement our business strategy and respond to the rapidly changing market conditions in which we operate. Moreover, our success will depend on our ability to attract, hire and retain management and other key personnel and on the abilities of the new management personnel to function effectively, both individually and as a group going forward. If we are unable to attract and retain effective permanent replacements for our key executives in a timely manner, our business, financial condition, results of operations and cash flows may be adversely affected and our ability to execute our business model could be impaired. Competition for qualified senior employees can be intense. We expect to experience difficulty in hiring and retaining highly skilled individuals with appropriate qualifications to support our growth and expansion. For example, both our interim Chief Financial Officer and interim General Counsel may choose not to participate as candidates in our search to fill these positions. If we fail to attract, hire and retain qualified management individuals, it could lead to dissatisfaction among our customers, which could slow our growth or result in a loss of business.

***We have been named as a party to several purported class action and derivative lawsuits relating to our past option granting practices, and we may be named in additional litigation, all of which could cause our business, financial condition, results of operations and cash flows to suffer.***

We have been named as a nominal defendant in purported shareholder derivative actions that name a number of our current and former directors and officers as defendants and that seek to recover damages purportedly sustained by us in connection with our option granting practices. Further, putative class actions have been filed against us and certain of our officers and directors that allege

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violations of the federal securities laws and seek to recover damages. We may in the future be subject to additional litigation relating to our past option granting practices. Regardless of the outcome, this litigation, and any other litigation that may be brought against us or our directors and officers, could be time consuming, result in significant expense, and divert the attention and resources of our management and other key employees. An unfavorable outcome in such litigation could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***The matters relating to the internal review of our historical stock option granting practices and the restatement of our financial statements may otherwise adversely impact our business.***

As a result of our delayed filing of our Quarterly Reports on Form 10-Q for the fiscal quarters ended July 29, 2006, October 28, 2006, and April 27, 2007 and our Annual Report on Form 10-K for the fiscal year ended January 27, 2007, we will be ineligible to register our securities on Form S-3 for sale by us or resale by others. We may use Form S-1 to raise capital or complete acquisitions, but doing so could increase transaction costs and adversely impact our ability to raise capital or complete acquisitions of other companies in a timely manner.

Employees who were awarded options that were granted at a discount from fair market value and were all or partially unvested as of December 31, 2004, which we refer to as discount options, may be subject to income tax liability on the vesting date of those discount options in addition to a 20% excise tax under Internal Revenue Code (“IRC”) section 409 . California has adopted IRC 409A and therefore a 20% excise tax will be levied on all California employees. In considering actions that we believe would be in the best interests of our shareholders and employees and might substantially reduce or eliminate section 409A exposure and adverse state tax liability for our employees, we have elected to comply with the Franchise Tax Board Notice 2007-1 program in California. The program allows us to pay the additional 20% tax and interest due to the exercise of certain discounted stock options in 2006 pursuant to Revenue and Taxation Code §17501. There is no guarantee that this measure to address employees’ adverse tax consequences will be effective or successful. Any such measures may cause us to incur additional cash or noncash compensation expense. In addition, these measures, or the failure of these measures, may require us to incur substantial expenses for legal, accounting, tax and other professional services, could cause employee satisfaction and retention issues, and may divert our management’s attention from our business, which could in the future harm our business, financial condition, results of operations and cash flows.

***We have had material weaknesses in internal control over financial reporting and cannot assure you that additional material weaknesses will not be identified in the future. If our internal control over financial reporting or disclosure controls and procedures are not effective, there may be errors in our financial statements that could require a restatement or our filings may not be timely and investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.***

We have determined that we have had material weaknesses in internal control over financial reporting. Effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. Any inability to provide reliable financial reports or prevent fraud could harm our business. The Sarbanes-Oxley Act of 2002 requires management and our auditors to evaluate and assess the effectiveness of our internal control over financial reporting.

Our management, including our Chief Executive Officer and interim Chief Financial Officer, does not expect that our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, involving us have been, or will be, detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

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We cannot assure you that significant deficiencies or material weaknesses in our internal control over financial reporting will not be identified in the future. We may not be able to effectively and timely implement necessary control changes and employee training to ensure continued compliance with the Sarbanes-Oxley Act and other regulatory and reporting requirements. Our rapid growth and numerous acquisitions in recent periods, and our possible future expansion through additional acquisitions, present challenges to maintain the internal control and disclosure control standards applicable to public companies. Any failure to maintain or implement required new or improved controls, or any difficulties we encounter in their implementation, could result in significant deficiencies or material weaknesses, cause us to fail to timely meet our periodic reporting obligations, or result in material misstatements in our financial statements. Any such failure could also adversely affect the results of periodic management evaluations and annual auditor attestation reports regarding disclosure controls and the effectiveness of our internal control over financial reporting required under the Sarbanes-Oxley Act. The existence of a material weakness could result in errors in our financial statements that could result in a restatement of financial statements, cause us to fail to timely meet our reporting obligations and cause investors to lose confidence in our reported financial information, leading to a decline in our stock price. If we fail to maintain effective internal controls we could be subject to regulatory scrutiny and sanctions and investors could lose confidence in the accuracy and completeness of our financial reports. We cannot assure you that we will be able to fully comply with the requirements of the Sarbanes-Oxley Act or that management or our auditors will conclude that our internal control over financial reporting is effective in future periods.

***We have not been in compliance with SEC periodic reporting requirements and NASDAQ listing requirements and may continue to face compliance issues with both, which could result in the delisting of our common shares from The NASDAQ Stock Market.***

As a result of our failure to timely file our quarterly reports on Form 10-Q for the fiscal quarters ended July 29, 2006 and October 28, 2006 (the “Fiscal 2007 10-Qs”), this annual report on Form 10-K for the fiscal year ended January 27, 2007 (the “10-K”) and the Quarterly Report on Form 10-Q for the fiscal quarter ended April 28, 2007 (“Q1 Fiscal 2008 10-Q”) (together with the Fiscal 2007 10-Qs, the “delayed Forms 10-Q”), we have not been in full compliance with NASDAQ Marketplace Rule 4310(c)(14) which requires us to make, on a timely basis, all filings with the SEC required by the Securities Exchange Act of 1934. With the filing of this 10-K and the Fiscal 2007 10-Qs, which have been filed concurrently, we must file our Q1 Fiscal 2008 10-Q to regain compliance with Marketplace Rule 4310(c)(14). We expect to file our Q1 Fiscal 2008 10-Q as soon as practicable.

If the SEC disagrees with the manner in which we have accounted for and reported, or not reported, the financial impact of past stock option grants, there could be further delays in filing subsequent SEC reports or other actions that might result in delisting of our common stock from the NASDAQ Global Select Market. If we are unable to maintain compliance with the conditions for continued listing required by NASDAQ, then our shares of common stock may be subject to delisting from the NASDAQ Global Select Market. If our shares of common stock are delisted from the NASDAQ Global Select Market, they may not be eligible to trade on any national securities exchange or the over-the counter market. If our common stock is no longer traded through a market system, the liquidity of our common stock may be greatly reduced, which could negatively affect its price. In addition, we may be unable to obtain future equity financing, or use our common stock as consideration for mergers or other business combinations. A delisting from the NASDAQ Global Select Market may also have other negative implications, including the potential loss of confidence by suppliers, customers and employees, the loss of institutional investor interest, and fewer business development opportunities.

***We are obligated to purchase and pre-pay for specified volumes of wafers from Intel Corporation which will adversely affect our cash flow and could lead to inventory write-downs and related charges to our earnings, but Intel is not obligated to increase supply if we encounter unexpected demand.***

In connection with our acquisition of Intel’s communications and application processor business, we entered into a supply agreement with Intel in an effort to secure supplies of the products and wafers that we will need to sell the acquired product lines. Under the terms of the supply agreement we have committed to purchase and Intel has agreed to supply, through June 2008, a minimum number of wafers at fixed prices. If at the end of any Intel fiscal quarter, there is a shortfall between the quantity of supply ordered by us and the quantities of supply required under the supply agreement commitment, Intel will invoice us for the shortfall and will deliver the corresponding quantity upon receipt of payment from us. The agreement requires us to prepay for certain wafers six months in advance of delivery and issue non cancellable purchase orders at least six months in advance of requested delivery dates for all purchases under the supply agreement.

The supply agreement contractually commits us to purchase supply from Intel regardless of future end customer demand for these products. The amount of wafers we committed to purchase was largely based on our forecasted demand over an extended period of

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time. Forecasting demand over such a period of time is difficult and is subject to many risks. If the level of demand does not materialize to consume the product we are obligated to purchase from Intel, we may record additional charges for excess inventory purchases and commitments which could be material.

The supply agreement also requires us to purchase inventory earlier than anticipated product shipments to our customers. As a result, we expect our inventory balances for these products to increase, resulting in higher inventory balances and the associated carrying costs. Additionally, these higher levels of inventory increase our risk of holding excess and obsolete inventory. This could harm our business, results of operations and cash flows by leading to inventory write-downs and related charges to our earnings.

The supply agreement also limits the amount of product that Intel is required to supply to us. If we experience an increase in demand, we might not be able to secure enough supply from Intel to meet that demand. This would lead to lost sales in the short term as well as the long term due to possible customer dissatisfaction.

***If we are unable to successfully transition and secure production capacity for our communications and application processor business, we could lose a significant portion of that business.***

Our supply agreement with Intel was entered into to secure a supply of wafers and products during a transition period while we arranged for our independent foundries and other contractors to begin fabrication, assembly and test for these products. Intel is only obligated to supply specified quantities of product for a limited amount of time, no later than June 2008. Some of these products are at earlier stages in their new product introduction processes, where manufacturing yields are not yet consistent and changes to the design and processes may still have to be made. This can make the transition of the manufacture of these products to independent foundries and other contractors more complicated and expensive. If we do not successfully transition the production of the wafers and products to independent foundries and other contractors, we will be unable to meet customer demand for these products. This

could result in a material decline in revenues, net income, and cash flow. Additionally, our customers could become dissatisfied with us and not continue to use our products if and when we were able to resume providing them with products or if the newly transitioned products would require extended customer re-qualification.

***Our recent acquisitions and any future acquisitions could harm our operating results and share price.***

In 2005, we acquired the hard disk and tape drive controller semiconductor business of QLogic Corporation and the semiconductor design business division of UTStarcom, Inc. In May 2006, we acquired the printer semiconductor division of Avago Technologies, Pte. as well as certain intellectual property and property and equipment from another company. On November 8, 2006, we completed the acquisition of the communications and application processor business (the “Business”) from Intel Corporation.

Any of these acquisitions, as well as acquisitions in the future, could materially harm our operating results or liquidity as a result of possible concurrent issuances of dilutive equity securities or payment of cash. In addition, the purchase price of any 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 acquired in-process research and development charges and other intangible assets, which could result in significant impairment and acquired in-process research and development 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. In addition, if we acquire a business that is operating at a loss or at lower overall gross margins than our other businesses, as is the case with the communications and application processor business we acquired from Intel, our profitability will be harmed unless we can improve its performance. 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.

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. If 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 $1.9 billion as of October 28, 2006. An impairment review could result in a write-down of all or a portion of these assets to their fair values. We intend to perform an annual impairment review during the fourth quarter of each fiscal year 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.

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***Past acquisitions and any future acquisitions or 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 acquired businesses;
* the potential disruption of our ongoing business;
* the distraction of management from our business;
* the potential inability of management to maximize our financial and strategic position as a result of an acquisition;
* the potential for costs and delays in implementing, and the potential difficulty in maintaining uniform standards, controls, procedures and policies, including the integration of different information systems;
* the impairment of relationships with employees and customers 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;
* the risk that there could be deficiencies in the internal control of any acquired company or investments that could result in a material weakness in our overall internal controls taken as a whole;
* the potential loss of key employees of an acquired company; and
* the potential dilution of earnings through acquisitions and options granted to employees of acquired companies or businesses.

Our ability to realize the expected benefits of our acquisition of the communications and application processor business of Intel Corporation and to eliminate the operating losses of that business will depend in large part on our ability to transition the manufacturing of that business’ products from Intel to third-party foundries, increase the gross margin of those products, and retain the business’ relationship with its principal customers, as well as the factors described above relating to our ability to integrate effectively the acquired business and its technologies, operations and personnel.

***A significant portion of our business is dependent on the hard disk drive industry, which is highly cyclical, experiences rapid technological change, and is facing increased competition from alternate technologies.***

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 because our customers are suppliers to this industry. Hard disk drive manufacturers tend to order more components than they may need during growth periods, and sharply reduce orders for components during periods of contraction. In addition, advances in existing technologies and the introduction of new technologies may result in lower demand for disk drive storage devices, thereby reducing demand for our products. Rapid technological changes in the hard disk drive industry often result in significant and rapid shifts in market share among the industry’s participants. If the hard disk drive manufacturers using our products do not retain or increase their market share, our sales may decrease.

Future changes in the nature of information storage products may reduce demand for traditional hard disk drives. For instance, products using alternative technologies, such as semiconductor memory, optical storage, and other storage technologies could become a significant source of competition to manufacturers disk drives. Flash memory has typically been more costly than disk drive

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technologies. However, flash memory manufacturers have been reducing the prices for their products, which could enable them to complete more effectively with very small form factor hard disk drive products. Demand for hard disk drives could be reduced if alternative storage technologies such as flash memory can meet customers’ cost and capacity requirements.

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

In the first nine months of fiscal 2007, approximately 51% of our net revenue was derived from sales to four customers, each of which individually accounted for 10% or more of our net revenue during this period. Of these customers, Western Digital accounted for approximately 16%, Samsung accounted for approximately 13%, Toshiba accounted for approximately 12%, and Fujitsu accounted for approximately 10%. No distributor accounted for 10% of our net revenue during the first six months of fiscal 2007. 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 due 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, purchase fewer products than they did in the past, or 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 may develop their own solutions;
* our customers may purchase integrated circuits from our competitors; or
* our customers may discontinue sales or lose market share in the markets for which they purchase our products.

***If we are unable to accurately predict our future sales and to appropriately budget for our expenses, our operating results could suffer.***

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 are 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.

***Because we expect to experience continued lower sequential growth rates in future periods, investors should not rely on our historical growth rates when evaluating our business.***

From fiscal year 2003 to fiscal year 2005, we have been consistently reported significant sequential quarterly growth in revenues; however, our revenues have been inconsistent and have generally grown at a slower sequential rate in the nine quarters ending with the third quarter of fiscal 2007 compared to the double digit sequential growth rate of the previous eleven quarters. This slower growth rate is due, among other things, to the larger base of revenue and market share we now enjoy, which makes continuation of double digit revenue growth on a sequential quarterly basis unlikely in the current market. Accordingly, investors should not rely on the results of any prior quarterly or annual periods as an indication of our future performance.

***Changes in financial accounting standards or practices or existing taxation rules or practices may cause adverse unexpected revenue and expense fluctuations and affect our reported results of operations.***

A change in accounting standards or practices or a change in existing taxation rules or practices can have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements and taxation rules and varying interpretations of accounting pronouncements and taxation practice have occurred and may occur in the future. Changes to existing rules or the questioning of current practices by regulators may adversely affect our reported financial results or the way we conduct our business.

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For example, the Financial Accounting Standards Board (“FASB”) issued its final standard on accounting for share-based payments, FASB Statement No. 123R (revised 2004), *Share-Based Payment* (FAS 123R), which required us, starting January 29, 2006, to measure compensation costs for all stock-

based compensation (including stock options) at fair value and to recognize these costs as expenses in our statements of operations. The recognition of these expenses in our statements of operations will reduce our earnings per share, which could negatively impact our future stock price.

***If we are unable to develop and introduce new and enhanced products that achieve market acceptance in a timely and cost-effective 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 and introduce new products and enhancements to our existing products. We must also achieve market acceptance for these products and enhancements. If we do not successfully develop and achieve market acceptance for new and enhanced products, our ability to maintain or increase revenues will suffer. The development of our products is highly complex. We occasionally have experienced delays in completing the development and introduction of new products and product enhancements, and we could experience delays in the future. Even if new and enhanced products are introduced to the market, we may not be able to achieve market acceptance of them in a timely manner.

In addition, our longstanding relationships with some of our larger customers may also deter other potential customers who compete with these customers from buying our products. To attract new customers or retain existing customers, we may offer certain customers favorable prices on our products. If these prices are lower than the prices paid by our existing customers, we would have to offer the same lower prices to certain of our customers who have contractual “most favored nation” pricing arrangements. In that event, our average selling prices and gross margins would decline. The loss of a key customer, a reduction in sales to any key customer or our inability to attract new significant customers could materially and adversely affect our business, financial condition and results of operations.

***If we fail to appropriately scale our operations in response to changes in demand for our existing products and services or to the demand for new products requested by our customers, our business could be materially and adversely affected.***

To achieve our business objectives, we anticipate that we will need to continue to expand. We have experienced rapid growth and expansion in the past. Through internal growth and acquisitions, we significantly increased the scope of our operations and expanded our workforce from 1,205 employees, as of January 31, 2003, to 3,743 employees, as of October 28, 2006. Nonetheless, we may not be able to expand our workforce and operations in a sufficiently timely manner to respond effectively to changes in demand for our existing products and services or to the demand for new products requested by our customers. In that event, we may be unable to meet competitive challenges or exploit potential market opportunities, and our current or future business could be materially and adversely affected. Conversely, if we expand our operations and workforce too rapidly in anticipation of increased demand for our products, and such demand does not materialize at the pace at which we expected, the rate of increase in our operating expenses may exceed the rate of increase in our revenue, which would adversely affect our operating results.

Our past growth has placed, and any future growth is expected to continue to place, a significant strain on our management personnel, systems and resources. To implement our current business and product plans, we will need to continue to expand, train, manage and motivate our workforce. All of these endeavors will require substantial management effort. Although we have implemented an enterprise resource planning system to help us improve our planning and management processes and are implementing a new human resources management system, we anticipate that we will also need to continue to implement and improve a variety of new and upgraded operational and financial systems, as well as additional procedures and other internal management systems. These processes can be time consuming and expensive, increase management responsibilities, and divert management attention. If we are unable to effectively manage our expanding operations, we may be unable to scale our business quickly enough to meet competitive challenges or exploit potential market opportunities, or conversely, we may scale our business too quickly and the rate of increase in our expenses may exceed the rate of increase in our revenue, either of which would materially and adversely affect our current or future business.

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***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 in-house testing facilities. Therefore, we rely on third-party vendors to manufacture, assemble and test the products we design. We currently rely on several third-party foundries to produce substantially all of our integrated circuit products. We also currently rely on several third-party assembly and test subcontractors to assemble, package and test our products. The resurgence of severe acute respiratory syndrome, the outbreak of avian flu and any similar future outbreaks in Asia, where these foundries are located, could affect the production capabilities of our manufacturers by resulting in quarantines or closures. In the event of such a quarantine or closure, if we were unable to quickly identify alternate manufacturing facilities, our revenues, cost of revenues and results of operations would be negatively impacted. 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 harm our business, financial condition or results of operations.

With limited exceptions, our vendors 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. These vendors may allocate capacity to the production of other companies’ products while reducing deliveries to us on short notice. In particular, some foundry customers may have long-term agreements with these foundries that 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 we are unable to obtain timely and adequate deliveries from our providers at the required 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 qualify 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.

***A number of our subsidiaries are incorporated under the laws of, and their principal offices are located in, the State of Israel and, therefore, their business operations may be harmed by adverse political, economic and military conditions affecting Israel.***

Each of Marvell Semiconductor Israel Ltd. (MSIL), Marvell T.I. Ltd. (MTIL) and Marvell Software Solutions Israel Ltd. (MSSI) is incorporated under the laws of and has its principal offices in Israel. In addition, MSIL and MSSI and maintain their research and development operations in Israel. Thus, MSIL,

MTIL and MSSI are directly influenced by the political, economic and military conditions affecting Israel. Major hostilities involving or within Israel could disrupt MSIL, MTIL and MSSI’s operations. For example, continued hostilities between Israel and the Palestinian authority in recent months have caused substantial political unrest, which could lead to a potential economic downturn in Israel. Additionally, the ongoing situation in Iraq could lead to more economic instability and uncertainty in the State of Israel and the Middle East. 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 negatively impact the business operations and financial results of each of MSIL, MTIL and MSSI.

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

We sell many of our products to customers through distributors and manufacturers’ representatives. Our relationships with some of our distributors and manufacturers’ representatives have been established within the last two years, 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.

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***We are subject to order and shipment uncertainties, and if we are unable to accurately predict customer demand, we may hold excess or obsolete inventory, which would reduce our profit margin, or, conversely, we may have insufficient inventory, which would result in lost revenue opportunities and potentially in loss of market share and damaged customer relationships.***

We typically sell products pursuant to purchase orders rather than long-term purchase commitments. Customers can generally cancel or defer purchase orders on short notice without incurring a significant penalty. In the recent past, some of our customers have developed excess inventories of their own products and have, as a consequence, deferred purchase orders for our products. We cannot accurately predict what or how many products our customers will need in the future. Anticipating demand is difficult because our customers face volatile pricing and unpredictable demand for their own products and are increasingly focused more on cash preservation and tighter inventory management. In addition, as an increasing number of our chips are being incorporated into consumer products, we anticipate greater fluctuations in demand for our products, which makes it more difficult to forecast customer demand. We place orders with our suppliers based on forecasts of customer demand and, in some instances, may establish buffer inventories to accommodate anticipated demand. Our forecasts are based on multiple 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 to, if at all. As a result, we would hold excess or obsolete inventory, which would reduce our profit margins and adversely affect our financial results. Conversely, if we underestimate customer demand or if insufficient manufacturing capacity is available, we would forgo revenue opportunities and potentially lose market share and damage our customer relationships. In addition, any future significant cancellations or deferrals of product orders or the return of previously sold products could materially and adversely affect our profit margins, increase product obsolescence and restrict our ability to fund our operations. Furthermore, we generally recognize revenue upon shipment of products to a customer. If a customer refuses to accept shipped products or does not timely pay for these products, we could incur significant charges against our income.

***The international nature of our business exposes us to financial and regulatory risks that may adversely impact our revenues and profitability.***

International operations are subject to a number of risks that may limit our ability to design, develop, test or market certain technologies and products, which could in turn have an adverse effect on our results of operations and financial condition, including:

* international terrorism and anti-American sentiment, particularly in the emerging
* security concerns, including crime, political instability, armed conflict and civil or military unrest;
* local business and cultural factors that differ from our normal standards and practices in the United;
* regulatory requirements and prohibitions that differ between jurisdictions;
* laws and business practices favoring local companies;
* differing employment practices and labor issues;
* withholding tax obligations on revenues that we may not be able to offset fully against our U.S. tax obligations, including the further risk that foreign tax authorities may increase tax rates, which could result in increased tax withholdings and penalties;
* less effective protection of intellectual property than is afforded to us in the United States or other developed countries; and
* limited infrastructure and disruptions, such as large-scale outages or interruptions of service from utilities or telecommunications providers and natural disasters.

These conditions make it extremely difficult for our customers, our vendors and for us to accurately forecast and plan future business activities. We cannot predict the timing, strength or duration of any economic recovery, worldwide, or in our served markets. If the worldwide economy or our served markets in which we operate were to experience any of the conditions above, our business, financial condition and results of operations could be adversely affected.

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***We are a mid-sized 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, some of our current and potential competitors have longer operating histories, significantly greater resources and name recognition, and a larger base of customers than we do. 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 do. 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 do, which would allow them to respond more quickly 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.

***Our future success depends in significant part on strategic relationships with customers. If we cannot maintain these relationships or if these customers develop their own solutions or adopt a competitor’s solutions instead of buying our products, our operating results would be adversely affected.***

In the past, we have relied in significant part on our strategic relationships with customers that are technology leaders in our target markets. We intend to pursue and continue to form these strategic relationships in the future but we cannot assure you that we will be able to do so. These relationships often require us to develop new products that may involve significant technological challenges. Our customers frequently place considerable pressure on us to meet their tight development schedules. Accordingly, we may have to devote a substantial amount of our limited resources to our strategic relationships, which could detract from or delay our completion of other important development projects. Delays in the development could impair our relationships with our strategic customers and negatively impact sales of the products under development. Moreover, it is possible that our customers may develop their own solutions or adopt a competitor’s solution for products that they currently buy from us. If that happens, our business, financial condition and results of operations could be materially harmed.

***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.

***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 constrained due to strong demand. The ability of each foundry to provide us with semiconductor devices is limited by its available capacity and existing obligations. Although we have entered into contractual commitments to supply specified levels of products to some of our customers, we may not have sufficient levels of production capacity with all of our foundries, despite signing a long-term guaranteed production capacity agreement with one of our foundries. Despite this agreement, foundry capacity may not be available when we need it or at reasonable prices. We place our orders on the basis of our customers’ purchase orders or our forecast of customer demand, and the foundries can allocate capacity to the production of other companies’ products and reduce deliveries to us on short notice. It is possible that foundry customers that are larger and better financed than we are or that have long-term agreements with our main foundries, may induce our foundries to reallocate capacity to those customers. This reallocation could impair our ability to secure the supply of components that we need. Although we use several independent foundries to manufacture substantially all of our semiconductor products, most of our components are not manufactured at more than one foundry at any given time, and our products typically are designed to be manufactured in a specific process at only one of these foundries. Accordingly, if one of our foundries is unable to provide us with components as needed, we could experience significant delays in securing sufficient supplies of those components. We cannot assure

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you that any of our existing or new foundries will be able to produce integrated circuits with acceptable manufacturing yields, or that our foundries will be able to deliver enough semiconductor devices to us on a timely basis, or at reasonable prices. These and other related factors could impair our ability to meet our customers’ needs and have a material and adverse effect on our operating results.

In order to secure sufficient foundry capacity when demand is high and mitigate the risks described in the foregoing paragraph, we may enter into various arrangements with suppliers that could be costly and harm our operating results, such as nonrefundable deposits with or loans to foundries in exchange for capacity commitments, and contracts that commit us to purchase specified quantities of integrated circuits over extended periods.

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. For example, amounts payable under our foundry capacity are non-refundable regardless of whether we are able to utilize all of any of the guaranteed wafer capacity under the terms of the agreement. 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 complexity of our products could result in unforeseen delays or expenses or undetected defects or bugs, which could adversely affect the market acceptance of new products, damage our reputation with current or prospective customers, and materially and adversely affect our operating costs.***

Highly complex products such as the products that we offer frequently contain defects and bugs when they are first introduced or as new versions are released. We have in the past experienced, and may in the future experience, these defects and bugs. Historically, we have been able to design workarounds to fix these defects and bugs with minimal to no disruption to our business or our customers’ business. If any of our products contain defects or bugs, or have reliability, quality, or compatibility problems, we may not be able to successfully design workarounds. Consequently, our reputation may be damaged and customers may be reluctant to buy our products, which could materially and adversely affect our ability to retain existing customers, attract new customers, and our financial results. In addition, these defects or bugs could interrupt or delay sales to our customers. To resolve these problems, we may have to invest significant capital and other resources. Although our products are tested by our suppliers, our customers and ourselves, it is possible that our new products will contain defects or bugs. If any of these problems are not found until after we have commenced commercial production of a new product, we may be required to incur additional development costs and product recall, repair or replacement costs. These problems may also result in claims against us by our customers or others. In addition, these problems may divert our technical and other resources from other development efforts. Moreover, we would likely lose, or experience a delay in, market acceptance of the affected product or products, and we could lose credibility with our current and prospective customers. As a result, our financial results could be materially harmed.

***We may experience difficulties in transitioning to smaller geometry process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries and increased expenses.***

In order to remain competitive, we expect to continue to transition our semiconductor products to increasingly smaller line width geometries. This transition requires us to modify the manufacturing processes for our products and to redesign some products. We periodically evaluate the benefits, on a product-by-product basis, of migrating to smaller geometry process technologies to reduce our costs. In the past, we have experienced some difficulties in shifting to smaller geometry process technologies or new manufacturing processes, which resulted in reduced manufacturing yields, delays in product deliveries and increased expenses. We may face similar difficulties, delays and expenses as we continue to transition our products to smaller geometry processes. We are dependent on our relationships with our foundry subcontractors to transition to smaller geometry processes successfully. We cannot assure you that the foundries that we use will be able to effectively manage the transition or that we will be able to maintain our existing foundry relationships or develop new ones. If any of our foundry subcontractors or we experience significant delays in this transition or fail to efficiently implement this transition, we could experience reduced manufacturing yields, delays in product deliveries and increased expenses, all of which could harm our relationships with our customers and our results of operations. As smaller geometry processes become more prevalent, we expect to continue to integrate greater levels of functionality, as well as customer and third party intellectual property, into our products. However, we may not be able to achieve higher levels of design integration or deliver new integrated products on a timely basis, if at all. Moreover, even if we are able to achieve higher levels of design integration, such integration may have a short-term adverse impact on our operating results, as we may reduce our revenue by integrating the functionality of multiple chips into a single chip.

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***We are subject to the risks of owning real property.***

Our U.S. headquarters located in Santa Clara, CA, land in Singapore, building in Malaysia, building in Switzerland and buildings in Shanghai, China subject us to the risks of owning real property, including:

* the possibility of environmental contamination and the costs associated with fixing any environmental problems;
* adverse changes in the value of these properties, due to interest rate changes, changes in the neighborhood in which the property is located, or other factors;
* the possible need for structural improvements in order to comply with zoning, seismic and other legal or regulatory requirements;
* the potential disruption of our business and operations arising from or connected with a relocation due to moving to or renovating the facility;
* increased cash commitments for improvements to the buildings or the property or both;
* increased operating expenses for the buildings or the property or both;
* possible disputes with tenants or other third parties related to the buildings or the property or both; and
* the risk of financial loss in excess of amounts covered by insurance, or uninsured risks, such as the loss caused by damage to the buildings as a result of an earthquake.

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

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering and sales and marketing personnel. The loss of any key employees or the inability to attract or retain qualified personnel, including engineers and sales and marketing personnel, could delay the development and introduction of and harm our ability to sell our products. We do not have employment contracts with our 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, manufacturing, marketing and sales of integrated circuits. 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 officers and directors own a large percentage of our voting stock, and two of them, together with another employee, are also significant shareholders and are related by blood or marriage. These factors may allow the officers and directors as a group or the three related employees to greatly influence the election of directors and the approval or disapproval of significant corporate actions.***

As of October 28, 2006, our executive officers and directors beneficially owned or controlled, directly or indirectly, approximately 20% of the outstanding shares our common stock. Additionally, Dr. Sehat Sutardja, our Chief Executive Officer, and Weili Dai, who now serves as our Director of Strategic Marketing and Business Development, are husband and wife and Dr. Sehat Sutardja and Dr. Pantas Sutardja are brothers. Together, these three individuals held approximately 20% of our outstanding common stock as of October 28, 2006. As a result, if the directors and officers as a group or any of Dr. Sehat Sutardja, Weili Dai and Dr. Pantas Sutardja act together, they will significantly influence 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. For instance, the voting power of these officers, directors and others could have the effect of delaying or preventing an acquisition of our company on terms that other shareholders may desire. Furthermore, we have a classified board, which could also further delay or prevent an acquisition, under certain circumstances.

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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 that 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 By-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.

***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 93% of our net revenue in the first nine months of fiscal 2007, 94% of our net revenue in fiscal 2006, and 93% of our net revenue in fiscal 2005.

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 risks associated with international operations, 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 substantially 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.

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***Our third-party foundries and subcontractors are concentrated in Taiwan and elsewhere in the Pan-Pacific region, 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 third-party foundries located in Taiwan. Currently our only alternative manufacturing sources are located in Taiwan, China and Singapore. In addition, substantially all of our assembly and testing facilities are located in Singapore, Taiwan, Malaysia 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. Major earthquakes also occurred in Taiwan in 2002 and 2003. Although our foundries and subcontractors did not suffer any significant damage as a result of these most recent earthquakes, 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.

***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 profits on our products are likely to decrease over the next fiscal year below levels we have historically experienced due to pricing pressures from our customers, an increase in sales of storage SOCs, which typically have lower margins than standalone read channel devices, and an increase in sales of wireless and other products into consumer application markets, which are highly competitive and cost sensitive.

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 product sales cycle that does not assure product sales, and that if unsuccessful, may harm our operating results.***

The sales cycle for many of our 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 an extended evaluation and test period, also known as qualification, during which our products undergo rigorous reliability testing by our customers.

Qualification is typically followed by an extended 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 its 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.

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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 must keep pace with rapid technological change and evolving industry standards in the semiconductor industry to remain competitive.***

Our future success will depend on our ability to anticipate and adapt to changes in technology and industry standards and our customers’ changing demands. We sell products in markets that are characterized by rapid technological change, evolving industry standards, frequent new product introductions, short product life cycles and increasing demand for higher levels of integration and smaller process geometries. Our past sales and profitability have resulted, to a large extent, from our ability to anticipate changes in technology and industry standards and to develop and introduce new and enhanced products incorporating the new standards and technologies. Our ability to adapt to these changes and to anticipate future standards, and the rate of adoption and acceptance of those standards, will be a significant factor in maintaining or improving our competitive position and prospects for growth. If new industry standards emerge, our products or our customers’ products could become unmarketable or obsolete, and we could lose market share. We may also have to incur substantial unanticipated costs to comply with these new standards. In addition, our target markets continue to undergo rapid growth and consolidation. A significant slowdown in any of these markets could materially and adversely affect our business, financial condition and results of operations. Our success will also depend on the ability of our customers to develop new products and enhance existing products for the markets we serve and to introduce and promote those products successfully.

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

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

***We may become involved with 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. Any potential intellectual property litigation also could force us to do one or more of the following:

* stop selling products or using technology that contain the allegedly infringing intellectual property;
* pay substantial damages to the party claiming infringement that could adversely impact our liquidity or operating results;
* 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.

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In addition, many of our contracts with our customers require us to indemnify our customers against claims alleging infringement of the proprietary rights of other parties. Customers have requested us to indemnify them in connection with a patent infringement lawsuit by Australia’s Commonwealth Scientific and Industrial Research Organisation (CSIRO). We have also filed an action against CSIRO seeking a declaratory judgment that CSIRO’s patent is invalid and unenforceable and that we and our customers do not infringe the CSIRO patent.

We are also party to other claims and litigation proceedings arising in the normal course of business. The impact on us as a result of such claims and litigation cannot currently be ascertained. Any litigation, regardless of the outcome, is time-consuming and expensive to resolve, may require us to pay significant monetary damages and can divert management time and attention. An unfavorable ruling in litigation could require us to pay damages or one-time license fees or royalty payments, which could adversely impact gross margins in future periods, or could prevent us from manufacturing or selling some of our products or limit or restrict the type of work that employees involved in such litigation may perform for us. There can be no assurance that these matters will be resolved in a manner that is not adverse to our business, financial condition, results of operations or cash flows.

***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.

***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 and 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 and capital gains, those taxes should not apply to us until March 28, 2016. However, it is possible that this exemption would not be extended beyond that date.

The Economic Development Board of Singapore granted Pioneer Status to our wholly-owned subsidiary in Singapore in July 1999. Initially, this tax exemption was to expire after ten years, but the Economic Development Board in June 2006 agreed to extend the term to fifteen years. As a result, we anticipate that a significant portion of the income we earn in Singapore during this period will be exempt from the Singapore income tax. 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. As a result of the Pioneer Status there was a tax savings of $7.4 million in fiscal 2007 resulting in earnings per share benefit of $0.01.

The Israeli government has granted Approved Enterprise Status to two of our wholly-owned subsidiaries in Israel, which provides a tax holiday on undistributed income derived from operations within certain “development regions” in Israel. In order to maintain our

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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. In fiscal 2007 the Israeli subsidiaries were not profitable and did not have any benefit from the tax incentive.

During fiscal 2007, our Switzerland subsidiary received from both Federal and Cantonal purposes a ten-year tax holiday on design and research centre and wafer supply trading activity revenues earned in Switzerland. Each jurisdiction has separate requirements that need to be met such as the ten-year business requirement and investment in head count, intellectual property, office equipment, software and other expense items. If the requirements are not, there would be tax dollars to be paid which may affect our financial results. As a result of the Swiss holiday, our Switzerland subsidiary benefited from an income tax savings of $1.3 million, which did not have a significant earnings per share benefit.

***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 September 5, 2001, a putative class action was filed in the Southern District of New York relating to our initial public offering, or IPO. In this action, the plaintiffs named several defendants including Marvell and two of our officers, one of whom is also a director. This complaint relating to our IPO has been consolidated with hundreds of other lawsuits by plaintiffs against approximately 40 underwriters and approximately 300 issuers across the United States.

Plaintiffs allege that defendants violated various provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934. In these actions, plaintiffs seek, among other items, unspecified damages, pre-judgment interest and reimbursement of attorneys’ and experts’ fees. A Consolidated Amended

Class Action Complaint against Marvell and two of our officers was filed on April 19, 2002. Subsequently, defendants in the consolidated proceedings moved to dismiss the actions. In February 2003, the trial court issued its ruling on the motions, granting the motions in part, and denying them in part. Thus, the cases may proceed against the underwriters and us as to alleged violations of section 11 of the Securities Act of 1933 and section 10(b) of the Securities Exchange Act of 1934. Claims against the individual officers have been voluntarily dismissed with prejudice by agreement with plaintiffs.

On June 26, 2003, the plaintiffs announced that a settlement among plaintiffs, the issuer defendants and their directors and officers, and their insurers had been structured, a part of which the insurers for all issuer defendants would guarantee up to $1 billion to investors who are class members, depending upon plaintiffs’ success against non-settling parties. Our board of directors has approved the proposed settlement, which, if approved by the court result in the plaintiffs’ dismissing the case against us and granting releases that extend to all of our officers and directors. The court issued an order preliminarily approving the settlement in August 2005 and held a public hearing on its fairness in April 2006. The court has not yet ruled following the public hearing. 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.

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

Not applicable.

**Item 3. *Defaults Upon Senior Securities***

Not applicable.

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

Not applicable.

**Item 5. *Other Information***

Not applicable.

**Item 6. *Exhibits***

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

31.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Sehat Sutardja Ph.D., President and Chief Executive Officer

31.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Michael Tate, Interim Chief Financial Officer

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

32.2\* Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Michael Tate, Interim Chief Financial Officer



* In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release No. 33-8238 and 34-47986, Final Rule: Management’s Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed “filed” for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filings under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

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**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. | | | | |  |
| July 2, 2007 | | |  |  | By: /s/ MICHAEL TATE | | | | |  |
|  | Date | |  |  |  |  | Michael Tate |  |  |  |
|  |  |  |  |  |  |  | Interim Chief Financial Officer | | |  |
|  |  |  |  |  | 88 | |  |  |  |  |
|  |  |  |  |  |  | | | |  |  |
|  |  |  |  |  | **EXHIBIT INDEX** | | | | |  |
| **Exhibit** | | |  |  |  | **Description** | | | |  |
| **Number** | | |  |  |  |  |
|  |  |  |  |  |  | | | |  |  |
|  | 31.1 |  | Certification Pursuant to 18 | | U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Sehat Sutardja | | | | |  |
|  |  |  | Ph.D., President and Chief Executive Officer | | | | | | |  |
| 31.2 | |  | Certification Pursuant to 18 | | U.S.C. Section 1350, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 of Michael Tate, | | | | |  |
|  |  |  | Interim Chief Financial Officer | | | | | | |  |
| 32.1\* | |  | Certification Pursuant to 18 | | U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Sehat Sutardja | | | | |  |
|  |  |  | Ph.D., President and Chief Executive Officer | | | | | | |  |
| 32.2\* | |  | Certification Pursuant to 18 | | U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 of Michael Tate, | | | | |  |
|  |  |  | Interim Chief Financial Officer | | | | | | |  |



* In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release No. 33-8238 and 34-47986, Final Rule: Management’s Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed “filed” for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filings under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

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**Exhibit 31.1**

**CERTIFICATION OF THE PRESIDENT AND CHIEF EXECUTIVE OFFICER PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a), AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, 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 report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   1. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   2. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   3. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   4. Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):
   1. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
   2. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Date: July 2, 2007 | | By: | /s/ SEHAT SUTARDJA PH.D. |  |
|  |  |  | Sehat Sutardja Ph.D. |  |
|  |  |  | President and Chief Executive Officer |  |
|  |  |  |  |  |



**Exhibit 31.2**

**CERTIFICATION OF THE INTERIM CHIEF FINANCIAL OFFICER PURSUANT TO SECURITIES EXCHANGE ACT RULES 13a-14(a) AND 15d-14(a), AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Michael Tate, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Marvell Technology Group Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   1. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   2. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   3. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   4. Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of registrant’s board of directors (or persons performing the equivalent functions):
   1. All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
   2. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Date: July 2, 2007 | | By: | /s/ MICHAEL TATE |  |
|  |  |  | Michael Tate |  |
|  |  |  | Interim Chief Financial Officer |  |
|  |  |  |  |  |



**Exhibit 32.1**

**STATEMENT OF THE PRESIDENT AND CHIEF EXECUTIVE OFFICER PURSUANT TO 18 U.S.C. § 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Sehat Sutardja Ph.D., the Chief Executive Officer of Marvell Technology Group Ltd. (the “Company”), certify for the purposes of section 1350 of chapter 63 of title 18 of the United States Code that, to the best of my knowledge,

1. the Quarterly Report of the Company on Form 10-Q for the fiscal quarter ended October 28, 2006 (the “Report”), fully complies with the requirements of section 13(a) or section 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 results of operations of the Company.

/s/ SEHAT SUTARDJA PH.D.

Sehat Sutardja Ph.D.



President and Chief Executive Officer

Date: July 2, 2007



**Exhibit 32.2**

**STATEMENT OF INTERIM CHIEF FINANCIAL OFFICER PURSUANT TO 18 U.S.C. § 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Michael Tate, the Interim Chief Financial Officer of Marvell Technology Group Ltd. (the “Company”), certify for the purposes of section 1350 of chapter 63 of title 18 of the United States Code that, to the best of my knowledge,

1. the Quarterly Report of the Company on Form 10-Q for the fiscal quarter ended October 28, 2006 (the “Report”), fully complies with the requirements of section 13(a) or section 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 results of operations of the Company.

/s/ MICHAEL TATE

Michael Tate



Interim Chief Financial Officer

Date: July 2, 2007

