10-Q 1 d10q.txt FOR PERIOD ENDED APRIL 29, 2001 ---------- ---------- SECURITIES AND EXCHANGE COMMISSION Washington, D.C. 20549 ---------- FORM 10-Q ---------- (Mark One) [X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the quarterly period ended April 29, 2001 OR [_] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934. For the transition period from to . Commission file number: 0-23985 ---------- NVIDIA CORPORATION (Exact Name of Registrant as Specified in Its Charter)

Delaware	94-3177549
~~(State or Other Jurisdiction of Incorporation or Organization)~~	~~(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) ---------- 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 [X] No [_] The number of shares of the registrant's common stock outstanding as of May 24, 2001 was 70,161,353 shares. ---------- ---------- NVIDIA CORPORATION

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2 PART I. FINANCIAL INFORMATION ITEM 1. CONDENSED FINANCIAL STATEMENTS (Unaudited) NVIDIA CORPORATION AND SUBSIDIARIES CONDENSED CONSOLIDATED BALANCE SHEETS (In thousands) (Unaudited)

	April 29, 2001	January 28, 2001
~~ASSETS~~		
~~Current assets:~~		
~~Cash and cash equivalents~~	~~$ 627,301~~	~~$ 674,275~~
~~Restricted cash~~	~~28,050~~	~~24,500~~
~~Accounts receivable, less allowances of $10,428 at April 29, 2001 and $8,403 at January 28, 2001~~	~~86,629~~	~~104,988~~
~~Inventory~~	~~86,770~~	~~89,905~~
~~Prepaid expenses and other current assets~~	~~11,172~~	~~8,355~~
~~Prepaid and deferred taxes~~	~~40,731~~	~~28,386~~
~~Total current assets~~	~~880,653~~	~~930,409~~
~~Property and equipment, net~~	~~74,333~~	~~47,280~~
~~Deposits and other assets~~	~~10,513~~	~~10,909~~
~~Prepaid and deferred taxes~~	~~30,053~~	~~4,034~~
~~Goodwill and intangible assets, net~~	~~86,232~~	~~23,795~~
	~~$1,081,784~~	~~$1,016,427~~
~~LIABILITIES AND STOCKHOLDERS' EQUITY~~		
~~Current liabilities:~~		
~~Accounts payable~~	~~$ 72,048~~	~~$ 72,241~~
~~Accrued liabilities~~	~~45,704~~	~~37,506~~
~~Current portion of capital lease obligations~~	~~429~~	~~588~~
~~Total current liabilities~~	~~118,181~~	~~110,335~~
~~Capital lease obligations, less current portion~~	~~307~~	~~378~~
~~Deferred revenue~~	~~200,000~~	~~200,000~~
~~Long-term debt~~	~~300,000~~	~~300,000~~
~~Stockholders' equity:~~		
~~Common stock~~	~~70~~	~~68~~
~~Additional paid-in capital~~	~~308,738~~	~~277,029~~
~~Deferred compensation~~	~~(2)~~	~~(6)~~
~~Retained earnings~~	~~154,490~~	~~128,623~~
~~Total stockholders' equity~~	~~463,296~~	~~405,714~~
	~~$1,081,784~~	~~$1,016,427~~

See accompanying notes to condensed consolidated financial statements. 3 NVIDIA CORPORATION AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF INCOME (In thousands, except per share data) (Unaudited)

	Three Months Ended	
	April 29, 2001	April 30, 2000
Net revenues	$240,932	$148,483
Cost of revenues	149,295	92,975
Gross profit	91,637	55,508
Operating expenses: Research and development	31,206	17,830
Sales, general and administrative	18,773	12,114
Amortization of goodwill and intangible assets	647	--
Acquisition related charges	9,573	--
Total operating expenses	60,199	29,944
Operating income	31,438	25,564
Interest and other income, net	5,515	1,328
Income before tax expense	36,953	26,892
Income tax expense	11,086	8,605
Net income	$ 25,867	$ 18,287
Basic net income per share	$ 0.37	$ 0.29
Diluted net income per share	$ 0.31	$ 0.24
Shares used in basic per share computation	69,322	63,360
Shares used in diluted per share computation	82,856	77,778

See accompanying notes to condensed consolidated financial statements. 4 NVIDIA CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (In thousands) (Unaudited)

	Three Months Ended	
	April 29, 2001	April 30, 2000
Cash flows from operating activities: Net income	$ 25,867	$ 18,287
Adjustments to reconcile net income to net cash provided by operating activities: Depreciation and amortization	6,195	3,048
Deferred income taxes	4,154	--
Amortization of deferred compensation	4	53
Tax benefit from employee stock plans	15,214	13,977
Changes in operating assets and liabilities: Accounts receivable	18,359	(4,774)

Inventory..... 3,135 (17,610) Prepaid income taxes..... (42,520) -- Prepaid expenses and other current assets..... (2,816) (9,427) Deposits and other assets..... 81 (1,087) Accounts payable..... (193) 3,367 Accrued liabilities..... 8,198 4,792 -------- -------- Net cash provided by operating activities..... 35,678 10,626 -------- -------- Cash flows used in investing activities: Purchase of property and equipment..... (31,741) (7,451) Acquisitions of businesses..... (63,610) -- Deposit of restricted cash..... (3,550) -- -------- -------- Net cash used in investing activities..... (98,901) (7,451) -------- -------- Cash flows from financing activities: Issuance costs--convertible notes..... (18) -- Issuance costs--public offering of common stock..... (17) Common stock issued under employee stock plans..... 16,514 5,566 Advance in connection with development agreement..... -- 200,000 Payments under capital leases..... (230) (501) -------- -------- Net cash provided by financing activities..... 16,249 205,065 -------- -------- Change in cash and cash equivalents..... (46,974) 208,240 Cash and cash equivalents at beginning of period..... 674,275 61,560 -------- -------- Cash and cash equivalents at end of period..... $627,301 $269,800 ======== ======== Cash paid for interest..... $ 7,364 $ 51 ======== ======== Cash paid for taxes..... $ 34,084 $ 71 ======== ========

See accompanying notes to condensed consolidated financial statements. 5 NVIDIA CORPORATION AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (1) Basis of presentation The accompanying condensed consolidated unaudited financial statements have been 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 that may be 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 28, 2001. Reclassifications Certain prior year balances have been reclassified to conform to the current period presentation. (2) Business Combinations During the three months ended April 29, 2001, the Company completed the purchase of certain assets from various businesses, including 3dfx Interactive, Inc. ("3dfx"), for an aggregate purchase price of approximately $83.4 million. These acquisitions have been accounted for under the purchase method of accounting. Excluding the 3dfx transaction, the aggregate purchase price is immaterial to the financials 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 one million shares of the Company's common stock, subject to 3dfx satisfying certain conditions. If the debts and liabilities of 3dfx cannot be satisfied, 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 receivable by 3dfx by up to 500,000 shares. Consequently, due to the possibility of contingent consideration, the components of the estimated purchase price could differ from that presented below. In addition, following the closing, 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. The initial 3dfx asset purchase price of $70.0 million and direct transaction costs of $4.4 million related to the closing were allocated based on fair values as follows:

(In thousands)	Straight-Line Amortization Period (Years)	3dfx
~~Workforce in place~~		$ 3,010
~~2 Patents and trademarks~~		11,510
~~5 Goodwill~~		59,927
~~5 Total~~		$74,447

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 NVIDIA CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued) (Unaudited) Pro Forma Results of Operations The following summary, prepared on a pro forma basis, presents the results of operations as if 3dfx assets had been purchased as of the beginning of the periods presented. Pro forma net income for the three months ending April 29, 2001 includes the impact of amortization of goodwill and intangible assets of $4.2 million. Excluded are acquisition related charges that consist of recruiting expenses and bonuses of $9.6 million and assumed tax benefits of $1.8 million. For the three months ending April 30, 2000, pro forma net income includes the same amount of amortization of goodwill and intangible assets. Also included are assumed salary related expenses of $4.2 million and tax benefits of $2.7 million.

Three Months Ended		
	April 29, 2001	April 30, 2000
	(In thousands)	
~~Pro forma revenue~~	~~$240,932~~	~~$148,483~~
~~Pro forma net income~~	~~$ 30,112~~	~~$ 12,626~~
~~Pro forma basic net income per share~~	~~$ 0.43~~	~~$ 0.20~~
~~Pro forma diluted net income per share~~	~~$ 0.36~~	~~$ 0.16~~

~~(3) 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 either the as-if- converted method for convertible debt and the treasury stock method for options. Equivalent shares of 3,235,897 for convertible debt outstanding during the quarter were not included in the computation of diluted earnings per share because the effect would be anti-dilutive.~~

At April 29, 2001, the Company had non-cancelable inventory purchase commitments totaling $70.7 million. 7 NVIDIA CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued) (Unaudited) (5) Accrued Liabilities

April 29, January 28, 2001 2001 ----- ---- ---------- (In thousands) Accrued sales and marketing allowances..... $ 24,173 $ 10,154 Taxes payable..... 11,024 10,369 Accrued payroll and related expenses..... 8,307 11,026 Other..... 2,200 5,957 -------- -------- Total accrued liabilities..... $ 45,704 $ 37,506 ========= ========= (6) Segment Information The Company operates in a single industry segment: the design, development and marketing of 3D graphics processors for the PC market. 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. Enterprise-wide information provided on geographic sales is based upon the billing location of the customer. The following table summarizes geographic information on net sales:

Revenues to significant customers, those representing approximately 10% or more of total revenue for the respective periods and the related accounts receivable, are summarized as follows:

Three Months Ended ---------- - April 29, April 30, 2001 2000 --------- ---------- Revenue: Creative..... -- 12% EDOM..... 30% 23% ASUSTeK..... 7% 11% Altantic..... 14% 3%

 NVIDIA CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued) (Unaudited)

(7) Development Agreements 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 the Xbox video game console under development by Microsoft. In April 2000, Microsoft paid us $200.0 million as an advance against graphics chip purchases. Microsoft may terminate the agreement at any time. If termination occurs prior to offset in full of the advance payments, we would be required to return to Microsoft up to $100.0 million of the prepayment and to convert the remainder into our preferred stock at a 30% premium to the 30-day average trading price of our common stock preceding Microsoft's termination of the agreement. In addition, in the event that an individual or corporation makes an offer to purchase shares equal to or greater than thirty percent (30%) of the outstanding shares of our common stock, Microsoft has first and last rights of refusal to purchase the stock. The graphics chip contemplated by the agreement is highly complex, and the development and release of the Microsoft Xbox video game console and its commercial success are dependent upon a number of parties, such as hardware and software developer, and a number of factors, many of which are outside of our control. On February 14, 2001, we announced that the Xbox GPU and Xbox media communications processor were released to Taiwan Semiconductor Manufacturing Company for prototype fabrication. (8) Litigation On February 22, 2000, Graphiques Matrox, Inc. and Systemes Electroniques Matrox Ltd. (collectively "Matrox") filed suit against us in the Superior Court, Judicial District of Montreal, Province of Quebec, Canada. The suit alleges that we improperly solicited and recruited Matrox employees and encouraged Matrox employees to breach their Matrox confidentiality and/or non- competition agreements. The suit by Matrox seeks, among other things, certain injunctive relief. We believe that the claims asserted by Matrox are without merit and we intend to vigorously defend this suit. The trial of this matter started on April 4, 2001. On April 24, 2001, the trial ended and the court took the case under submission. The court indicated that it would not likely issue a final decision on the merits for approximately two months. On September 21, 1998, 3dfx Interactive, Inc. filed a patent infringement lawsuit against us in the United States District

Court for the Northern District of California alleging infringement of a 3dfx patent. The lawsuit was amended in 1999 to add two additional 3dfx patents. On August 28, 2000, we filed a patent infringement lawsuit against 3dfx in the United States District Court for the Northern District of California alleging infringement by 3dfx of five of our patents. The complaint by 3dfx alleged that our RIVA TNT, RIVA TNT2 and RIVA TNT Ultra products infringed the patents in suit and sought unspecified compensatory and trebled damages and attorney's fees, as well as injunctive relief. Our current generation of products was not identified as infringing any of the patents in suit. The lawsuit filed by us against 3dfx alleged that 3dfx's graphics chips and card products, which were used to accelerate 3D graphics on personal computers, infringed five of our patents and sought an injunction restraining 3dfx from manufacturing, selling, or importing infringing graphics chips and card products, including its Voodoo3, Voodoo4, Voodoo5 and VSA-100 family of products, as well as monetary damages. Following the closing of the definitive agreement entered into by us, NVIDIA US Investment and 3dfx, we and 3dfx jointly filed to dismiss with prejudice the above-described patent litigation between us. Sunonwealth Electric Machine Industry Co., Ltd. filed a complaint against the Company in the United States District Court for the Central District of California, Case Number CV-01-00870 CBM (CTx), for infringement of US Patent Nos. 6,109,892 and 6,114,785. The other defendants are Creative Technology, Ltd., 9 NVIDIA CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued) (Unaudited) a Singapore corporation and Creative Labs, Inc., a California corporation. A related case is Sunonwealth v. Adda Corporation, et al, filed in the Unites States District Court for the Central District on October 19, 2001, with case number 00-CV-1041. The patents are for a positioning device for a sensor element of a miniature fan. The Company purchased these fans from Adda. Adda has agreed to defend the Company in this suit through the law firm of Mount & Stoelker of San Jose, California. Adda shall pay all fees and costs incurred in connection with Mount & Stoelker's representation of the Company and may control the defense and settlement of the lawsuit. The Company may elect to have its own counsel involved in the lawsuit, to confer with Mount & Stoelker and to otherwise review and keep the Company apprised of the work performed by Mount & Stoelker. However, such separate counsel shall be at the Company's sole cost and expense. In the event that this lawsuit proceeds to judgment based upon liability for infringement of the patents in suit, Adda has agreed to pay that judgment rendered against the Company. Also, Adda shall pay any settlement to the extent that the Company's liability in such settlement arises from patent infringement resulting from its purchase of products from Adda. 10 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 "Certain Business Risks" section, among other things, should be considered in evaluating our prospects and future financial performance. Overview We design, develop and market graphics processors and related software for personal computers and digital entertainment platforms. We provide a "top-to- bottom" family of award-winning performance 3D graphics processors and 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 were the first to incorporate a 128-bit multi- texturing graphics architecture designed to deliver to users of our products a highly immersive, interactive 3D experience with compelling visual quality, realistic imagery and motion, stunning effects and complex object and scene interaction at real-time frame rates. The NVIDIA TNT2, TNT2 M64 and Vanta graphics processors deliver 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 graphics processors are designed to be architecturally compatible backward and forward between generations, giving our original equipment manufacturer, or OEM, customers and end users a low cost of ownership. We are recognized for developing the world's first GPU, the GeForce 256, which incorporates independent hardware transform and lighting processing units along with a complete rendering pipeline into a single-chip architecture. Our GPUs the GeForce3, the GeForce2 Ultra, the GeForce2 GTS, the GeForce2 MX, the GeForce2 Go, the NVIDIA Quadro2 Pro and the Quadro2 MXR process hundreds of billions of operations per second and increase the PC's ability to render high-definition 3D scenes in real-time. Our GPU 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. We recognize revenue from product sales to customers when a contract is in place, the price is determined, shipment is made and collectability is reasonably assured. Our policy on sales to distributors is to defer recognition of sales and related cost of sales until the distributors resell the product. Royalty revenue is recognized upon shipment of product by the licensee to its customers. We believe that the software sold with our products is incidental to the product as a whole. 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 the future. Since we have no other product line, 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, primarily ASUSTeK Computer Inc., ELSA AG Corporation, and Guillemot Corporation, and contract equipment manufacturers, or CEMs; including Celestica Hong Kong Ltd., Mitac International Corporation, Micro-Star International Co. Ltd., SCI Systems, Inc. and VisionTek Inc. These manufacturers incorporate our processors in the boards they sell to PC OEMs, 11 retail outlets and systems integrators. The average selling prices for our products, as well as our customers' products, vary by distribution channel. Our two largest customers accounted for approximately 44% of revenues for first quarter of fiscal 2002. Sales to Edom accounted for 30% and sales to Atlantic Semiconductor accounted for 14% of our total revenue for the first quarter of fiscal 2002. For the first quarter of fiscal 2001, sales to Creative Technology, Ltd. accounted for 12%, sales to Edom accounted for 23% and sales to ASUSTeK accounted for 11% of our total revenue. The number of potential customers for our products is limited, and we expect sales to be concentrated to a few major customers for the foreseeable future. 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 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 currently utilize Taiwan Semiconductor Manufacturing Company, or TSMC, our primary manufacturer, to produce semiconductor wafers, and utilize independent contractors to perform assembly, test 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 not always be able to meet our near-term or long-term manufacturing requirements. Yields or product performance could suffer due to difficulties associated with adapting our technology and product design to the proprietary process technology and design rules of a new manufacturer. The level of finished goods inventory we maintain may fluctuate and therefore a manufacturing disruption experienced by these manufacturers would impact the production of our products, which could harm our business. In addition, as the complexity of our products and the accompanying manufacturing process increases, there is an increasing risk that we will experience problems with the performance of new products and that there will be yield problems or other delays in the development or introduction of these products. 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. Product returns or delays or difficulties in collecting accounts receivable could result in significant charges against income, which could harm our business. 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 one million shares of NVIDIA common stock, subject to 3dfx satisfying certain conditions. In addition, following the closing, we and 3dfx filed a stipulation to dismiss with prejudice the patent litigation between us. The litigation was dismissed on April 26, 2001, pursuant to a judicial order. The transaction is accounted for under the purchase method of accounting. 12 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 total revenue.

	Three Months Ended	
	April 29, 2001	April 30, 2000
Revenue	100.0%	100.0%
Cost of revenue	62.0	62.6
Gross profit	38.0	37.4
Operating expenses:		
Research and development	13.0	12.0
Sales, general and administrative	7.8	8.2
Amortization of goodwill and purchased intangible assets	0.3	--
Acquisition related charges	4.0	--
Total operating expenses	25.1	20.2
Operating income	12.9	17.2
Interest and other income, net	2.3	0.9
Income before income tax expense	15.2	18.1
Income tax expense	4.6	5.8
Net income	10.6%	12.3%

Three Months Ended April 29, 2001, and April 30, 2000. Revenue Revenue increased by 62.3% to $240.9 million in the three months ended April 29, 2001. The growth was primarily the result of increased sales of our graphics processors and the strong demand for new products at higher unit average selling prices. Revenue from sales outside of the United States accounted for 94% and 90% of total revenue for the first three months of fiscal 2002 and 2001, respectively. Our international revenue increased 69% to $225.7 million for the first quarter of fiscal 2002 from $133.6 million a year ago. This

increase in revenue from sales outside of the United States is primarily attributable to (i) expanded use of CEMs, add-in board and motherboard manufacturers located outside of the United States, and (ii) increased demand for our products in the Asia Pacific and European regions. Revenue by geographical region is allocated to individual countries based on the location to which the products are initially billed. The portion of revenue derived from foreign CEMs and add-in board manufacturers that are attributable to end customers in the United States is not separately disclosed. Although we achieved substantial growth in product revenue for the first quarter of 2002 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 the products. The declines in average selling prices of 3D graphics processors generally may also accelerate as the market develops 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 costs of semiconductors purchased from contract manufacturers (including assembly, test and packaging), manufacturing support costs (labor and overhead associated with such purchases), 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 margin increased 65% from the first quarter of fiscal 2001 to the 13 same period of fiscal 2002, primarily due to significant increases in unit shipments and the favorable impact of the higher margin RIVA TNT2 and GeForce graphics processors, partially offset by declining profit margins in our older product families. Although we achieved substantial growth in gross profit for the first three months of fiscal 2002 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, costs of prototypes of new products and consultant costs. Research and development expenses increased by 75% from the first quarter of fiscal 2001 to the same period of fiscal 2002, primarily due to new employees from 3dfx, other additional personnel and related engineering costs to support our next generation's products, such as depreciation charges incurred on capital expenditures and software license and maintenance fees. 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 increased complexity and the number of products under development. Research and development expenses are likely to fluctuate from 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 55% from the first quarter of fiscal 2001 to the same period of fiscal 2002, primarily due to costs associated with additional personnel and commissions and bonuses on sales of the RIVA TNT2 and GeForce families of graphic processors. We expect sales and marketing expenses to continue to increase in absolute dollars as we continue to expand our operations and our sales. General and administrative expenses are also likely to increase in absolute dollars as we continue to expand our operations. However, we do not expect significant changes in these expenses as a percentage of revenue in future periods. Amortization of goodwill and intangible assets. Amortization of goodwill and purchased intangible assets consist primarily of goodwill and intangible assets from the asset purchase of 3dfx. The initial allocation of the purchase price was to workforce in place; amortized over two years, patents and trademarks; amortized over five years and goodwill; amortized over five years. The final allocation will depend upon the additional consideration given to 3dfx, subject to 3dfx satisfying certain conditions. Consequently, the actual allocation of the purchase price could differ from that presented in footnote 2, Business Combinations. Acquisition related charges. Acquisition related charges are attributable to expenses related to the acquisition of 3dfx. These charges primarily consist of recruiting expenses and bonuses for employees during the first quarter of fiscal 2002. Interest and Other Income (Expense), Net Interest expense increased for the first three months of fiscal 2002 compared to fiscal 2001 due to the issuance of $300.0 million of convertible debt in October 2000. Interest income increased 586% during the first quarter of fiscal 2002 from the same period in fiscal 2001 due to higher average cash balances as a result of the $200.0 million advance received from Microsoft in connection with our agreement with Microsoft and the receipt of $387.4 million from our combined convertible debt and common stock offerings which closed in October of fiscal 2001. Income Taxes Income taxes as a percentage of pretax income was 30% for the first quarter of fiscal 2002 and 32% for the same period in fiscal 2001. Foreign income taxed at rates different from United States statutory rates contributed to the lower tax rate for the first quarter in fiscal 2002. 14 Stock-Based Compensation With respect to stock options granted to employees, we recorded deferred compensation of $4.3 million in 1997 and $361,000 in the one month ended January 31, 1998. These amounts are being amortized over the vesting period of the individual options, generally four years. We amortized approximately $4,000 in the first three months of fiscal 2002 and $53,000 in the first three months of fiscal 2001. We anticipate total amortization of approximately $6,000 in fiscal 2002. Liquidity and Capital Resources As of April 29, 2001, we had $627.3 million in cash and cash equivalents, a decrease of $47.0 million from the end of fiscal 2001. We historically have held our cash balances in cash equivalents such as money market funds or as cash. We place the money market funds with high-quality financial institutions and limit the amount of exposure with any one financial institution. We had $70.7 million of non-cancelable manufacturing commitments outstanding at April 29, 2001. Operating activities generated cash of $35.7 million during the first quarter of fiscal 2002 and $10.6 million during first quarter of fiscal 2001. The increase from the first quarter of fiscal 2001 to the same period in fiscal 2002 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 with employees' exercise of stock options totaled $15.2 million in the first quarter of fiscal 2002 compared to $14.0 million in the same period of fiscal 2001. Our accounts receivable are highly concentrated. At April 29, 2001, the three largest customers accounted for approximately 52% of accounts receivable. Although we have not experienced any significant bad debt write- offs to date, we may be required to write off bad debt in the future, which could harm our business. To date, our investing activities have consisted primarily of acquisition of businesses and purchases of property and equipment and leasehold improvements for our new facility under construction. We incurred acquisition costs of $63.6 million during the first quarter of fiscal 2002, primarily due to the closing of 3dfx asset purchase. There were no business purchases during the same period a year ago. Our capital expenditures increased from $7.5 million in the first quarter of fiscal 2001 to $31.7 million in the first quarter of fiscal 2002. The increase was primarily attributable to the construction of our new facility as well as for purchases of computer and emulation equipment to support increased research and development activities and enterprise resource planning system implementation. We expect capital expenditures to increase as we further expand research and development initiatives and as our employee base grows. The timing and amount of future capital expenditures will depend primarily on our future growth. We expect to spend approximately $60.0 million to $70.0 million for capital expenditures in fiscal 2002, primarily for software licenses, emulation equipment, purchase of computer and engineering workstations, future phases of enterprise resource planning system implementation and tenant and leasehold improvements in

our new headquarters facility. In April 2000, we entered into leases for our new headquarters complex in Santa Clara, California. Our new complex will comprised of four buildings, representing approximately 500,000 total square feet. The first phase of two buildings consisting of approximately 250,000 square feet was completed in June 2001. We expect the second phase of one building consisting of approximately 125,000 square feet to be completed in July 2001 and the last phase consisting of approximately 125,000 square feet to be completed in March 2002. We have $28.1 million of restricted cash related to the construction. The leases expire in 2012 and include two seven-year renewals at our option. Future minimum lease payments under these operating leases total approximately $227.1 million over the terms of the leases. We currently are in the process of locating a subtenant for our former office space and we also need to secure a subtenant for one of the buildings that will comprise part of our new office complex. We may be unable to secure subtenants for both spaces due to the recent decrease in demand for commercial rental space in Santa Clara. See "Certain Business Risks--We recently moved into new headquarters and we will have increased operating expenses and write-offs if we are unable to sublease our former office space and one building." 15 Financing activities provided cash of $16.2 million in the first quarter of fiscal 2002 compared to $205.1 million in fiscal 2001. 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 April 2000, Microsoft advanced us $200.0 million as an advance against graphics chip purchases. Microsoft may terminate the agreement at any time. If termination occurs prior to offset in full of the advance payments, we would be required to return to Microsoft up to $100.0 million of the prepayment and to convert the remainder into shares of our preferred stock a 30% premium to the 30-day average trading price of our common stock preceding Microsoft's termination of the agreement. 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. ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK Interest Rate Risk The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from the investments without significantly increasing risk. To minimize potential loss arising from adverse changes in interest rates, we maintain a portfolio of cash and cash equivalents primarily in highly rated domestic money market funds. In general, money market funds are not subject to market risk because the interest paid on such funds fluctuates with the prevailing interest rate. Our convertible subordinated notes are at a fixed interest rate of 4 3/4 % 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. Certain Business Risks In addition to the risks discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations," our business is subject to the risks set forth below. Our operating results are unpredictable and may fluctuate. 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 and 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 adversely affect 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; 16 . 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 regions; . competitive pressures resulting in lower than expected average selling prices; . 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 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; . 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. Because most operating expenses are relatively fixed in the short term, we may be unable to adjust spending sufficiently in a timely manner to compensate for any unexpected sales shortfall. 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. 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 17 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 we have no other product line, 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. Our integrated graphics product may not be accepted by the PC

market. We expect that integrated graphics chipset products will become an increasing part of the lower cost segment of the PC graphics market. We are currently developing integrated chipset products. If these products are not competitive in this segment and the integrated chipset segment continues to account for an increasing percentage of the units sold in the PC market, our business may suffer. We need to develop new products and to manage product transitions in order to succeed. Our business will depend to a significant extent on our ability to successfully develop new products for the 3D graphics market. Our add-in board 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 and add-in board manufacturers or CEMs; . price our products competitively; and . introduce the products to the market within the limited window for PC OEMs and add-in board 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, our primary manufacturer, and any additional third- party manufacturers to effectively manufacture our new products in a timely manner; . the quality of any new products; . 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 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. 18 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 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 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, either of which would harm our business. 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. 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 or 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 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 will 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. 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 products. 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. 19 Litigation by or 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, whether or not the litigation results in a favorable determination for us. We have in the past been subject to patent infringement suits, and we may be subject to patent infringement suits brought by other parties in the future. For example, we have been advised by Rambus Inc. that it believes our products infringe certain patents owned by Rambus, and Rambus has requested that we agree to certain licensing terms, including royalty payments. We believe that Rambus' patents are invalid, not infringed by us and unenforceable. We cannot guarantee that we will be able to reach a satisfactory agreement with Rambus. If we are unable to do so, Rambus may sue us and/or our customers for patent infringement at any time. We could be subject to future lawsuits that could divert our resources and result in the payment of substantial damages. We may be 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. As of June 4, 2001, we owned 55 issued United States patents, and have 94 United States patent applications pending and our issued patents had expiration dates from April 2015 to December 2019. As of June 4, 2001, our issued patents and pending patent applications related to technology developed by us in connection with the development of our products, including our 3D graphics processors. 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. 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 manufacturers. Our add-in board 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. 20 We are dependent on the PC market, which may not continue to grow. During the first three months of fiscal 2002, we derived most of our revenue from the sale of products for use in the entire desktop PC market, from professional workstations to low-cost PCs. We expect to continue to derive substantially most of our revenue from the sale or license of products for use in the entire 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. Although the PC market has grown substantially in recent years, this growth may not continue. A reduction in sales of PCs, or a reduction in the growth rate of PC sales, would likely reduce 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 on 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. 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. Sales to add-in board manufacturers and CEMs are primarily dependent on achieving design wins with leading PC OEMs. The number of add-in board manufacturers, CEMs and leading PC OEMs is limited. We expect that a small number of add-in board 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 manufacturers and CEMs. In addition, revenue from add-in board manufacturers, 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 and currently are experiencing strained relations. A worsening of these relations 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, it is possible that recent foreign relations matters between the U.S. and The People's Republic of China could further strain relations in Asia. While we believe political 21 instability in Asia has not adversely affected our business, because of our reliance on companies with operations in Asia, continued economic and political instability in Asia might harm it. 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 29, 2001, we had 814 employees as compared to 796 employees as of January 28, 2001. 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 will be 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 our relationships with these officers and employees are, therefore, 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. We depend on third-party fabrications to produce our products. 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, test 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. In September 1999, the earthquake in Taiwan contributed to a temporary shortage of graphics processors in the third and fourth quarters of fiscal 2000. 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, and if relations between the U.S. and The People's Republic of China are strained due to recent 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. 22 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 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. Failure to achieve expected manufacturing yields would reduce our product supply and harm our business. 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 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 have migrated to the .15 micron technology with the GeForce3 family of graphics processors, and we believe that the transition of our products to increasingly smaller geometries will be important to our competitive position. 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. 23 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 graphics add-in boards that utilize their internally developed graphics chips, such as ATI Technologies Inc. and Matrox Electronics Systems Ltd.; . 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.; . suppliers of mobile graphics processors that incorporate 2D or 3D graphics functionality as part of their existing solutions, such as ATI, Trident Microsystems, Inc. and the joint venture of a division of SONICblue

Incorporated (formerly S3 Incorporated) and Via Technologies, Inc.; . companies that have traditionally focused on the professional market and provide high end 3D solutions for PCs and workstations, including 3Dlabs, SGI and SONICblue; and . companies that focus on the video game market, such as Imagination Technologies and ST Microelectronics. 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 compete with Intel in the integrated low-cost chipset market. In June 2000, Intel began shipping the Intel 815 and 815e, 3D graphics chipset that is targeted at the low-cost PC market. Intel has significantly greater resources than we do, and our products may not compete effectively against future products introduced by Intel. In addition, we may be unable to compete effectively against Intel or Intel may introduce additional products that are competitive with our products in either performance or price or both. We expect Intel to continue to do the following: . invest heavily in research and development and new manufacturing facilities; . maintain its position as the largest manufacturer of PC microprocessors; . increasingly dominate the PC platform; and . promote its product offerings through advertising campaigns designed to engender brand loyalty among PC users. Intel may in the future develop graphics add-in cards or graphics-enabled motherboards that could directly compete with graphics add-in cards or graphics-enabled motherboards that our customers may develop. In addition, due to the widespread industry acceptance of Intel's microprocessor architecture and interface architecture, including its accelerated graphics port, or AGP, and Intel's intellectual property position with respect to such architecture, Intel exercises significant influence over the PC industry generally. Any significant 24 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. We are dependent on third parties for assembly and testing 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 and testing 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. We are subject to risks associated with product defects and incompatibilities. 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 software 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. We may not be successful in producing the processors in volumes required for the Microsoft Xbox product and, even if we do successfully produce these processors in the volumes required, we may not achieve profit margins consistent with those of our other products. The Xbox Graphics Processing Unit and Xbox Media Communications Processor are new, complicated processors that have not been produced in volume. 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 and within the required time frames or that we will be able to produce these processors consistent with profit margins achieved on our other products. Finally, there can be no assurance that the Xbox program will be commercially successful. If any of the aforementioned risks occur, our business may suffer and our stock price may decline. We recently moved into new headquarters and we will have increased operating expenses and write-offs if we are unable to sublease our former office space and one building. We moved into new headquarters at the end of May 2001 but we are still obligated to pay rent on our previous office space. We currently are in the process of locating a subtenant for our former office space and we also need to secure a subtenant for one of the buildings that will comprise part of our new office complex. We may be unable to secure subtenants for both spaces due to the recent decrease in demand for commercial rental space in Santa Clara, California. If we are unable to secure subtenants or if the rental values in Santa Clara, California, decrease such that even if we found subtenants we would still be obligated to pay a portion of the rent at both locations, our operating expenses will increase, perhaps substantially, which will have a 25 negative impact on our net income. In addition, if we do not enter into a sublease for our former office space, we will have to write-off unutilized leasehold improvements associated with that space, which will adversely affect our net income. We are subject to risks associated with international operations. Our reliance on foreign third-party manufacturing, assembly and testing 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. 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. The semiconductor industry is cyclical in nature. 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. Failure in implementation of our enterprise resource planning system could adversely affect

our operations. In December 1999, we began the implementation of an SAP A.G. system as our enterprise resource planning or ERP system to replace our information systems in business, finance, operations and service. The first phase of the implementation was successfully completed in June 2000 and our operations are fully functioning under the new ERP system. Future phases of the implementation are expected to occur throughout fiscal 2002. We are heavily dependent upon the proper functioning of our internal systems to conduct our 26 business. System failure or malfunctioning may result in disruptions of operations and inability to process transactions. Our results of operations and financial position could be adversely affected if we encounter unforeseen problems with respect to system operations or future implementation. Some 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 shareholder approval; . the prohibition of shareholder action by written consent; . a classified board of directors; and . advance notice requirements for director nominations and shareholder proposals. On March 5, 2000, we entered into a licensing and development agreement with Microsoft that included a grant to Microsoft of first and last rights of refusal over any offer we receive to purchase 30% or more of the outstanding shares of our common stock. The provision could also delay or prevent a change in control of our company. Rising energy costs and power system shortages in California may result in increased operating expenses and reduced net income. California is currently experiencing an energy crisis and has recently experienced significant power shortages. As a result, energy costs in California, including natural gas and electricity, may rise significantly over the next year. Because our principal operating facilities are located in California, our operating expenses may increase significantly if this trend continues. In addition, California has on some occasions implemented, and may in the future continue to implement, rolling blackouts throughout the state, including the county where we have our principal offices. If blackouts interrupt our power supply, we may be temporarily unable to operate and any such interruption could harm our business. Our stock price may continue to experience large 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, such as the recent decline in some economic indicators in the U.S., related to the general volatility that currently exists in the market 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. This type of litigation could result in substantial cost and a diversion of management's attention and resources, which could have an adverse effect on our revenues and earnings. Any adverse determination in this type of litigation could also subject us to significant liabilities. See "Risk Factors--Our operating results are unpredictable and may fluctuate." We may not be able to realize the potential financial or strategic benefits of future business acquisitions which could hurt our ability to grow our business and sell our products. In the future we may acquire or invest in other businesses that offer products, services and technologies that we believe would help expand or enhance our products and services or help expand our distribution 27 channels. If we were to make such an 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 work force of the acquired business; . disruption of our on-going businesses; . 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. Any amortization of goodwill or other assets resulting from any acquisition could materially adversely affect our operating results and financial condition. 28 PART II: OTHER INFORMATION ITEM 1. LEGAL PROCEEDINGS On February 22, 2000, Graphiques Matrox, Inc. and Systemes Electroniques Matrox Ltd. (collectively "Matrox") filed suit against us in the Superior Court, Judicial District of Montreal, Province of Quebec, Canada. The suit alleges that we improperly solicited and recruited Matrox employees and encouraged Matrox employees to breach their Matrox confidentiality and/or non- competition agreements. The suit by Matrox seeks, among other things, certain injunctive relief. We believe that the claims asserted by Matrox are without merit and we intend to vigorously defend this suit. The trial of this matter started on April 4, 2001. On April 24, 2001, the trial ended and the court took the case under submission. The court indicated that it would not likely issue a final decision on the merits for approximately two months. On September 21, 1998, 3dfx Interactive, Inc. filed a patent infringement lawsuit against us in the United States District Court for the Northern District of California alleging infringement of a 3dfx patent. The lawsuit was amended in 1999 to add two additional 3dfx patents. On August 28, 2000, we filed a patent infringement lawsuit against 3dfx in the United States District Court for the Northern District of California alleging infringement by 3dfx of five of our patents. The complaint by 3dfx alleged that our RIVA TNT, RIVA TNT2 and RIVA TNT Ultra products infringed the patents in suit and sought unspecified compensatory and trebled damages and attorney's fees, as well as injunctive relief. Our current generation of products was not identified as infringing any of the patents in suit. The lawsuit filed by us against 3dfx alleged that 3dfx's graphics chips and card products, which were used to accelerate 3D graphics on personal computers, infringed five of our patents and sought an injunction restraining 3dfx from manufacturing, selling, or importing infringing graphics chips and card products, including its Voodoo3, Voodoo4, Voodoo5 and VSA-100 family of products, as well as monetary damages. Following the closing of the definitive agreement entered into by us, NVIDIA US Investment and 3dfx, we and 3dfx jointly filed to dismiss with prejudice the above-described patent litigation between us. The lawsuit was dismissed on April 26, 2001, pursuant to a judicial order. Sunonwealth Electric Machine Industry Co., Ltd. filed a complaint against us in the United States District Court for the Central District of California, Case Number CV-01-00870 CBM (CTx), for infringement of US Patent Nos. 6,109,892 and 6,114,785. The other defendants are Creative Technology, Ltd., a Singapore corporation and Creative Labs, Inc., a California corporation. A related case is Sunonwealth v. Adda Corporation, et al, filed in the Unites States District Court for the Central District on October 19, 2001, with case number 00-CV- 1041. The patents are for a positioning device for a sensor element of a miniature fan. We purchase these fans from Adda. Adda has agreed to defend us in this suit through the law firm of Mount & Stoelker of San Jose, California. Adda shall pay all fees and costs incurred in connection with Mount & Stoelker's representation of us and may control the defense and settlement of the lawsuit. We may elect to have our own counsel involved in the lawsuit, to confer with Mount & Stoelker and to otherwise review and keep us apprised of the work performed by Mount & Stoelker. However, such separate counsel shall be at our sole cost and expense. In the event that this lawsuit proceeds to judgment based upon liability for infringement of the patents in suit, Adda has agreed to pay that judgment rendered against us. Also, Adda has agreed to pay any settlement to the extent our liability in

such settlement arises from patent infringement resulting from our purchase of products from Adda. In addition, we may be subject to litigation in the future. See "Certain Business Risks--Litigation by or 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, whether or not the litigation results in a favorable determination for us." From time to time, we are also subject to claims in the ordinary course of business, none of which in our view would have a material adverse impact on our business or financial position if resolved unfavorably. 29 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 12, 2001. NVIDIA Corporation /s/ Christine B. Hoberg By: _____ Christine B. Hoberg Chief Financial Officer (Principal Financial and Accounting Officer) 30