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

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**FORM 10-Q**

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

**For the quarterly period ended April 28, 2002**

**OR**

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

**Commission file number: 0-23985**

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**NVIDIA CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**94-3177549**  
(I.R.S. Employer Identification No.)

**2701 San Tomas Expressway  
Santa Clara, California 95050  
(408) 486-2000**

(Address, including Zip Code, of Registrant's Principal Executive Offices and Registrant's Telephone Number, including Area Code)

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

The number of shares of the registrant's common stock outstanding as of May 24, 2002 was 151,974,062 shares.

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**NVIDIA CORPORATION**

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**PART I. FINANCIAL INFORMATION**

**ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**NVIDIA CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

**(In thousands)**

**(Unaudited)**

	<u>April 28, 2002</u>	<u>January 27, 2002</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 307,151	\$ 333,000
Restricted cash	7,000	7,000
Marketable securities	521,246	458,377
Accounts receivable, less allowances of \$21,884 at April 28, 2002 and \$18,079 at January 27, 2002	151,429	147,348
Inventory	253,927	213,877
Prepaid expenses and other current assets	11,882	8,078
Prepaid and deferred taxes	66,429	66,429
	<u>1,319,064</u>	<u>1,234,109</u>
Property and equipment, net	131,267	120,128
Deposits and other assets	10,488	11,897
Prepaid and deferred taxes	56,041	55,921
Goodwill and intangible assets, net	82,857	81,119
	<u>\$ 1,599,717</u>	<u>\$ 1,503,174</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 190,360	\$ 214,019
Accrued liabilities	181,928	141,210
Current portion of note and capital lease obligations	3,944	3,896
Interest payable on convertible debenture	528	4,176
Deferred revenue	49,369	70,193
	<u>426,129</u>	<u>433,494</u>
Capital lease obligations, less current portion	4,937	5,861
Long-term convertible debenture	300,000	300,000
Stockholders' equity:		
Common stock	151	150
Additional paid-in capital	478,481	456,621
Other comprehensive income (loss), net	(166)	108
Retained earnings	390,185	306,940
	<u>868,651</u>	<u>763,819</u>
	<u>\$ 1,599,717</u>	<u>\$ 1,503,174</u>

See accompanying notes to condensed consolidated financial statements.

**NVIDIA CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, except per share data)  
(Unaudited)

	Three Months Ended	
	April 28, 2002	April 29, 2002 (As restated—see Note 2)
Revenue	\$ 582,905	\$ 240,932
Cost of revenue	375,740	146,712
Gross profit	207,165	94,220
Operating expenses:		
Research and development	52,492	32,593
Sales, general and administrative	37,482	19,122
Amortization of goodwill	—	375
Acquisition related charges	—	9,573
Total operating expenses	89,974	61,663
Operating income	117,191	32,557
Interest and other income, net	1,731	5,515
Income before income tax expense	118,922	38,072
Income tax expense	35,677	11,422
Net income	\$ 83,245	\$ 26,650
Basic net income per share	\$ 0.55	\$ 0.19
Diluted net income per share	\$ 0.47	\$ 0.16
Shares used in basic per share computation	150,684	138,643
Shares used in diluted per share computation	182,565	165,711

See accompanying notes to condensed consolidated financial statements.

**NVIDIA CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)  
(Unaudited)

	April 28, 2002	April 29, 2002 (As restated—see Note 2)
Cash flows from operating activities:		
Net income	\$ 83,245	\$ 26,650
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	12,830	6,195
Deferred income taxes	(120)	4,154
Stock based compensation	(156)	—
Amortization of deferred compensation	—	4
Bad debt expense	236	189
Tax benefit from employee stock plans	7,030	15,214
Changes in operating assets and liabilities:		
Accounts receivable	(4,317)	18,170
Inventory	(40,050)	928
Prepaid income taxes	—	(42,520)
Prepaid expenses and other current assets	(3,804)	(2,179)
Deposits and other assets	1,077	81
Accounts payable	(23,659)	(692)
Accrued liabilities	37,287	9,484
Deferred revenue	(20,824)	—
Net cash provided by operating activities	48,775	35,678
Cash flows from investing activities:		
Purchases of marketable securities	(113,638)	—
Maturities of marketable securities	50,075	—
Purchase of certain assets from various businesses	(3,980)	(63,610)
Purchase of property and equipment	(21,192)	(31,741)
Deposit and release of restricted cash	—	(3,550)
Net cash used in investing activities	(88,735)	(98,901)
Cash flows from financing activities:		
Convertible debenture-net of issuance costs	—	(18)
Common stock issued under employee stock plans	14,981	16,514
Sale of common stock under public offering, net of issuance costs	—	(18)
Payments under capital leases	(870)	(230)
Net cash provided by financing activities	14,111	16,248
Change in cash and cash equivalents	(25,849)	(46,975)
Cash and cash equivalents at beginning of period	333,000	674,275
Cash and cash equivalents at end of period	\$ 307,151	\$ 627,300
Cash paid for interest	\$ 7,331	\$ 7,364
Cash paid (refund) for taxes	\$ (6,508)	\$ 34,084

See accompanying notes to condensed consolidated financial statements.

**NVIDIA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(unaudited)**

**(1) Basis of presentation**

The accompanying condensed consolidated unaudited financial statements were prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments except as otherwise noted, considered necessary for a fair presentation have been included. The results for the interim periods presented are not necessarily indicative of the results expected for any future period. The following information should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended January 27, 2002.

*Reclassifications*

Certain prior year balances were reclassified to conform to the current period presentation.

**(2) Restatement**

In January 2002, NVIDIA's Audit Committee initiated a review at the request of, and in cooperation with, the staff of the SEC. Based on findings of the review, the financial statements for the first three quarters of fiscal year 2002 and for the fiscal years 2001 and 2000 were restated in the Company's Annual Report on Form 10-K for the fiscal year ended January 27, 2002 filed on May 14, 2002. The accompanying condensed consolidated income statement and balance sheet for the first quarter ended April 29, 2001 present restated results. For the three months ended April 29, 2001, adjustments to cost of revenues reflect primarily the recording of manufacturing costs, as well as the timing of inventory write-downs. Adjustments to operating expenses reflect primarily the timing of the recording of accruals.

**NVIDIA CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

A comparison of the restated and previously reported income statement and balance sheet for the three months ended April 29, 2001 follows:

		<b>Condensed Consolidated Income Statement For the Three Months Ended April 29, 2001 (unaudited)</b>	
		<b>As Restated</b>	<b>Previously Reported</b>
		<b>(in thousands, except per share data)</b>	
Revenue		\$ 240,932	\$ 240,932
Cost of revenue		146,712	149,295
<b>Gross profit</b>		<b>94,220</b>	<b>91,637</b>
<b>Operating expenses:</b>			
Research and development		32,593	31,414
Sales, general and administrative		19,122	18,837
Amortization of goodwill		375	375
Acquisition related charges		9,573	9,573
<b>Total operating expenses</b>		<b>61,663</b>	<b>60,199</b>
<b>Operating income</b>		<b>32,557</b>	<b>31,438</b>
Interest and other income, net		5,515	5,515
<b>Income before tax expense</b>		<b>38,072</b>	<b>36,953</b>
Income tax expense		11,422	11,086
<b>Net income</b>		<b>\$ 26,650</b>	<b>\$ 25,867</b>
<b>Basic net income per share</b>		<b>\$ 0.19</b>	<b>\$ 0.19</b>
<b>Diluted net income per share</b>		<b>\$ 0.16</b>	<b>\$ 0.16</b>
Shares used in basic per share computation		138,643	138,643
Shares used in diluted per share computation		165,711	165,711

**NVIDIA CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

		Condensed Consolidated Balance Sheet As of April 29, 2001 (unaudited)	
		As Restated	As Previously Reported
ASSETS			
		(in thousands)	
Current assets:			
Cash and cash equivalents	\$	627,301	\$ 627,301
Restricted cash		28,050	28,050
Accounts receivable, net		86,629	86,629
Inventory		89,452	86,770
Prepaid expenses and other current assets		10,535	11,172
Prepaid and deferred taxes		40,731	40,731
Total current assets		882,698	880,653
Property and equipment, net		74,333	74,333
Deposits and other assets		10,513	10,513
Prepaid and deferred taxes		30,053	30,053
Goodwill and intangible assets, net		86,232	86,232
	\$	1,083,829	\$ 1,081,784
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	\$	71,610	\$ 72,048
Accrued liabilities		46,011	45,704
Current portion of capital lease obligations		429	429
Deferred revenue		200,000	200,000
Total current liabilities		318,050	318,181
Capital lease obligations, less current portion		307	307
Long-term convertible debenture		300,000	300,000
Stockholders' equity:			
Common stock		140	140
Additional paid-in capital		308,668	308,668
Deferred compensation		(2)	(2)
Retained earnings		156,666	154,490
Total stockholders' equity		465,472	463,296
	\$	1,083,829	\$ 1,081,784

**(3) Recent Accounting Pronouncements**

Effective fiscal 2003, the Company completed the adoption of Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 requires all business combinations initiated after June 30, 2001, to be accounted for using the purchase method of accounting. As required by SFAS No. 142, the Company discontinued amortizing the remaining balances of goodwill as of the beginning of fiscal 2003. All remaining and future acquired goodwill will be subject to impairment tests annually, or earlier if indicators of potential impairment exist, using a fair-value-based approach. All other intangible assets will continue to be amortized over their estimated useful lives and assessed for impairment under SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."



## NVIDIA CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

In conjunction with the implementation of SFAS No. 142, the Company has completed a transitional goodwill impairment test and found no impairment. Upon adoption of the new business combination rules, acquired workforce no longer meets the definition of an identified intangible asset. As a result, the net balance of \$1.8 million has been reclassified to goodwill in fiscal 2003. The adoption of SFAS No. 142 ceased the amortization of goodwill which otherwise would have been approximately \$3.2 million for the quarter ended April 28, 2002. The adjusted effects of the adoption of SFAS No. 142 are as follows:

	Three Months Ended		
	April 28, 2002 As Reported	April 29, 2001 As Adjusted	April 29, 2001 As Restated
Amortization of goodwill	\$ —	\$ —	\$ 375
Net income	\$ 83,245	\$ 26,913	\$ 26,650
Basic EPS	\$ 0.55	\$ 0.19	\$ 0.19
Diluted EPS	\$ 0.47	\$ 0.16	\$ 0.16

In October 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that the fair value of retirement obligations be recognized as a liability when they are incurred and that the associated retirement costs be capitalized as a long-term asset and expensed over its useful life. The provisions of SFAS No. 143 will be effective for fiscal years beginning after June 15, 2002. The Company does not expect that the adoption of SFAS No. 143 will have a material effect on its financial position or results of operations.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supercedes SFAS No. 121 and the accounting and reporting provisions of APB Opinion No. 30 as it relates to the disposal of a segment of a business. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. The Company adopted SFAS No. 144 effective fiscal 2003. The adoption of SFAS 144 has not had an impact on the Company's consolidated financial position or results of operations.

**(4) Net Income Per Share**

Basic net income per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted average number of common and dilutive common equivalent shares outstanding during the period, using the as-if-converted method for the convertible debenture and the treasury stock method for stock options. Under the as-if-converted method, the convertible debentures are not included in the computation of net income per share for the period ended April 29, 2001 as their effect is antidilutive. The following is a reconciliation of the numerators and denominators of the basic and diluted net income per share computations for the periods presented.

**NVIDIA CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

	<b>April 28, 2002</b>	<b>Three Months Ended April 29, 2001</b>
		<b>(As restated – see Note 2) (in thousands)</b>
<b>Numerator:</b>		
Numerator for basic net income per share	\$ 83,245	\$ 26,650
Effect of adding back interest and amortization expense associated with the convertible debentures after tax	2,665	—
Numerator for diluted net income per share	\$ 85,910	\$ 26,650
<b>Denominator:</b>		
Demoninator for basic net income per share, Weighted average shares	150,684	138,643
<b>Effect of dilutive securities:</b>		
Convertible debentures	6,472	—
Stock options outstanding	25,409	27,068
Demoninator for diluted net income per share	182,565	165,711
<b>Net income per share:</b>		
Basis net income per share	\$ 0.55	\$ 0.19
Diluted net income per share	\$ 0.47	\$ 0.16

For the quarter ended April 28, 2002, instruments excluded from the computation of diluted earnings per share were options to acquire 1,963,350 shares of common stock with a weighted average exercise price of \$59.21. For the quarter ended April 29, 2001, instruments excluded from the computation of diluted earnings per share were options to acquire 2,917,900 shares of common stock with a weighted average exercise price of \$32.25 and the assumed conversion of convertible debt into 6,471,793 shares of common stock at a conversion price of \$46.36.

**(5) Business Combination**

During fiscal year 2002, the Company completed the purchase of certain assets from various businesses, including 3dfx Interactive, Inc. ("3dfx") and other acquisitions, for an aggregate purchase price of approximately \$79.1 million. These acquisitions have been accounted for under the purchase method of accounting. Excluding the 3dfx transaction, the aggregate purchase price for all other acquisitions is immaterial to the condensed consolidated financial statements of the Company.

On April 18, 2001, the Company completed the purchase of certain assets of 3dfx, including patents and patent applications. Under the terms of the Asset Purchase Agreement, the cash consideration due at the closing was \$70.0 million, less \$15.0 million that was loaned to 3dfx pursuant to a Credit Agreement dated December 15, 2000, between the Company and 3dfx. Pursuant to the Asset Purchase Agreement, following the closing, the Company is to pay 3dfx additional consideration in the form of stock equal to two million shares of the Company's common stock, subject to 3dfx satisfying certain conditions. If the debts and liabilities of 3dfx can be satisfied for less than \$25.0 million and in accordance with the provisions set forth in the agreement, under some circumstances, 3dfx could receive a post-closing advance from the Company of up to \$25.0 million and this advance would reduce the number of shares of the Company's common stock potentially payable to 3dfx by up to one million shares. In the event 3dfx cannot satisfy all of its obligations for \$25.0 million, NVIDIA will not be obligated to pay any additional consideration. At this time, 3dfx has not satisfied all terms and conditions necessary to receive any contingent consideration. Consequently, due to the possibility of contingent consideration, the components of the final purchase price could differ from those presented below. In addition, following the asset purchase, the Company and 3dfx filed a stipulation to dismiss with prejudice the patent litigation between the parties. The litigation was dismissed on April 26, 2001, pursuant to a judicial order.

# **NVIDIA CORPORATION AND SUBSIDIARIES**

## **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

As of April 28, 2002, the 3dfx asset purchase price of \$70.0 million and direct transaction costs of \$4.2 million were allocated based on fair values presented below. Upon the adoption of SFAS No. 142, approximately \$3.0 million of intangible assets previously allocated to workforce in place were subsumed into goodwill in fiscal 2003. In addition, amortization of goodwill ceased in accordance with the new accounting rules.

	<b>3dfx</b>	<b>Straight-Line Amortization Period</b>
	<b>(in thousands)</b>	<b>(years)</b>
Property and equipment	\$ 2,433	1-2
Patents and trademarks	11,310	5
Goodwill	60,418	—
<b>Total</b>	<b>\$ 74,161</b>	

The final allocation will depend upon the composition of 3dfx assets acquired and the Company's evaluation of the fair value of the net assets. Consequently, the actual allocation of the purchase price could differ from that presented above.

### **(6) Marketable Securities**

The Company accounts for its investment instruments in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." All of the cash equivalents and marketable securities are treated as "available-for-sale" under SFAS No. 115. Cash equivalents consist of financial instruments which are readily convertible into cash and have original maturities of three months or less at the time of acquisition. The Company classifies its marketable debt securities at the date of acquisition in the available-for-sale category. These securities are reported at fair value with the related unrealized gains and losses included in other comprehensive income, net of tax, a component of stockholders' equity. The average holding periods until maturity of our cash equivalents and marketable securities were approximately 16 and 556 days, respectively. The principal amounts and related weighted-average interest rates for our investment portfolio were \$305.6 million and 1.79% for cash equivalents, and \$521.2 million and 3.24% for marketable securities as of April 28, 2002.

### **(7) Balance Sheet Components**

Certain balance sheet components are as follows:

	<b>April 28, 2002</b>	<b>January 27, 2002</b>
<b>Inventory:</b>	<b>(in thousands)</b>	
Raw material	\$ 29,781	\$ 13,367
Work in-process	33,772	77,130
Finished goods	190,374	123,380
<b>Total inventory</b>	<b>\$ 253,927</b>	<b>\$ 213,877</b>

At April 28, 2002, the Company had noncancelable inventory purchase commitments totaling \$454.5 million.

# NVIDIA CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	April 28, 2002	January 27, 2002
<b>Accrued Liabilities:</b>		
	(in thousands)	
Accrued customer programs	\$ 55,954	\$ 55,627
Taxes payable	98,232	62,922
Accrued payroll and related expenses	17,568	16,389
Other	10,174	6,272
<b>Total accrued liabilities</b>	<b>\$ 181,928</b>	<b>\$ 141,210</b>

### (8) Segment Information

The Company operates in a single industry segment: the design, development and marketing of 3D graphics and media communication processors and related software for PCs, workstations and digital entertainment platforms. The Company's chief operating decision maker, the Chief Executive Officer, reviews financial information presented on a consolidated basis for purposes of making operating decisions and assessing financial performance. Revenue by geographical region is allocated to individual countries based on the location to which the products are initially billed even if the foreign CEMs' and add-in board and motherboard manufacturers' revenue is attributable to end customers located in the United States. The following table summarizes information pertaining to the Company's operations in different geographic areas as follows:

	Three Months Ended	
	April 28, 2002	April 29, 2001
	(in thousands)	
<b>Revenue:</b>		
U.S. and North America	\$ 191,736	\$ 15,249
Asia Pacific	376,727	211,625
Europe	14,442	14,058
<b>Total revenue</b>	<b>\$ 582,905</b>	<b>\$ 240,932</b>

Revenues from significant customers, those representing approximately 10% or more of total revenue for the respective periods, are summarized as follows:

	Three Months Ended	
	April 28, 2002	April 29, 2001
<b>Revenue:</b>		
Customer A	14%	6%
Customer B	22%	—
Customer C	17%	31%
Customer D	9%	14%
Customer E	8%	10%

## NVIDIA CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	As of April 28, 2002	As of January 27, 2002
<b>Accounts Receivable:</b>		
Customer A	20%	16%
Customer B	—	—
Customer C	15%	14%
Customer D	12%	9%
Customer E	12%	7%

**(9) Microsoft Agreement**

On March 5, 2000, the Company entered into an agreement with Microsoft in which the Company agreed, under certain terms and conditions, to develop and sell processors for use in the Xbox video game console. On February 14, 2001, the Company announced that its Xbox IGP and Xbox media communications processor were released to Taiwan Semiconductor Manufacturing Company, or TSMC, for prototype fabrication. These processors are fabricated on a .15-micron process technology and commercial shipment began in July 2001. In April 2000, Microsoft paid the Company \$200.0 million under the agreement as an advance against processor purchases. This advance was fully utilized by purchases made by Microsoft through the quarter ended April 28, 2002 and Microsoft is currently paying in advance for processor chipsets sold to it.

The Company is engaged with Microsoft in discussions related to pricing and volumes of the Xbox chipset. These discussions and the Company's agreement contemplated use of a third party to resolve matters and on April 23, 2002 Microsoft submitted the matter to binding arbitration. Microsoft requested that the arbitration panel require that the Company supply chipsets in whatever quantities are ordered by Microsoft. Microsoft has also asked for damages for alleged violations of the agreement and requested that the arbitration panel reduce chipset prices paid by Microsoft. The Company does not believe it has a requirements obligation to Microsoft and has submitted its position to the arbitration panel. The Company has agreed only to fulfill the Microsoft purchase orders that the Company has already accepted, which the Company believes will result in shipments to Microsoft sufficient for it to meet its published expectations for installed units as of the end of this year. For sales of the Xbox media communication processor, the Company has deferred revenue in an amount equal to the difference between the price being paid by Microsoft and the price Microsoft claims it should be paying. This amount was approximately \$25.6 million as of April 28, 2002. The Company expects that it will continue to defer revenue related to the disputed pricing for future sales of this processor until resolution of the matter. The arbitration will be conducted in New York by a panel under the rules of the American Arbitration Association.

**(10) Litigation**

On February 19, 2002 an NVIDIA stockholder, Dominic Castaldo, on behalf of himself and purportedly on behalf of a class of Company stockholders, filed an action in the United States District Court for the Northern District of California, or the Northern District, against the Company and certain officers of the Company, alleging violations of the federal securities laws arising out of the Company's announcement on February 14, 2002 of an internal investigation of certain accounting matters. As of April 30, 2002, approximately 13 similar actions ("the Federal Class Actions") were filed in the Northern District, along with three related derivative actions against the Company, certain of its executive officers, directors and its independent auditors, KPMG LLP, in California Superior Court and in Delaware Chancery Court, collectively the Actions. The Actions allege claims in connection with various alleged statements and omissions to the public and to the securities markets and seek damages together with interest and reimbursement of costs and expenses of the litigation. The derivative actions also seek disgorgement of alleged profits from insider trading by officers and directors. The Actions are in the preliminary stages. No discovery has been conducted. The Federal Class Actions have been consolidated and lead plaintiffs appointed. The consolidated amended complaint should be filed by August 5, 2002. The Company is obligated to indemnify its officers and directors in connection with the Actions and has insurance for such individuals, to the extent of the limits of the applicable insurance policies and subject to potential reservations of rights. The Company intends to vigorously defend these Actions. The Company is unable, however, to predict the ultimate outcome of the Actions. There can be no assurance the

**NVIDIA CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Company will be successful in defending the Actions and if the Company is unsuccessful the Company may be subject to significant damages. Even if the Company is successful, defending the Actions is likely to be expensive and may divert management's attention from other business concerns and harm our business.

The SEC staff informed the Company in January 2002 that it had concerns relating to certain accounting matters and that the SEC along with the U.S. Attorney's Office for the Northern District of California had authorized a private investigation into such matters. In accordance with the suggestion and advice of the SEC staff, the Company launched a review of these matters. On April 29, 2002, the Company announced that the Audit Committee of the Board of Directors had, with assistance from the law firm of Cooley Godward LLP and forensic auditors from the firm of KPMG LLP, concluded its review and determined that it was appropriate to restate the Company's financial statements for fiscal 2000, 2001 and the first three quarters of fiscal 2002. The Audit Committee has worked in cooperation with the SEC and has provided the SEC with extensive information and the conclusions of the review. Further actions by the SEC or other governmental or regulatory agencies with respect to the Company or its personnel arising out of the restatement of its financial statements or other matters may take significant time, may be expensive and may divert management's attention from other business concerns and harm the Company's business.

The Company is engaged with Microsoft in discussions related to pricing and volumes of the Xbox chipset. These discussions and the Company's agreement contemplated use of a third party to resolve matters and on April 23, 2002 Microsoft submitted the matter to binding arbitration. Microsoft requested that the arbitration panel require that the Company supply chipsets in whatever quantities are ordered by Microsoft. Microsoft has also asked for damages for alleged violations of the agreement and requested that the arbitration panel reduce chipset prices paid by Microsoft. The Company does not believe it has a requirements obligation to Microsoft and has submitted its position to the arbitration panel. The Company has agreed only to fulfill the Microsoft purchase orders that the Company has already accepted, which the Company believes will result in shipments to Microsoft sufficient for it to meet its published expectations for installed units as of the end of this year. For sales of the Xbox media communication processor, the Company has deferred revenue in an amount equal to the difference between the price being paid by Microsoft and the price Microsoft claims it should be paying. This amount was approximately \$25.6 million as of April 28, 2002. The Company expects that it will continue to defer revenue related to the disputed pricing for future sales of this processor until resolution of the matter. The arbitration will be conducted in New York by a panel under the rules of the American Arbitration Association.

There can be no assurance that the Company will prevail in the arbitration or continue to supply graphics and other processors for the Xbox. If it does not prevail, the Company may (i) be compelled to deliver Xbox processors at reduced pricing, resulting in reduced gross margins, or a loss, on such processors; (ii) be required to reduce production and delivery of other products in order to satisfy obligations to Microsoft; (iii) be required to pay significant damages to Microsoft; or (iv) be subject to other remedies that could have a material adverse impact on the Company's business. Even if the Company does prevail, there can be no assurance that its business will not be materially harmed.

The Company is subject to other legal proceedings, but does not believe that the ultimate outcome of any of these proceedings will have a material adverse effect on its financial position or overall trends in results of operations. However, if an unfavorable ruling were to occur in any specific period, there exists the possibility of a material adverse impact on the results of operations of that period.

Management currently believes that resolving these matters will not have a material adverse impact on the Company's financial position or its results of operations. As of April 28, 2002 and April 29, 2001, no accruals for these contingencies have been recorded. In addition to the above litigation, from time to time the Company is subject to claims in the ordinary course of business, none of which are viewed to have a material adverse impact on the Company's business or financial position if resolved unfavorably.

## **ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are subject to the "safe harbor" created by those sections. These forward-looking statements include but are not limited to: statements related to industry trends and future growth in the markets for 3D graphics processors; our product development efforts; the timing of our introduction of new products; industry and consumer acceptance of our products; and future profitability. These forward-looking statements involve risks and uncertainties that could cause our actual results to differ materially from those in the forward-looking statements. We undertake no obligation to publicly release any revisions to the forward-looking statements or reflect events or circumstances after the date of this document. The "Business Risks" section, among other things, should be considered in evaluating our prospects and future financial performance.

### **Restatement**

We conducted a review of our accounting records and financial statements in response to an inquiry from the SEC. Based on the results of the review, we restated the financial statements and related disclosures for the first three quarters of fiscal year 2002 and for the fiscal years 2001 and 2000 in our Annual Report on Form 10-K for the fiscal year ended January 27, 2002 filed on May 14, 2002. All information, discussions and comparisons in this Form 10-Q reflect the restatement.

The following discussion should be read in conjunction with the accompanying restated condensed consolidated financial statements as of and for the three months ended April 29, 2001. For additional information on the restatement, refer to Note 2 to the Condensed Consolidated Financial Statements.

### **Overview**

We design, develop and market graphics and media communication processors and related software for personal computers, or PCs, workstations and digital entertainment platforms. We provide an architecturally compatible "top-to-bottom" family of award-winning performance 3D graphics processors and graphics processing units, or GPUs, that set the standard for performance, quality and features for a broad range of desktop PCs, from professional workstations to low-cost PCs and mobile PCs, from performance laptops to thin-and-light notebooks. Our 3D graphics processors are used for a wide variety of applications, including games, digital image editing, business productivity, the Internet and industrial design. Our graphics processors are designed to be architecturally compatible backward and forward between generations, giving our original equipment manufacturers, or OEMs, customers and end users a low cost of ownership.

We have five major product brands: GeForce, nForce, GeForce Go, Quadro and TNT2. The GeForce family represents our desktop GPUs. We are recognized for developing the world's first programmable GPUs, the GeForce4 and GeForce3. The GeForce4 and GeForce3 GPUs are designed to deliver the highest performance and cinematic-quality for interactive entertainment, digital image editing and digital video playback applications through the use of highly-programmable processing elements. The nForce and Xbox integrated graphics processor units, or IGP's, and media communications processors, or MCP's, are the industry's first highly-integrated platform processors to incorporate a comprehensive set of multimedia capabilities, such as 2D, 3D, DVD, HDTV, Dolby Digital audio playback and fast broadband and networking communications. Our mobile product family, which consists of the GeForce 4 and GeForce2 Go GPUs, are designed to deliver desktop graphics performance and features for multiple laptop configurations from desktop replacements to thin-and-lights. The Quadro family of workstation GPUs consists of an extensive range of products for the high-end, mid-range, entry level, multi-display 2D and digital content creation markets. The NVIDIA TNT2 family of graphics processors delivers high performance 3D and 2D graphics at affordable prices, making them the graphics hardware of choice for a wide range of applications for both consumer and commercial use. Our entire product family provides superior processing and rendering power at competitive prices and is architected to deliver the maximum performance from industry standards such as Microsoft's Direct3D Application Programming Interface, or API, and Silicon Graphics, Inc.'s, or SGI's, OpenGL API on Windows operating systems and Linux platforms.

Currently, all of our product sales and our arrangements with third-party manufacturers provide for pricing and payment in U.S. dollars. We have not engaged in any foreign currency hedging activities, although we may do so in

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the future. Since the majority of our products are sold into the PC market, our business would suffer if for any reason our graphics processors do not achieve widespread acceptance in the PC market.

A majority of our sales have been to a limited number of customers and sales are highly concentrated. We sell graphics processors to add-in board and motherboard manufacturers and contract equipment manufacturers, or CEMs. These manufacturers incorporate our processors in the boards they sell to PC OEMs, retail outlets and systems integrators. We also sell graphics processors to independent stocking representatives that purchase our products and resell these products to PC OEMs. The average selling prices for our products, as well as our customers' products, vary by distribution channel. Our three largest customers accounted for approximately 53% of revenues for the first quarter of fiscal 2003. Sales to Microsoft accounted for 22% and sales to two customers accounted for 31% of our total revenue for the first quarter of fiscal 2003. For the first quarter of fiscal 2002, sales to three customers accounted for 55% of total revenue. Although we have major customers, our end customers include Acer Inc., Apple Computer, Inc., Compaq Computer Corporation, Dell Computer Corporation, eMachines Inc., Fujitsu-Siemens Computers, Gateway Inc., Hewlett Packard Company, IBM, Micron Electronics Inc., NEC Corporation, Packard Bell NEC Inc., Silicon Graphics Inc. and Sony Corporation.

As markets for our 3D graphics processors develop and competition increases, we anticipate that product life cycles in the high end will remain short and average selling prices will continue to decline. In particular, average selling prices and gross margins are expected to decline as each product matures. Our add-in board and motherboard manufacturers and major OEM customers typically introduce new system configurations as often as twice per year for the high end, typically based on spring and fall design cycles. In order to maintain average selling prices and gross margins, our existing and new products must achieve competitive performance levels to be designed into new system configurations and must be produced at low costs, in sufficient volumes and on a timely basis, especially with respect to our new products. We primarily utilize Taiwan Semiconductor Manufacturing Company, or TSMC, to produce semiconductor wafers and we utilize independent contractors to perform assembly, testing and packaging.

The majority of our sales are made on the basis of purchase orders rather than long-term agreements. As a result, we may commit resources to the production of products without having received advance purchase commitments from customers. Any inability to sell products to which we have devoted significant resources could harm our business. In addition, cancellation or deferral of product orders could result in our holding excess inventory, which could harm our profit margins and restrict our ability to fund operations. We may build memory and component inventories during periods of anticipated growth and in connection with selling workstation boards directly to major OEMs. We could be subject to excess or obsolete inventories and be required to take corresponding write-downs if growth slows or if we incorrectly forecast product demand. A reduction in demand could negatively impact our gross margins and financial results. Product returns or delays or difficulties in collecting accounts receivable could result in significant charges against income, which could harm our business.

### **Critical Accounting Policies and Estimates**

The financial results that we report are impacted by the application of a several accounting policies that require us to make subjective and complex judgments. Changes in our estimates or judgments could materially impact our results of operations, financial condition and cash flows in future years. We believe our most critical accounting policies include revenue recognition, allowance for doubtful accounts, inventory and tax valuation allowance. Our accounting practices are discussed in more detail in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and Note 1 of "Notes to Consolidated Financial Statements" in our Annual Report on Form 10-K for the year ended January 27, 2002.



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**Results of Operations**

The following table sets forth, for the periods indicated, certain items in our condensed consolidated statements of income expressed as a percentage of revenue.

	Three Months Ended	
	April 28, 2002	April 29, 2001 (As restated—see Note 2)
Revenue	100.0%	100.0%
Cost of revenue	64.5	60.9
Gross profit	35.5	39.1
Operating expenses:		
Research and development	9.0	13.5
Sales, general and administrative	6.4	7.9
Amortization of goodwill	0.0	0.2
Acquisition related charges	0.0	4.0
Total operating expenses	15.4	25.6
Operating income	20.1	13.5
Interest and other income, net	0.3	2.3
Income before income tax expense	20.4	15.8
Income tax expense	6.1	4.7
Net income	14.3%	11.1%

Three Months Ended April 28, 2002 and April 29, 2001

**Revenue**

Revenue increased by 142% to \$582.9 million for the three months ended April 28, 2002. The growth was primarily the result of increased sales of our graphics processors driven by the strong demand for our products in the PC, workstation and mobile laptop markets and the introduction of our graphics processors into the game console market. Revenue from sales outside of the United States accounted for 67% and 94% of total revenue for the first three months of fiscal 2003 and 2002, respectively. Geographic sales are based on bill-to address and this decrease in revenue from sales outside of the United States is primarily attributable to sales of the graphics and media communication processors used in the Microsoft Xbox product billed to Microsoft in the United States. Revenue by geographical region is allocated to individual countries based on the location to which the products are initially billed even if the foreign CEMs' and add-in board and motherboard manufacturers' revenue is attributable to end customers located in the United States. Although we achieved substantial growth in product revenue for the first quarter of 2003 from the same period a year ago, we do not expect to sustain this rate of growth in future periods. In addition, we expect that the average selling prices of our products will decline over the lives of our products. The decline in average selling prices of 3D graphics processors in general may accelerate as the market continues to develop and competition increases.

**Gross Profit**

Gross profit consists of total revenue, net of allowances, less cost of revenue. Cost of revenue consists primarily of the cost of semiconductors purchased from contract manufacturers (including assembly, testing and packaging), manufacturing support costs (including labor and overhead associated with such purchases), final test yield fallout, inventory provisions and shipping costs. Our gross profit margin can vary in any period depending on the mix of types of graphics processors sold. Our gross profit margins were 35.5% and 39.1% for the first three months of fiscal 2003 and 2002, respectively. Gross margins decreased primarily due to the deferral of Xbox revenues discussed in Note 9 to the Condensed Consolidated Financial Statements. Gross profit increased by \$112.9 million, or 120%, from the first quarter of fiscal 2002 due to an increase in unit shipments. Although we achieved substantial growth in gross profit for the first three months of fiscal 2003 from the same period a year ago, we do not expect to sustain these rates of growth in future periods.

**Operating Expenses**

**Research and Development.** Research and development expenses consist of salaries and benefits, cost of development tools and software, cost of new product prototypes and consultant costs. Research and development expenses increased by \$19.9 million, or 61%, from the first quarter of fiscal 2002 to the first quarter of fiscal 2003 primarily due to a \$7.5 million increase related to additional personnel, a \$5.9 million increase associated with lab equipment, software licenses, maintenance fees and depreciation charges, a \$1.8 million increase related to engineering costs to develop our next generation products, and a \$4.7 million increase in facilities costs due to the move into our new headquarters and other expenses during the period.

We anticipate that we will continue to devote substantial resources to research and development, and we expect these expenses to increase in absolute dollars in the foreseeable future due to the increased complexity and the greater number of products under development. Research and development expenses are likely to fluctuate from

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time to time to the extent we make periodic incremental investments in research and development and these investments may be independent of our level of revenues.

*Sales, General and Administrative.* Sales, general and administrative expenses consist primarily of salaries, commissions and bonuses, promotional tradeshow and advertising expenses, travel and entertainment expenses and legal and accounting expenses. Sales, general and administrative expenses increased \$18.4 million, or 96%, from the first quarter of fiscal 2002 to the first quarter of fiscal 2003 primarily due to a \$6.7 million increase related to additional personnel and commissions, a \$3.1 million increase in tradeshow and product launch costs, a \$5.2 million increase associated with facilities costs, general administrative activities and travel and entertainment expenses, and \$3.4 million incurred in connection with our recent internal accounting review.

We expect sales and marketing expenses to continue to increase in absolute dollars as we continue to expand our operations and our sales.

### ***Amortization of Goodwill***

During fiscal 2002, amortization of goodwill was associated with goodwill from the asset purchase from 3dfx. The initial allocation of the purchase price includes \$60.4 million of goodwill, including approximately \$3.0 million of intangible assets previously allocated to workforce in place which was subsumed into goodwill as of the beginning of fiscal 2003. Additional consideration is potentially payable to 3dfx, subject to 3dfx satisfying certain conditions.

In accordance with Statement of Financial Accounting Standards No. ("SFAS") 142, "Goodwill and Other Intangible Assets," we no longer amortize goodwill as of the beginning of fiscal 2003. We have conducted a transitional impairment test on our goodwill and concluded that no impairment charge was required. In the three months ended April 29, 2001, the amortization of goodwill, including workforce in place, was \$375,000.

### ***Acquisition Related Charges***

Acquisition related charges are attributable to expenses related to the acquisition of assets of 3dfx in fiscal 2002. These charges primarily consisted of bonuses for former 3dfx employees.

### ***Interest and Other Income (Expense), Net***

Interest income primarily consists of interest earned on cash, cash equivalents and marketable securities. Interest expense primarily consists of interest incurred as a result of capital lease obligations and interest on our convertible debt. Interest income decreased \$4.0 million from the first quarter of fiscal 2002 to the first quarter of fiscal 2003 primarily due to the decline in market interest rates. Interest expense remained flat for the first quarter of fiscal 2003 as compared to the same period of fiscal 2002.

### ***Income Taxes***

We had income tax expense of \$35.7 million and \$11.4 million for the first quarter of fiscal 2003 and 2002, respectively. Income taxes as a percentage of pretax income were 30.0% for the first quarter of fiscal 2003 and 2002.

### ***Liquidity and Capital Resources***

As of April 28, 2002, we had \$828.4 million in cash, cash equivalents and marketable securities, an increase of \$37.0 million from the end of fiscal 2002. We historically have held our cash balances in cash or cash equivalents, such as money market funds. In August 2001, we began to invest in marketable securities. Our portfolio of cash equivalents and marketable securities is managed by several financial institutions. Our investment policy requires the purchase of top-tier investment grade securities, the diversification of asset type and places certain limits on our portfolio duration.

Operating activities generated cash of \$48.6 million during the first quarter of fiscal 2003 and \$35.7 million during the first quarter of fiscal 2002. The increase from the first quarter of fiscal 2002 to the same period in fiscal 2003 was due to a substantial increase in net income, offset by changes in operating assets and liabilities. Income tax benefit derived from the difference between the exercise price and the fair value of acquired stock in association

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with employees' exercise of stock options totaled \$7.0 million in the first quarter of fiscal 2003 compared to \$15.2 million in the first quarter of fiscal 2002. Our accounts receivable are highly concentrated. At April 28, 2002, our four largest customers accounted for approximately 59% of accounts receivable. We may be required to write off bad debts in the future, which could harm our business.

On March 5, 2000, we entered into an agreement with Microsoft in which we agreed, under certain terms and conditions, to develop and sell processors for use in the Xbox video game console. In April 2000, Microsoft paid us \$200.0 million under the agreement as an advance against processor purchases. This advance was fully utilized by purchases made by Microsoft through the quarter ended April 28, 2002 and Microsoft is currently paying in advance for processor chipsets sold to it. We are engaged with Microsoft in discussions related to pricing and volumes of the Xbox chipset sold to them by NVIDIA. These discussions and our agreement with Microsoft contemplated use of a third party to resolve matters and on April 23, 2002 Microsoft submitted the matter to binding arbitration. Microsoft requested that the arbitration panel require that we supply chipsets in whatever quantities are ordered by Microsoft. Microsoft has also asked for damages for alleged violations of the agreement and requested that the arbitration panel reduce chipset prices paid by Microsoft. We do not believe we have a requirements obligation to Microsoft and we have submitted our position to the arbitration panel. We have agreed only to fulfill the Microsoft purchase orders we have already accepted, which we believe will result in shipments to Microsoft sufficient for it to meet its published expectations for installed units as of the end of this year. For sales of the Xbox media communication processor, we have deferred revenue in an amount equal to the difference between the price being paid by Microsoft and the price Microsoft claims it should be paying. This amount was approximately \$25.6 million as of April 28, 2002. We expect that we will continue to defer revenue related to the disputed pricing for future sales of this processor until resolution of the matter.

Investing activities used cash of \$88.6 million in the first quarter of fiscal 2003 compared to \$98.9 million in the first quarter of fiscal 2002. The decrease from the first quarter of fiscal 2002 was due to the decrease in capital expenditures and asset purchases from various businesses offset by the purchase of marketable securities. We expect to spend approximately \$70.0 million to \$80.0 million for capital expenditures in fiscal 2003, primarily for software licenses, emulation equipment, purchase of computer and engineering workstations, future phases of our enterprise resource planning system implementation, and tenant and leasehold improvements in our new headquarters facility. In addition, we may continue to use cash in connection with the acquisition of businesses or assets.

Financing activities provided cash of \$14.1 million in the first quarter of fiscal 2003 compared to \$16.2 million in the first quarter of fiscal 2002. The decrease from the first quarter of fiscal 2003 compared to the same period in prior year was due to a decrease in employee stock purchases.

### *Common Stock and Convertible Subordinated Debenture Offering*

In October 2000, we sold 2,800,000 shares of our common stock and \$300.0 million of convertible subordinated debentures due October 15, 2007 in a public offering. Proceeds from the offering were approximately \$387.4 million after deducting underwriting discounts, commissions and offering expenses. Issuance costs related to the offering are being amortized to interest expense on a straight-line basis over the term of the debentures. Interest on the convertible subordinated debentures accrues at the rate of 4¾% per annum and is payable semiannually in arrears on April 15 and October 15 of each year, commencing April 15, 2001. The convertible subordinated debentures are redeemable at our option on or after October 20, 2003. The debentures are convertible at the option of the holder at any time prior to the close of business on the maturity date, unless previously redeemed or repurchased, into shares of common stock at a conversion price of \$46.36 per share, subject to adjustment in certain circumstances.

### *3dfx Asset Purchase*

On April 18, 2001, we completed the purchase of certain assets of 3dfx, including patents and patent applications. Under the terms of the Asset Purchase Agreement, the cash consideration due at the closing was \$70.0 million, less \$15.0 million that was loaned to 3dfx pursuant to a Credit Agreement dated December 15, 2000, between us and 3dfx. Pursuant to the Asset Purchase Agreement, following the closing, we are to pay 3dfx additional consideration in the form of stock equal to two million shares of NVIDIA common stock, subject to 3dfx satisfying certain conditions. If the debts and liabilities of 3dfx can be satisfied for less than \$25.0 million and in accordance with the provisions as set forth in the agreement, under some circumstances, 3dfx could receive a post-closing advance from us of up to \$25.0 million and this advance would reduce the number of shares of NVIDIA

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common stock potentially payable to 3dfx by up to one million shares. In the event 3dfx cannot satisfy all of its obligations for \$25.0 million, NVIDIA will not be obligated to pay any additional consideration. At this time, 3dfx has not satisfied all terms and conditions necessary to receive any contingent consideration. Consequently, due to the possibility of contingent consideration, the components of the final purchase price could differ from those presented in Note 5 of the Notes to Condensed Consolidated Financial Statements.

The transaction is accounted for under the purchase method of accounting. As a result, this purchase transaction has impacted our working capital in fiscal year 2002 and may have further impact if the additional conditions are met by 3dfx.

### *Contractual Cash Obligations*

As of April 28, 2002, there were no material changes in our contractual cash obligations from those disclosed in our Annual Report on Form 10-K for the year ended January 27, 2002. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" in our Annual Report on Form 10-K for the year ended January 27, 2002.

### *Operating Capital and Capital Expenditure Requirements*

We believe that our existing cash balances and anticipated cash flows from operations, will be sufficient to meet our operating and capital requirements for at least the next 12 months. However, there is no assurance that we will not need to raise additional equity or debt financing within this time frame. Additional financing may not be available on favorable terms or at all and may be dilutive to our then-current stockholders. We also may require additional capital for other purposes not presently contemplated. If we are unable to obtain sufficient capital, we could be required to curtail capital equipment purchases or research and development expenditures, which could harm our business. Factors which could affect our cash used or generated from operations and as a result, our need to seek additional borrowings or capital include:

- decreased demand and market acceptance for our products and/or our customers' products;
- inability to successfully develop and produce in volume production our next-generation products;
- competitive pressures resulting in lower than expected average selling prices; and
- new product announcements or product introductions by our competitors.

For additional factors see "Business Risks—Our operating results are unpredictable and may fluctuate, and if our operating results are below the expectations of securities analysts or investors, our stock price could decline."

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### **Interest Rate Risk**

We invest in a variety of financial instruments, consisting principally of investments in commercial paper, money market funds and highly liquid debt securities of corporations, municipalities and the U.S. Government and its agencies. These investments are denominated in U.S. dollars.

We account for our investment instruments in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." All of the cash equivalents and marketable securities are treated as "available-for-sale" under SFAS No. 115. Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities that decline in market value due to changes in interest rates; however, we reduce our interest rate risk by investing cash primarily in instruments with short maturities. However, because our debt securities are classified as available for sale, no gains or losses are recognized unless such securities are sold. The average holding periods until maturity of our cash equivalents and marketable securities were approximately 16 and 556 days, respectively. The principal amounts and related weighted-average interest rates for our investment portfolio were \$305.6 million and 1.79% for cash equivalents, and \$521.2 million and 3.24% for marketable securities as of April 28, 2002.

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Our convertible subordinated debentures due 2007 possess a fixed interest rate of 4¾% and are not subject to interest rate fluctuations.

### **Exchange Rate Risk**

We consider our exposure to foreign exchange rate fluctuations to be minimal. Currently, sales and arrangements with third-party manufacturers provide for pricing and payment in U.S. dollars, and therefore are not subject to exchange rate fluctuations. To date, we have not engaged in any currency hedging activities, although we may do so in the future. Fluctuations in currency exchange rates could harm our business in the future.

### **Business Risks**

In addition to the risks discussed in “Business” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” our business is subject to the risks set forth below.

### **Risks Related to Our Operations**

***Our operating results are unpredictable and may fluctuate, and if our operating results are below the expectations of securities analysts or investors our stock price could decline.***

Many of our revenue components fluctuate and are difficult to predict, and our operating expenses are largely independent of revenue in any particular period. It is therefore difficult for us to accurately forecast revenue and profits or losses. As a result, it is possible that in some quarters our operating results could be below the expectations of securities analysts or investors, which could cause the trading price of our common stock to decline, perhaps substantially. We believe that our quarterly and annual results of operations will be affected by a variety of factors that could harm our revenue, gross profit and results of operations.

Factors that have affected our results of operations in the past, and could affect our results of operations in the future, include the following:

- demand and market acceptance for our products and/or our customers’ products;
- the successful development and volume production of next-generation products;
- new product announcements or product introductions by our competitors;
- our ability to introduce new products in accordance with OEM design requirements and design cycles;
- changes in the timing of product orders due to unexpected delays in the introduction of our customers’ products;
- fluctuations in the availability of manufacturing capacity or manufacturing yields;
- declines in spending by corporations and consumers related to perceptions regarding an economic downturn in the U.S. and international economies;
- competitive pressures resulting in lower than expected average selling prices;
- product rates of return in excess of that forecasted or expected due to quality issues;
- the rescheduling or cancellation of customer orders;
- the loss of a key customer or the termination of a strategic relationship;
- seasonal fluctuations associated with the PC market;
- substantial disruption in our suppliers’ operations, either as a result of a natural disaster, equipment failure, terrorism or other cause;
- supply constraints for and changes in the cost of the other components incorporated into our customers’ products, including memory devices;
- our ability to reduce the manufacturing costs of our products;
- legal and other costs related to defending intellectual property and other types of lawsuits;

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- bad debt write-offs;
- costs associated with the repair and replacement of defective products;
- unexpected inventory write-downs; and
- introductions of enabling technologies to keep pace with faster generations of processors and controllers.

Any one or more of the factors discussed above could prevent us from achieving our expected future revenue or net income.

***Our operating expenses are relatively fixed, and we order materials in advance of anticipated customer demand. Therefore, we have limited ability to reduce expenses quickly in response to any revenue shortfalls.***

Most of our operating expenses are relatively fixed in the short term, and we may be unable to adjust spending sufficiently in a timely manner to compensate for any unexpected sales shortfall. Substantially all of our sales are made on the basis of purchase orders rather than long-term agreements. As a result, we may commit resources to the production of products without having received advance purchase commitments from customers. Any inability to sell products to which we have devoted significant resources could harm our business. In addition, cancellation or deferral of product orders could result in our holding excess inventory, which could adversely affect our profit margins and restrict our ability to fund operations. We may build memory and component inventories during periods of anticipated growth and in connection with selling workstation boards directly to major OEMs. We could be subject to excess or obsolete inventories and be required to take corresponding write-downs if growth slows or if we incorrectly forecast product demand. A reduction in demand could negatively impact our gross margins and financial results.

We may be required to reduce prices in response to competition or to pursue new market opportunities. If new competitors, technological advances by existing competitors or other competitive factors require us to invest significantly greater resources than anticipated in research and development or sales and marketing efforts, our business could suffer. Accordingly, we believe that period-to-period comparisons of our results of operations should not be relied upon as an indication of future performance. In addition, the results of any quarterly period are not indicative of results to be expected for a full fiscal year.

***We need to develop new products and to manage product transitions in order to succeed.***

Our business depends to a significant extent on our ability to successfully develop new products for the 3D graphics market. Our add-in board and motherboard manufacturers and major OEM customers typically introduce new system configurations as often as twice per year, typically based on spring and fall design cycles. Accordingly, our existing products must have competitive performance levels or we must timely introduce new products with such performance characteristics in order to be included in new system configurations. This requires that we do the following:

- anticipate the features and functionality that consumers will demand;
- incorporate those features and functionality into products that meet the exacting design requirements of PC OEMs, CEMs and add-in board and motherboard manufacturers;
- price our products competitively; and
- introduce the products to the market within the limited window for PC OEMs and add-in board and motherboard manufacturers.

As a result, we believe that significant expenditures for research and development will continue to be required in the future. The success of new product introductions will depend on several factors, including the following:

- proper new product definition;
- timely completion and introduction of new product designs;
- the ability of TSMC and any additional third-party manufacturers to effectively manufacture our new products in a timely manner;
- the quality of any new products;

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- differentiation of new products from those of our competitors;
- market acceptance of our products and our customers' products; and
- availability of adequate quantity and configurations of various types of memory products.

Our strategy is to utilize the most advanced semiconductor process technology appropriate for our products and available from commercial third-party foundries. Use of advanced processes has in the past resulted in initial yield problems. New products that we introduce may not incorporate the features and functionality demanded by PC OEMs, add-in board and motherboard manufacturers and consumers of 3D graphics. In addition, we may not successfully develop or introduce new products in sufficient volumes within the appropriate time to meet both the PC OEMs' design cycles and market demand. We have in the past experienced delays in the development of some new products. Our failure to successfully develop, introduce or achieve market acceptance for new 3D graphics products would harm our business.

### ***Our failure to identify new product opportunities or develop new products could harm our business.***

As markets for our 3D graphics processors develop and competition increases, we anticipate that product life cycles at the high end will remain short and average selling prices will continue to decline. In particular, we expect average selling prices and gross margins for our 3D graphics processors to decline as each product matures and as unit volume increases. As a result, we will need to introduce new products and enhancements to existing products to maintain overall average selling prices and gross margins. In order for our 3D graphics processors to achieve high volumes, leading PC OEMs and add-in board and motherboard manufacturers must select our 3D graphics processor for design into their products, and then successfully complete the designs of their products and sell them. We may be unable to successfully identify new product opportunities or to develop and bring to market in a timely fashion any new products. In addition, we cannot guarantee that any new products we develop will be selected for design into PC OEMs' and add-in board and motherboard manufacturers' products, that any new designs will be successfully completed or that any new products will be sold. As the complexity of our products and the manufacturing process for products increases, there is an increasing risk that we will experience problems with the performance of products and that there will be delays in the development, introduction or volume shipment of our products. We may experience difficulties related to the production of current or future products or other factors may delay the introduction or volume sale of new products we developed. In addition, we may be unable to successfully manage the production transition risks with respect to future products. Failure to achieve any of the foregoing with respect to future products or product enhancements could result in rapidly declining average selling prices, reduced margins, and reduced demand for products or loss of market share. In addition, technologies developed by others may render our 3D graphics products non-competitive or obsolete or result in our holding excess inventory, any of which would harm our business.

### ***We could suffer a loss of market share if our products contain significant defects.***

Products as complex as those offered by us may contain defects or failures when introduced or when new versions or enhancements to existing products are released. We have in the past discovered defects and incompatibilities with customers' hardware in certain of our products and may experience delays or lost revenue to correct any new defects in the future. Errors in new products or releases after commencement of commercial shipments could result in loss of market share or failure to achieve market acceptance. Our products typically go through only one verification cycle prior to beginning volume production and distribution. As a result, our products may contain defects or flaws that are undetected prior to volume production and distribution. If these defects or flaws exist and are not detected prior to volume production and distribution, we may be required to reimburse customers for costs to repair or replace the affected products in the field. These costs could be significant and could adversely affect our business and operating results. The production and distribution of defective products could harm our business.

### ***Failure to achieve expected manufacturing yields for existing and/or new products would reduce our gross margins.***

Semiconductor manufacturing yields are a function both of product design, which is developed largely by us, and process technology, which typically is proprietary to the manufacturer. Since low yields may result from either design or process technology failures, yield problems may not be effectively determined or resolved until an actual product exists that can be analyzed and tested to identify process sensitivities relating to the design rules that are

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used. As a result, yield problems may not be identified until well into the production process, and resolution of yield problems would require cooperation by and communication between us and the manufacturer.

The risk of low yields is compounded by the offshore location of most of our manufacturers, increasing the effort and time required to identify, communicate and resolve manufacturing yield problems. Because of our potentially limited access to wafer fabrication capacity from our manufacturers, any decrease in manufacturing yields could result in an increase in our per unit costs and force us to allocate our available product supply among our customers. This could potentially harm customer relationships as well as revenue and gross profit. Our wafer manufacturers may be unable to achieve or maintain acceptable manufacturing yields in the future. Our inability to achieve planned yields from our wafer manufacturers could harm our business. We also face the risk of product recalls or product returns resulting from design or manufacturing defects that are not discovered during the manufacturing and testing process. In the event of a significant number of product returns due to a defect or recall, our business could suffer.

***Failure to transition to new manufacturing process technologies could affect our ability to compete effectively.***

Our strategy is to utilize the most advanced process technology appropriate for our products and available from commercial third-party foundries. Use of advanced processes may have greater risk of initial yield problems. Manufacturing process technologies are subject to rapid change and require significant expenditures for research and development. We continuously evaluate the benefits of migrating to smaller geometry process technologies in order to improve performance and reduce costs. We currently use .15-micron process technology for the GeForce4, Quadro4, GeForce3, Quadro DCC, Xbox and nForce families of graphics processors, and we believe that the transition of our products to increasingly smaller geometries will be important to our competitive position. We are currently evaluating and qualifying the .13 micron process technology for products that are estimated to begin commercial shipment later in our fiscal 2003. Other companies in the industry have experienced difficulty in migrating to new manufacturing processes and, consequently, have suffered reduced yields, delays in product deliveries and increased expense levels. We may experience similar difficulties and the corresponding negative effects. Moreover, we are dependent on our relationships with our third-party manufacturers to migrate to smaller geometry processes successfully. We may be unable to migrate to new manufacturing process technologies successfully or on a timely basis.

***We may be unable to manage our growth and, as a result, may be unable to successfully implement our strategy.***

Our rapid growth has placed, and is expected to continue to place, a significant strain on our managerial, operational and financial resources. As of April 28, 2002, we had 1,273 employees as compared to 1,123 employees as of January 27, 2002. We expect that the number of our employees will increase substantially over the next 12 months. Our future growth, if any, will depend on our ability to continue to implement and improve operational, financial and management information and control systems on a timely basis, as well as our ability to maintain effective cost controls. Further, we will be required to manage multiple relationships with various customers and other third parties. Our systems, procedures or controls may not be adequate to support our operations and our management may be unable to achieve the rapid execution necessary to successfully implement our strategy.

***We are dependent on key personnel and the loss of these employees could harm our business.***

Our performance is substantially dependent on the performance of our executive officers and key employees. None of our officers or employees is bound by an employment agreement, and so our relationships with these officers and employees are at will. We do not have "key person" life insurance policies on any of our employees. The loss of the services of any of our executive officers, technical personnel or other key employees, particularly Jen-Hsun Huang, our President and Chief Executive Officer, would harm our business. Our success will depend on our ability to identify, hire, train and retain highly qualified technical and managerial personnel. Our failure to attract and retain the necessary technical and managerial personnel would harm our business.



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### ***We are subject to risks associated with international operations which may harm our business.***

Our reliance on foreign third-party manufacturing, assembly, testing and packaging operations subjects us to a number of risks associated with conducting business outside of the United States, including the following:

- unexpected changes in, or impositions of, legislative or regulatory requirements;
- delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers and restrictions;
- longer payment cycles;
- imposition of additional taxes and penalties;
- the burdens of complying with a variety of foreign laws; and
- other factors beyond our control, including terrorism, which may delay the shipment of our products.

We also are subject to general political risks in connection with our international trade relationships. In addition, the laws of certain foreign countries in which our products are or may be manufactured or sold, including various countries in Asia, may not protect our products or intellectual property rights to the same extent as do the laws of the United States. This makes the possibility of piracy of our technology and products more likely.

Currently, all of our arrangements with third-party manufacturers provide for pricing and payment in U.S. dollars, and to date we have not engaged in any currency hedging activities, although we may do so in the future. Fluctuations in currency exchange rates could harm our business in the future.

### ***Failure in operation or future enhancement or implementation of our enterprise resource planning system could harm our operations.***

We are heavily dependent upon the proper functioning of our internal systems to conduct our business. System failure or malfunction may result in disruptions of operations and inability to process transactions. Our results of operations and financial position could be harmed if we encounter unforeseen problems with respect to system operations or future implementations.

### ***Provisions in our certificate of incorporation, our bylaws and our agreement with Microsoft could delay or prevent a change in control.***

Our certificate of incorporation and bylaws contain provisions that could make it more difficult for a third party to acquire a majority of our outstanding voting stock. These provisions include the following:

- the ability of the board of directors to create and issue preferred stock without prior stockholder approval;
- the prohibition of stockholder action by written consent;
- a classified board of directors; and
- advance notice requirements for director nominations and stockholder proposals.

On March 5, 2000, we entered into an agreement with Microsoft in which we agreed to develop and sell graphics chips and to license certain technology to Microsoft and its licensees for use in a product under development by Microsoft. In the event that an individual or corporation makes an offer to purchase shares equal to or greater than 30% of the outstanding shares of our common stock, Microsoft has first and last rights of refusal to purchase the stock. The provision could also delay or prevent a change in control of our company.

### ***We may not be able to realize the potential financial or strategic benefits of business acquisitions and that could hurt our ability to grow our business and sell our products.***

In the past we have acquired and invested in other businesses that offered products, services and technologies that we believed would help expand or enhance our products and services or help expand our distribution channels. For any previous or future acquisition or investment, the following risks could impair our ability to grow our business and develop new products and, ultimately, could impair our ability to sell our products:

- difficulty in combining the technology, operations or workforce of the acquired business;
- disruption of our ongoing businesses;

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- difficulty in realizing the potential financial or strategic benefits of the transaction;
- difficulty in maintaining uniform standards, controls, procedures and policies; and
- possible impairment of relationships with employees and customers as a result of any integration of new businesses and management personnel.

In addition, the consideration for any future acquisition could be paid in cash, shares of our common stock, or a combination of cash and common stock. If the consideration is paid with our common stock, existing stockholders would be further diluted.

### **Risks Related to Our Partners**

#### ***We are dependent on a small number of customers and we are subject to order and shipment uncertainties.***

We have only a limited number of customers and our sales are highly concentrated. We primarily sell our products to add-in board and motherboard manufacturers and CEMs, which incorporate graphics products in the boards they sell to PC OEMs and system builders. Sales to add-in board and motherboard manufacturers and CEMs are primarily dependent on achieving design wins with leading PC OEMs. The number of add-in board and motherboard manufacturers, CEMs and leading PC OEMs is limited. We expect that a small number of add-in board and motherboard manufacturers and CEMs directly, and a small number of PC OEMs indirectly, will continue to account for a substantial portion of our revenue for the foreseeable future. As a result, our business could be harmed by the loss of business from PC OEMs or add-in board and motherboard manufacturers and CEMs. In addition, revenue from add-in board and motherboard manufacturers, CEMs and PC OEMs that have directly or indirectly accounted for significant revenue in past periods, individually or as a group, may not continue, or may not reach or exceed historical levels in any future period.

Our business may be harmed by instability in Asia due to the concentration of customers who are located or have substantial operations in Asia, including Taiwan. The People's Republic of China and Taiwan have in the past experienced strained relations. A worsening of these relationships or the development of hostilities between the two could result in disruptions in Taiwan and possibly other areas of Asia, which could harm our business. In addition, if relations between the U.S. and The People's Republic of China become strained, our business could be harmed. While we believe political instability in Asia has not harmed our business, because of our reliance on companies with operations in Asia, continued economic and political instability in Asia might harm it.

#### ***We rely on third-party vendors to supply us tools for the development of our new products and we may be unable to obtain the tools necessary to develop these products.***

In the design and development of new products and product enhancements, we rely on third-party software development tools. While we currently are not dependent on any one vendor for the supply of these tools, some or all of these tools may not be readily available in the future. For example, we have experienced delays in the introduction of products in the past as a result of the inability of then available software development tools to fully simulate the complex features and functionalities of our products. The design requirements necessary to meet consumer demands for more features and greater functionality from 3D graphics products in the future may exceed the capabilities of the software development tools available to us. If the software development tools we use become unavailable or fail to produce designs that meet consumer demands, our business could suffer.

#### ***We may not be successful in producing the processors in volumes required for Microsoft's Xbox and, even if successful we may not achieve profit margins consistent with management's expectations.***

Our Xbox IGP and MCP are new and complicated processors. Both processors have increased in complexity and features from what was contemplated at the time we entered into the agreement with Microsoft. There can be no assurance that we will be able to produce these processors in the volume necessary and within the required time frames or that the payments for these processors will be consistent with profit margins achieved on our other products. Finally, there can be no assurance that the Xbox program will achieve long term commercial success, given the high level of competition in the game console market. If any of these risks occur, our business may be harmed.

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***We may not prevail in the arbitration with Microsoft over pricing of the Xbox chipset and even if we do prevail, there is no assurance that our business will not be materially harmed.***

We have been engaged with Microsoft in discussions related to pricing and volumes of the Xbox chipset. These discussions and our agreement contemplated use of a third party to resolve matters and on April 23, 2002 Microsoft submitted the matter to binding arbitration. Microsoft has requested that the arbitration panel require that we supply chipsets in whatever quantities are ordered by Microsoft. Microsoft has also asked for damages for alleged violations of the agreement and requested that the arbitration panel reduce chipset prices paid by Microsoft. We do not believe we have a requirements obligation to Microsoft and we have submitted our position to the arbitration panel. We have agreed only to fulfill the Microsoft purchase orders we have already accepted, which we believe will result in shipments to Microsoft sufficient for it to meet its published expectations for installed units as of the end of this year. For sales of the Xbox media communication processor, we have deferred revenue in an amount equal to the difference between the price being paid by Microsoft and the price Microsoft claims it should be paying. This amount was approximately \$25.6 million as of April 28, 2002. We expect that we will continue to defer such amount on future sales of this processor until resolution of the matter. The arbitration will be conducted in New York by a panel under the rules of the American Arbitration Association.

There can be no assurance that we will prevail in the arbitration or continue to supply graphics and other processors for the Xbox. If we do not prevail, we may (i) be compelled to deliver Xbox processors at reduced pricing, resulting in reduced gross margins, or a loss, on such processors; (ii) be required to reduce production and delivery of other products in order to satisfy obligations to Microsoft; (iii) be required to pay significant damages to Microsoft; or (iv) be subject to other remedies that could have a material adverse impact on our business. Even if we do prevail, there can be no assurance that our business will not be materially harmed.

***We depend on foreign foundries and independent contractors to manufacture our products and these third parties may not be able to satisfy our manufacturing requirements, which would harm our business.***

We do not manufacture the semiconductor wafers used for our products and do not own or operate a wafer fabrication facility. Our products require wafers manufactured with state-of-the-art fabrication equipment and techniques. We utilize TSMC to produce our semiconductor wafers and utilize independent contractors to perform assembly, testing and packaging. We depend on these suppliers to allocate to us a portion of their manufacturing capacity sufficient to meet our needs, to produce products of acceptable quality and at acceptable manufacturing yields, and to deliver those products to us on a timely basis. These manufacturers may be unable to meet our near-term or long-term manufacturing requirements. We obtain manufacturing services on a purchase order basis and TSMC has no obligation to provide us with any specified minimum quantities of product. TSMC fabricates wafers for other companies, including certain of our competitors, and could choose to prioritize capacity for other users or reduce or eliminate deliveries to us on short notice. Because the lead-time needed to establish a strategic relationship with a new manufacturing partner could be several quarters, there is no readily available alternative source of supply for any specific product. We believe that long-term market acceptance for our products will depend on reliable relationships with TSMC and any other manufacturers used by us to ensure adequate product supply to respond to customer demand.

Because of our reliance on TSMC, our business may be harmed by political instability in Taiwan, including the worsening of the strained relations between The People's Republic of China and Taiwan, or if relations between the U.S. and The People's Republic of China are strained due to foreign relations events. Furthermore, any substantial disruption in our suppliers' operations, either as a result of a natural disaster, political unrest, economic instability, equipment failure or other cause, could harm our business.

We are dependent primarily on TSMC and we expect in the future to continue to be dependent upon third-party manufacturers to do the following:

- produce wafers of acceptable quality and with acceptable manufacturing yields;
- deliver those wafers to us and our independent assembly and testing subcontractors on a timely basis; and
- allocate to us a portion of their manufacturing capacity sufficient to meet our needs.

Our wafer requirements represent a significant portion of the total production capacity of TSMC. Although our products are designed using TSMC's process design rules, TSMC may be unable to achieve or maintain acceptable yields or deliver sufficient quantities of wafers on a timely basis and/or at an acceptable cost. Additionally, TSMC

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may not continue to devote resources to the production of our products, or to advance the process design technologies on which the manufacturing of our products are based. Any difficulties like these would harm our business.

### ***We are dependent on third parties for assembly, testing and packaging of our products.***

Our graphics processors are assembled and tested by Siliconware Precision Industries Company Ltd., ChipPAC Incorporated and Advanced Semiconductor Engineering. We do not have long-term agreements with any of these subcontractors. As a result of our dependence on third-party subcontractors for assembly, testing and packaging of our products, we do not directly control product delivery schedules or product quality. Any product shortages or quality assurance problems could increase the costs of manufacture, assembly or testing of our products and could harm our business. Due to the amount of time typically required to qualify assemblers and testers, we could experience significant delays in the shipment of our products if we are required to find alternative third parties to assemble or test our products or components. Any delays in delivery of our products could harm our business.

## **Risks Related to Our Competition**

### ***The 3D graphics industry is highly competitive and we may be unable to compete.***

The market for 3D graphics processors for PCs in which we compete is intensely competitive and is characterized by rapid technological change, evolving industry standards and declining average selling prices. We believe that the principal competitive factors in this market are performance, breadth of product offerings, access to customers and distribution channels, backward-forward software support, conformity to industry standard APIs, manufacturing capabilities, price of graphics processors and total system costs of add-in boards and motherboards. We expect competition to increase both from existing competitors and new market entrants with products that may be less costly than our 3D graphics processors, or may provide better performance or additional features not provided by our products. We may be unable to compete successfully in the emerging PC graphics market.

Our primary source of competition is from companies that provide or intend to provide 3D graphics solutions for the PC market. Our competitors include the following:

- suppliers of integrated core logic chipsets that incorporate 2D and 3D graphics functionality as part of their existing solutions, such as Intel, Silicon Integrated Systems and Via Technologies, Inc., or Via;
- suppliers of graphics add-in boards that utilize their internally developed graphics chips, such as ATI Technologies Inc. and Matrox Electronics Systems Ltd.;
- suppliers of mobile graphics processors that incorporate 2D or 3D graphics functionality as part of their existing solutions, such as ATI Technologies, Trident Microsystems, Inc. and the joint venture of a division of SONICblue Incorporated (formerly S3 Incorporated) and Via Technologies; and
- companies that have traditionally focused on the professional market and provide high end 3D solutions for PCs and workstations, including 3DLabs and ATI Technologies Inc.

If and to the extent we offer products outside of the 3D graphics processor market, we may face competition from some of our existing competitors as well as from companies with which we currently do not compete. We cannot accurately predict if we will compete successfully in any new markets we may enter.

### ***We may not successfully compete with Intel in the integrated chipset market.***

It is projected by analysts that integrated chipsets are likely to become a majority share of the PC graphics market. We have recently introduced and begun shipment of the nForce platform processor, an integrated 3D graphics chipset. The nForce platform processor is initially designed to support microprocessors produced by AMD. Intel is the dominant supplier of integrated 3D graphics chipsets and has commenced production of an integrated chipset for its Pentium 4 microprocessor. Intel has significantly greater resources than we do, and the nForce platform processor, or other 3D graphics products that we may introduce, may not compete effectively against Intel's current chipset products or its future products, either in terms of price or performance.

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In addition, due to the widespread industry acceptance of Intel's microprocessor architecture and interface architecture, including its accelerated graphics port architecture, or AGP, Intel exercises significant influence over the PC industry and over companies developing products for such architecture. Any significant modifications by Intel to the AGP, the microprocessor or core logic components or other aspects of the PC microprocessor architecture could result in incompatibility with our technology, which would harm our business. In addition, any delay in the public release of information relating to modifications like this could harm our business.

In addition to its influence over the PC architecture, Intel has asserted intellectual property rights in various PC architecture interfaces. For example, as a result of patents held by Intel, it has asserted that companies wishing to develop a chipset compatible with the Pentium 4 microprocessor or similar microprocessors obtain a license from Intel. We believe that the principal competitive factors in the market are performance, breadth of product offerings, access to customers and distribution channels, backward-forward software support, conformity to industry standard APIs, manufacturing capabilities, price of graphics processors and total system costs of add-in boards and motherboards. In September 2001 Intel filed a patent infringement suit against Via with respect to a Via chipset for the Pentium 4. We do not have a license from Intel for such a chipset.

We expect Intel to continue to do the following:

- invest heavily in research and development and continue development of integrated 3D graphics products;
- maintain its position as the largest manufacturer of PC microprocessors;
- use its intellectual property position with respect to the PC microprocessor and architecture to defend its position in 3D graphics, including the filing of patent infringement suits against competitors;
- follow business practices in its PC business, which strongly encourage use of Intel integrated chipsets; increasingly dominate the PC platform; and
- promote its product offerings through advertising campaigns designed to engender brand loyalty among PC users.

### ***Our failure to achieve one or more design wins would harm our business.***

Our future success will depend in large part on achieving design wins, which entails having our existing and future products chosen as the 3D graphics processors for hardware components or subassemblies designed by PC OEMs and add-in board and motherboard manufacturers. Our add-in board and motherboard manufacturers and major OEM customers typically introduce new system configurations as often as twice per year, generally based on spring and fall design cycles. Accordingly, our existing products must have competitive performance levels or we must timely introduce new products with such performance characteristics in order to be included in new system configurations. Our failure to achieve one or more design wins would harm our business. The process of being qualified for inclusion in a PC OEM's product can be lengthy and could cause us to miss a cycle in the demand of end users for a particular product feature, which also could harm our business.

Our ability to achieve design wins also depends in part on our ability to identify and ensure compliance with evolving industry standards. Unanticipated changes in industry standards could render our products incompatible with products developed by major hardware manufacturers and software developers, including Intel and Microsoft. This would require us to invest significant time and resources to redesign our products to ensure compliance with relevant standards. If our products are not in compliance with prevailing industry standards for a significant period of time, our ability to achieve design wins could suffer.

### **Risks Related to Financial and Market Conditions**

#### ***We are dependent on the PC market and the slowdown in its growth may have a negative impact on our business.***

During fiscal 2002, we derived most of our revenue from the sale of products for use in the desktop PC market, from professional workstations to low-cost PCs. We expect to continue to derive most of our revenue from the sale or license of products for use in the desktop PC market in the next several years. The PC market is characterized by rapidly changing technology, evolving industry standards, frequent new product introductions and significant price competition. These factors result in short product life cycles and regular reductions of average selling prices over the life of a specific product. A reduction in sales of PCs, or a reduction in the growth rate of PC sales, could reduce

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demand for our products. Moreover, changes in demand could be large and sudden. Since PC manufacturers often build inventories during periods of anticipated growth, they may be left with excess inventories if growth slows or if they have incorrectly forecast product transitions. In these cases, PC manufacturers may abruptly suspend substantially all purchases of additional inventory from suppliers like us until the excess inventory has been absorbed. It is possible that the recent slowing of the economy in the U.S. and international regions, which has negatively impacted some PC manufacturers and led to some reductions in the demand for PCs, could lead to reductions in inventory purchases by PC manufacturers. Any reduction in the demand for PCs generally, or for a particular product that incorporates our 3D graphic processors, could harm our business.

### ***The acceptance of next generation products in business PC 3D graphics may not continue to develop.***

Our success will depend in part upon the demand for performance 3D graphics for business PC applications. The market for performance 3D graphics on business PCs has only recently begun to emerge and is dependent on the future development of, and substantial end-user and OEM demand for, 3D graphics functionality. As a result, the market for business PC 3D graphics computing may not continue to develop or may not grow at a rate sufficient to support our business. The development of the market for performance 3D graphics in business PCs will in turn depend on the development and availability of a large number of business PC software applications that support or take advantage of performance 3D graphics capabilities. Currently, there are only a limited number of software applications like this, most of which are games, and a broader base of software applications may not develop in the near term or at all. Consequently, a broad market for full function performance 3D graphics on business PCs may not develop. Our business prospects will suffer if the market for business PC 3D graphics fails to develop or develops more slowly than expected.

### ***Our 3D graphics solution may not continue to be accepted by the PC market.***

Our success will depend in part upon continued broad adoption of our 3D graphics processors for high performance 3D graphics in PC applications. The market for 3D graphics processors has been characterized by unpredictable and sometimes rapid shifts in the popularity of products, often caused by the publication of competitive industry benchmark results, changes in dynamic random memory devices pricing and other changes in the total system cost of add-in boards, as well as by severe price competition and by frequent new technology and product introductions. Only a small number of products have achieved broad market acceptance and such market acceptance, if achieved, is difficult to sustain due to intense competition. Since the PC market is our core business, our business would suffer if for any reason our current or future 3D graphics processors do not continue to achieve widespread acceptance in the PC market. If we are unable to complete the timely development of or successfully and cost-effectively manufacture and deliver products that meet the requirements of the PC market, our business would be harmed.

### ***The semiconductor industry is cyclical in nature and an industry downturn could harm our business.***

The semiconductor industry historically has been characterized by the following factors:

- rapid technological change;
- cyclical market patterns;
- significant average selling price erosion;
- fluctuating inventory levels;
- alternating periods of overcapacity and capacity constraints; and
- variations in manufacturing costs and yields and significant expenditures for capital equipment and product development.

In addition, the industry has experienced significant economic downturns at various times, characterized by diminished product demand and accelerated erosion of average selling prices. We may experience substantial period-to-period fluctuations in results of operations due to general semiconductor industry conditions.

### ***Our stock price may continue to experience significant short-term fluctuations.***

The price of our common stock has fluctuated greatly. These price fluctuations have been rapid and severe. The price of our common stock may continue to fluctuate greatly in the future due to factors that are non-company

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specific, such as the decline in the U.S. economy, or due to a variety of company specific factors, including quarter to quarter variations in our operating results, shortfalls in revenue or earnings from levels expected by securities analysts and the other factors discussed above in these risk factors. In the past, following periods of volatility in the market price of a company's stock, securities class action litigation has been initiated against the issuing company. Since February 2002, multiple securities class action lawsuits and several derivative suits have been filed against us. We expect that this litigation, whether or not resolved favorably, may result in substantial cost and a diversion of management's attention and resources, which could harm our revenues and earnings. Any adverse determination in this litigation could also subject us to significant liabilities. See "Legal Proceedings" and Note 10 of the Notes to Condensed Consolidated Financial Statements for a description of this litigation.

***We are exposed to fluctuations in the market values of our portfolio investments and in interest rates.***

For additional information regarding the sensitivity of and risks associated with the market value of portfolio investments and interest rates, see Item 7a "Quantitative and Qualitative Disclosures About Market Risk—Interest Rate Risk."

### **Risks Related to Intellectual Property, Litigation and Government Action**

***Our industry is characterized by vigorous protection and pursuit of intellectual property rights or positions that could result in substantial costs to us.***

The semiconductor industry is characterized by vigorous protection and pursuit of intellectual property rights and positions, which has resulted in protracted and expensive litigation. The 3D graphics market in particular has been characterized recently by the aggressive pursuit of intellectual property positions, and we expect our competitors to continue to pursue aggressive intellectual property positions. In addition, from time to time we receive notices or are included in legal actions alleging that we have infringed patents or other intellectual property rights owned by third parties. We expect that, as the number of issued hardware and software patents increases, and as competition in our markets intensifies, the volume of intellectual property infringement claims may increase. If infringement claims are made against us, we may seek licenses under the claimants' patents or other intellectual property rights. However, licenses may not be offered at all or on terms acceptable to us, particularly by competitors. The failure to obtain a license from a third party for technology used by us could cause us to incur substantial liabilities and to suspend the manufacture of and sale of one or more products, which could reduce our revenues and harm our business. Furthermore, we may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. We have agreed to indemnify certain customers for claims of infringement arising out of sale of our products.

***Litigation against us or our customers concerning infringement would likely result in significant expense to us and divert the efforts of our technical and management personnel.***

We are currently subject to patent infringement suits, and we may be subject to patent infringement suits brought by other parties in the future. We do not believe that current suits will have a material impact on our business or financial condition. However, these lawsuits and any future lawsuits could divert our resources and result in the payment of substantial damages.

***Our ability to compete will be harmed if we are unable to adequately protect our intellectual property.***

We rely primarily on a combination of patents, trademarks, trade secrets, employee and third-party nondisclosure agreements and licensing arrangements to protect our intellectual property. Our pending patent applications and any future applications may not be approved. In addition, any issued patents may not provide us with competitive advantages or may be challenged by third parties. The enforcement of patents by others may harm our ability to conduct our business. Others may independently develop substantially equivalent intellectual property or otherwise gain access to our trade secrets or intellectual property. Our failure to effectively protect our intellectual property could harm our business. We have licensed technology from third parties for incorporation in our graphics processors, and expect to continue to enter into license agreements for future products. These licenses may result in royalty payments to third parties, the cross-licensing of technology by us or payment of other consideration. If these arrangements are not concluded on commercially reasonable terms, our business could suffer.

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### ***Future actions by the SEC or other governmental or regulatory agencies and resolution of related litigation arising out of the restatement of our financial statements or other matters could harm our business.***

The SEC staff informed us in January 2002 that it had concerns relating to certain accounting matters and that the SEC along with the U.S. Attorney's Office for the Northern District of California had authorized a private investigation into such matters. In accordance with the suggestion and advice of the SEC staff, we launched a review of these matters. On April 29, 2002, we announced that the Audit Committee of our Board of Directors had, with assistance from the law firm of Cooley Godward LLP and forensic auditors from the firm of KPMG LLP, concluded its review and determined that it was appropriate to restate our financial statements for fiscal 2000, 2001 and the first three quarters of fiscal 2002. The Audit Committee has worked in cooperation with the SEC and has provided the SEC with extensive information and the conclusions of the review. Further actions by the SEC or other governmental or regulatory agencies with respect to us or our personnel arising out of the restatement of our financial statements or other matters may take significant time, may be expensive and may divert management's attention from other business concerns and harm our business. In addition, a number of lawsuits have been filed against us following our announcement on February 14, 2002 of the internal review. The defense of, and any resolution of such lawsuits may require significant expenditures and materially impact our business and results of operations.

## **PART II: OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

On February 19, 2002 an NVIDIA stockholder, Dominic Castaldo, on behalf of himself and purportedly on behalf of a class of our stockholders, filed an action in the United States District Court for the Northern District of California, or the Northern District, against NVIDIA and certain NVIDIA officers, alleging violations of the federal securities laws arising out of our announcement on February 14, 2002 of an internal investigation of certain accounting matters. As of April 30, 2002, approximately 13 similar actions ("the Federal Class Actions") were filed in the Northern District, along with three related derivative actions against us, certain of our executive officers, directors and our independent auditors, KPMG LLP, in California Superior Court and in Delaware Chancery Court, collectively the Actions. The Actions allege claims in connection with various alleged statements and omissions to the public and to the securities markets and seek damages together with interest and reimbursement of costs and expenses of the litigation. The derivative actions also seek disgorgement of alleged profits from insider trading by officers and directors. The Actions are in the preliminary stages. No discovery has been conducted. The Federal Class Actions have been consolidated and lead plaintiffs appointed. The consolidated amended complaint should be filed by August 5, 2002. We are obligated to indemnify our officers and directors in connection with the Actions and have insurance for such individuals, to the extent of the limits of the applicable insurance policies and subject to potential reservations of rights. We intend to vigorously defend these Actions. We are unable, however, to predict the ultimate outcome of the Actions. There can be no assurance we will be successful in defending the Actions and if we are unsuccessful we may be subject to significant damages. Even if we are successful, defending the Actions is likely to be expensive and may divert management's attention from other business concerns and harm our business.

The SEC staff informed us in January 2002 that it had concerns relating to certain accounting matters and that the SEC along with the U.S. Attorney's Office for the Northern District of California had authorized a private investigation into such matters. In accordance with the suggestion and advice of the SEC staff, we launched a review of these matters. On April 29, 2002, we announced that the Audit Committee of our Board of Directors had, with assistance from the law firm of Cooley Godward LLP and forensic auditors from the firm of KPMG LLP, concluded its review and determined that it was appropriate to restate our financial statements for fiscal 2000, 2001 and the first three quarters of fiscal 2002. The Audit Committee has worked in cooperation with the SEC and has provided the SEC with extensive information and the conclusions of the review. Further actions by the SEC or other governmental or regulatory agencies with respect to us or our personnel arising out of the restatement of our financial statements or other matters may take significant time, may be expensive and may divert management's attention from other business concerns and harm our business.

We are engaged with Microsoft in discussions related to pricing and volumes of the Xbox chipset sold to them by NVIDIA. These discussions and our agreement with Microsoft contemplated use of a third party to resolve matters and on April 23, 2002 Microsoft submitted the matter to binding arbitration. Microsoft requested that the arbitration panel require that we supply chipsets in whatever quantities are ordered by Microsoft. Microsoft has also asked for damages for alleged violations of the agreement and requested that the arbitration panel reduce chipset prices paid by Microsoft. We do not believe we have a requirements obligation to Microsoft and we have submitted our position to the arbitration panel. We have agreed only to fulfill the Microsoft purchase orders we have already accepted, which we believe will result in shipments to Microsoft sufficient for it to meet its published expectations.



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for installed units as of the end of this year. For sales of the Xbox media communication processor, we have deferred revenue in an amount equal to the difference between the price being paid by Microsoft and the price Microsoft claims it should be paying. This amount was approximately \$25.6 million as of April 28, 2002. We expect that we will continue to defer revenue related to the disputed pricing for future sales of this processor until resolution of the matter. The arbitration will be conducted in New York by a panel under the rules of the American Arbitration Association.

There can be no assurance that we will prevail in the arbitration or continue to supply graphics and other processors for the Xbox. If we do not prevail, we may (i) be compelled to deliver Xbox processors at reduced pricing, resulting in reduced gross margins, or a loss, on such processors; (ii) be required to reduce production and delivery of other products in order to satisfy obligations to Microsoft; (iii) be required to pay significant damages to Microsoft; or (iv) be subject to other remedies that could have a material adverse impact on our business. Even if we do prevail, there can be no assurance that our business will not be materially harmed.

We are subject to other legal proceedings, but we do not believe that the ultimate outcome of any of these proceedings will have a material adverse effect on our financial position or overall trends in results of operations. However, if an unfavorable ruling were to occur in any specific period, there exists the possibility of a material adverse impact on the results of operations of that period.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not applicable.

### **ITEM 5. OTHER INFORMATION**

Not applicable.

### **ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

#### (a) Exhibits

10.7 1998 Non-Employee Directors' Stock Option Plan, as amended.

#### (b) Reports on Form 8-K

- (i) NVIDIA filed a Current Report on Form 8-K, dated April 29, 2002 and filed April 29, 2002, to report the restatement.
- (ii) NVIDIA filed a Current Report on Form 8-K, dated April 23, 2002 and filed April 29, 2002, to report arbitration over pricing of the Xbox chipset with Microsoft.
- (iii) NVIDIA filed a Current Report on Form 8-K, dated May 1, 2002 and filed May 1, 2002, to report additional information regarding the restatement.

**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) 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, on June 10, 2002.

NVIDIA CORPORATION

By: /s/ MARY DOTZ

Mary Dotz  
Chief Financial Officer  
(Principal Financial and Accounting Officer)