

[Table of Contents](#)

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

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended July 28, 2002

OR

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

Commission file number: 0-23985

NVIDIA CORPORATION

(Exact name of registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

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

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

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

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

The number of shares of the registrant's common stock outstanding as of August 23, 2002 was 153,027,214 shares.

[Table of Contents](#)

NVIDIA CORPORATION

TABLE OF CONTENTS

	Page
	—
PART I: FINANCIAL INFORMATION	
Item 1.	Condensed Consolidated Financial Statements (Unaudited)
	Condensed Consolidated Balance Sheets as of July 28, 2002 and January 27, 2002 1
	Condensed Consolidated Statements of Income for the three and six months ended July 28, 2002 and July 29, 2001 2
	Condensed Consolidated Statements of Cash Flows for the six months ended July 28, 2002 and July 29, 2001 3
	Notes to Condensed Consolidated Financial Statements 4
Item 2.	Management’s Discussion and Analysis of Financial Condition and Results of Operations 14
Item 3.	Quantitative and Qualitative Disclosures About Market Risk 21
Item 4.	Controls and Procedures 33
PART II: OTHER INFORMATION	
Item 1.	Legal Proceedings 33
Item 2.	Changes in Securities and Use of Proceeds 34
Item 3.	Defaults Upon Senior Securities 34
Item 4.	Submission of Matters to a Vote of Security Holders 34
Item 5.	Other Information 34
Item 6.	Exhibits and Reports on Form 8-K 35
	Signature 36
	Certifications 37

[Table of Contents](#)

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NVIDIA CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

	July 28, 2002	January 27, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 246,816	\$ 333,000
Restricted cash	—	7,000
Marketable securities	579,595	458,377
Accounts receivable, net	133,038	147,348
Inventories	285,350	213,877
Prepaid expenses and other current assets	13,252	8,078
Prepaid and deferred taxes	66,429	66,429
Total current assets	1,324,480	1,234,109
Property and equipment, net	143,578	120,128
Deposits and other assets	10,593	11,897
Prepaid and deferred taxes	56,041	55,921
Goodwill and intangible assets, net	80,462	81,119
	\$ 1,615,154	\$ 1,503,174
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 165,395	\$ 214,019
Accrued liabilities	186,157	141,210
Current portion of note and capital lease obligations	5,607	3,896
Interest payable on convertible debenture	4,117	4,176
Deferred revenue	62,420	70,193
Total current liabilities	423,696	433,494
Capital lease obligations, less current portion	7,926	5,861
Long-term convertible debenture	300,000	300,000
Stockholders' equity:		
Common stock	153	150
Additional paid-in capital	485,762	456,621
Accumulated other comprehensive income, net	2,179	108
Retained earnings	395,438	306,940
Total stockholders' equity	883,532	763,819
	\$ 1,615,154	\$ 1,503,174

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended July 28, 2002	July 29, 2001	Six Months Ended July 28, 2002	July 29, 2001
		(As restated – see Note 2)		(As restated – see Note 2)
Revenue	\$ 427,285	\$ 259,875	\$1,010,190	\$ 500,807
Cost of revenue	327,983	157,636	703,723	304,348
Gross profit	99,302	102,239	306,467	196,459
Operating expenses:				
Research and development	57,229	33,894	109,721	66,487
Sales, general and administrative	35,908	20,278	73,390	39,400
Amortization of goodwill	—	3,236	—	3,611
Acquisition related charges	—	457	—	10,030
Total operating expenses	93,137	57,865	183,111	119,528
Operating income	6,165	44,374	123,356	76,931
Interest and other income, net	1,340	2,663	3,071	8,178
Income before income tax expense	7,505	47,037	126,427	85,109
Income tax expense	2,251	14,111	37,928	25,533
Net income	\$ 5,254	\$ 32,926	\$ 88,499	\$ 59,576
Basic net income per share	\$ 0.03	\$ 0.23	\$ 0.58	\$ 0.42
Diluted net income per share	\$ 0.03	\$ 0.19	\$ 0.51	\$ 0.35
Shares used in basic per share computation	152,296	141,876	151,490	140,259
Shares used in diluted per share computation	168,770	170,302	172,628	168,321

See accompanying notes to condensed consolidated financial statements.

[Table of Contents](#)

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

	July 28, 2002	Six Months Ended July 29, 2001 (As restated – see Note 2)
Cash flows from operating activities:		
Net income	\$ 88,499	\$ 59,576
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	26,899	16,815
Deferred income taxes	(120)	(8,301)
Stock based compensation	(156)	—
Amortization of deferred compensation	—	6
Bad debt expense	1,987	1,147
Tax benefit from employee stock plans	9,120	30,820
Changes in operating assets and liabilities:		
Accounts receivable	12,323	(9,005)
Inventories	(71,473)	(807)
Prepaid income taxes	—	(37,205)
Prepaid expenses and other current assets	(5,174)	(3,184)
Deposits and other assets	629	(2,590)
Accounts payable	(48,624)	15,997
Accrued liabilities	43,306	32,661
Deferred revenue	(7,773)	(2,136)
Net cash provided by operating activities	49,443	93,794
Cash flows from investing activities:		
Purchases of marketable securities	(267,546)	—
Sales and maturities of marketable securities	149,986	—
Purchase of certain assets from various businesses	(3,901)	(64,109)
Purchases of property and equipment	(45,123)	(55,570)
Deposit and release of restricted cash	7,000	(3,550)
Net cash used in investing activities	(159,584)	(123,229)
Cash flows from financing activities:		
Convertible debenture-net of issuance costs	—	(75)
Common stock issued under employee stock plans	20,181	31,663
Sale of common stock under public offering, net of issuance costs	—	(75)
Sale lease back financing	5,734	5,249
Principal payments on capital leases	(1,958)	(524)
Net cash provided by financing activities	23,957	36,238
Change in cash and cash equivalents	(86,184)	6,803
Cash and cash equivalents at beginning of period	333,000	674,275
Cash and cash equivalents at end of period	\$ 246,816	\$ 681,078
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 7,518	\$ 7,364
Cash paid (refund) for taxes	\$ (8,156)	\$ 34,158

See accompanying notes to condensed consolidated financial statements.

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

Note 1—Basis of presentation

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

Reclassifications

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

Note 2—Restatement

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

A comparison of the restated and previously reported balance sheet and income statements as of, and for the three and six months ended July 29, 2001 follows:

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

Condensed Consolidated Income Statements

	Three Months Ended July 29, 2001		Six Months Ended July 29, 2001	
	As Restated	As Previously Reported	As Restated	As Previously Reported
	(In thousands, except per share data)			
Revenue	\$259,875	\$ 260,259	\$500,807	\$ 501,191
Cost of revenue	157,636	156,571	304,348	305,866
Gross profit	102,239	103,688	196,459	195,325
Operating expenses:				
Research and development	33,894	34,007	66,487	65,421
Sales, general and administrative	20,278	20,378	39,400	39,215
Amortization of goodwill	3,236	3,236	3,611	3,611
Acquisition related charges	457	764	10,030	10,337
Total operating expenses	57,865	58,385	119,528	118,584
Operating income	44,374	45,303	76,931	76,741
Interest and other income, net	2,663	2,663	8,178	8,178
Income before tax expense	47,037	47,966	85,109	84,919
Income tax expense	14,111	14,390	25,533	25,476
Net income	\$ 32,926	\$ 33,576	\$ 59,576	\$ 59,443
Basic net income per share	\$ 0.23	\$ 0.24	\$ 0.42	\$ 0.42
Diluted net income per share	\$ 0.19	\$ 0.20	\$ 0.35	\$ 0.35
Shares used in basic per share computation	141,876	141,876	140,259	140,259
Shares used in diluted per share computation	170,302	170,302	168,321	168,321

[Table of Contents](#)

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

Condensed Consolidated Balance Sheet

	As Restated	July 29, 2001 As Previously Reported
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 681,078	\$ 681,078
Restricted cash	28,050	28,050
Accounts receivable, net	112,846	112,846
Inventory	91,187	89,610
Prepaid expenses and other current assets	11,539	12,235
Prepaid and deferred taxes	41,911	41,911
Total current assets	966,611	965,730
Property and equipment, net	94,863	94,863
Deposits and other assets	11,681	11,681
Prepaid and deferred taxes	36,015	36,015
Goodwill and intangible assets, net	80,969	80,969
	<u>\$ 1,190,139</u>	<u>\$ 1,189,258</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 88,683	\$ 88,737
Accrued liabilities	64,685	65,278
Current portion of capital lease obligations	2,019	2,019
Interest payable on convertible debenture	4,117	4,117
Deferred revenue	197,864	197,864
Total current liabilities	357,368	358,015
Capital lease obligations, less current portion	3,672	3,672
Long-term convertible debenture	300,000	300,000
Stockholders' equity:		
Common stock	143	143
Additional paid-in capital	339,362	339,362
Retained earnings	189,594	188,066
Total stockholders' equity	529,099	527,571
	<u>\$ 1,190,139</u>	<u>\$ 1,189,258</u>

Note 3—Recent Accounting Pronouncements

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

In conjunction with the implementation of SFAS No. 142, the Company has completed a transitional goodwill impairment test and has concluded that no impairment was indicated. Upon adoption of the new business

NVIDIA CORPORATION AND SUBSIDIARIES

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

combination rules, acquired workforce no longer meets the definition of an identified intangible asset. As a result, the net balance of \$1.8 million has been reclassified to goodwill in fiscal 2003. The adoption of SFAS No. 142 ceased the amortization of goodwill, which otherwise would have been approximately \$3.2 million and \$6.5 million for the three and six months ended July 28, 2002, respectively. In accordance with SFAS No. 142, the Company has elected to perform its annual impairment review during the fourth quarter. The effects of the adoption of SFAS No. 142 are as follows:

Three Months Ended			
	July 28, 2002 As Reported	July 29, 2001 As Adjusted	July 29, 2001 As Restated
(In thousands, except per share data)			
Amortization of goodwill	\$ —	\$ —	\$ 3,236
Net income	\$ 5,254	\$ 35,191	\$ 32,926
Basic EPS	\$ 0.03	\$ 0.25	\$ 0.23
Diluted EPS	\$ 0.03	\$ 0.21	\$ 0.19

Six Months Ended			
	July 28, 2002 As Reported	July 29, 2001 As Adjusted	July 29, 2001 As Restated
(In thousands, except per share data)			
Amortization of goodwill	\$ —	\$ —	\$ 3,611
Net income	\$ 88,499	\$ 62,104	\$ 59,576
Basic EPS	\$ 0.58	\$ 0.44	\$ 0.42
Diluted EPS	\$ 0.51	\$ 0.37	\$ 0.35

Years Ended			
	January 27, 2002 As Reported	January 28, 2001 As Restated	January 30, 2000 As Restated
(In thousands, except per share data)			
Net income	\$ 176,924	\$ 98,469	\$ 40,959
Goodwill and workforce amortization, tax effected	\$ 7,021	\$ —	\$ —
Adjusted net income	\$ 183,945	\$ 98,469	\$ 40,959
Reported basic EPS	\$ 1.24	\$ 0.75	\$ 0.34
Reported diluted EPS	\$ 1.03	\$ 0.62	\$ 0.28
Adjusted basic EPS	\$ 1.29	\$ 0.75	\$ 0.34
Adjusted diluted EPS	\$ 1.08	\$ 0.62	\$ 0.28

The carrying amount of goodwill is as follows:

	July 28, 2002	January 27, 2002
(In thousands)		
3dfx	\$ 50,326	\$ 50,326
Other	3,901	—
Total intangible assets	\$ 54,227	\$ 50,326

The components of our amortizable intangible assets are as follows:

July 28, 2002		January 27, 2002	
Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
(In thousands)			
Technology licenses	\$ 6,270	\$ (3,134)	\$ 6,116
Patents	9,000	(2,365)	9,000
Acquired existing technology	12,442	(4,588)	12,331
Trademarks	11,310	(2,908)	11,310
Other	250	(42)	250
Total intangible assets	\$39,272	\$ (13,037)	\$39,007

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

Amortization expense for the net carrying amount of intangible assets at July 28, 2002 is estimated to be \$4.8 million for the remainder of fiscal 2003, \$9.4 million in fiscal 2004, \$7.5 million in fiscal 2005, \$4.0 million in fiscal 2006 and \$506K in fiscal 2007.

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

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 requires that the liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002. The effect of adopting SFAS 146 is not expected to have a material effect on the Company's financial position or results of operations.

Note 4—Net Income Per Share

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

	Three Months Ended		Six Months Ended	
	July 28, 2002	July 29, 2001	July 28, 2002	July 29, 2001
		(As restated – see Note 2)		(As restated – see Note 2)
	(In thousands, except per share data)			
Numerator:				
Numerator for basic net income per share	\$ 5,254	\$ 32,926	\$ 88,499	\$ 59,576
Numerator for diluted net income per share	\$ 5,254	\$ 32,926	\$ 88,499	\$ 59,576
Denominator:				
Denominator for basic net income per share, weighted average shares	152,296	141,876	151,490	140,259
Effect of dilutive securities:				
Stock options outstanding	16,474	28,426	21,138	28,062
Denominator for diluted net income per share	168,770	170,302	172,628	168,321
Net income per share:				
Basic net income per share	\$ 0.03	\$ 0.23	\$ 0.58	\$ 0.42
Diluted net income per share	\$ 0.03	\$ 0.19	\$ 0.51	\$ 0.35

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

Diluted net income per share does not include the effect of the following anti-dilutive common equivalent shares:

	Three Months Ended		Six Months Ended	
	July 28, 2002	July 29, 2001	July 28, 2002	July 29, 2001
	(In thousands)			
Stock options outstanding	22,391	—	4,385	392
Convertible debentures	6,472	6,472	6,472	6,472
	28,863	6,472	10,857	6,864

The weighted-average price of stock options excluded from the computation of diluted earnings per share was \$37.52 and \$49.89 for the three and six months ended July 28, 2002. All stock options outstanding were dilutive for the three months ended July 29, 2001. The weighted-average price of stock options excluded from the computation of diluted earnings per share was \$36.88 for the six months ended July 29, 2001. The convertible debentures are convertible into shares of common stock at a conversion price of \$46.36 per share and were anti-dilutive for all periods shown.

Note 5—Accumulated Other Comprehensive Income

Accumulated other comprehensive income consists of cumulative translation adjustments and unrealized gains or losses on available-for-sale securities. The components of comprehensive income, net of tax, were as follows:

	Three Months Ended		Six Months Ended	
	July 28, 2002	July 29, 2001	July 28, 2002	July 29, 2001
	(In thousands)			
Net income	\$ 5,254	\$ 32,926	\$88,499	\$59,576
Decrease in cumulative translation adjustments	(353)	—	(302)	—
Increase in net unrealized gains on available-for-sale securities, net of tax	2,698	—	2,373	—
Total comprehensive income	\$ 7,599	\$ 32,926	\$90,570	\$59,576

The Company commenced investing activities beginning August 2001 and therefore there were no unrealized gains or losses in prior periods.

Note 6—Business Combination

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

On April 18, 2001, the Company completed the purchase of certain assets of 3dfx including patents and patent applications. Under the terms of the Asset Purchase Agreement, the cash consideration due at the closing was \$70.0 million, less \$15.0 million that was loaned to 3dfx pursuant to a Credit Agreement dated December 15, 2000, between the Company and 3dfx. Pursuant to the Asset Purchase Agreement, following the closing, the Company agreed to pay 3dfx as additional consideration for the purchased assets two million shares of NVIDIA common stock, subject to 3dfx certifying to our satisfaction that all its debts and other liabilities have been paid or otherwise adequately provided for. If the debts and liabilities of 3dfx can be satisfied for an amount less than \$25.0 million, 3dfx can under the agreement instead elect to receive a cash payment from the Company in the amount of the liabilities.

NVIDIA CORPORATION AND SUBSIDIARIES

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

and a reduced number of shares of NVIDIA common stock, with such reduction calculated by dividing the cash payment by \$25.00 per share. In the event 3dfx cannot satisfy all of its liabilities for less than \$25.0 million, NVIDIA is not obligated under the agreement to pay any additional consideration for the assets. At this time, 3dfx has not provided evidence that its liabilities are less than \$25.0 million.

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

	3dfx	Straight-Line Amortization Period
	(In thousands)	(Years)
Property and equipment	\$ 2,433	1-2
Patents and trademarks	11,310	5
Goodwill	60,418	—
Total	\$74,161	

The final allocation of the purchase price of the 3dfx assets is contingent upon the amount of additional consideration, if any, paid to 3dfx upon the final satisfaction of their liabilities. Any such contingent consideration paid to 3dfx would increase the purchase price and be allocated to goodwill.

Note 7—Marketable Securities

The Company accounts for its investment instruments in accordance with SFAS No. 115, “Accounting for Certain Investments in Debt and Equity Securities.” All of the Company’s cash equivalents and marketable securities are treated as “available-for-sale” under SFAS No. 115. Cash equivalents consist of financial instruments which are readily convertible into cash and have original maturities of three months or less at the time of acquisition. Marketable securities consist of highly liquid investments with a maturity of greater than three months when purchased. The Company classifies its marketable debt securities at the date of acquisition in the available-for-sale category as the Company’s intention is to convert them into cash for operations. These securities are reported at fair value with the related unrealized gains and losses included in accumulated other comprehensive income, a component of stockholders’ equity, net of tax. The average holding periods until maturity of our cash equivalents and marketable securities were approximately 10 and 585 days, respectively. The principal amounts and related weighted-average interest rates for our investment portfolio were \$248.3 million and 1.76% for cash equivalents, and \$579.6 million and 4.39% for marketable securities as of July 28, 2002.

Note 8—Balance Sheet Components

Certain balance sheet components are as follows:

	July 28, 2002	January 27, 2002
	(In thousands)	
Inventories:		
Raw material	\$ 23,691	\$ 13,367
Work in-process	30,705	77,130
Finished goods	230,954	123,380
Total inventories	\$285,350	\$ 213,877

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

At July 28, 2002, the Company had outstanding inventory purchase obligations totaling \$181.0 million.

	July 28, 2002	January 27, 2002
	(In thousands)	
Accrued Liabilities:		
Accrued customer programs	\$ 54,079	\$ 55,627
Taxes payable	102,641	62,922
Accrued payroll and related expenses	18,591	16,389
Other	10,846	6,272
	<u>186,157</u>	<u>141,210</u>
Total accrued liabilities	\$ 186,157	\$ 141,210

Note 9—Segment Information

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

	Three Months Ended		Six Months Ended	
	July 28, 2002	July 29, 2001	July 28, 2002	July 29, 2001
		(As restated -see Note 2)		(As restated -see Note 2)
	(In thousands)			
Revenue:				
U.S. and North America	\$ 160,771	\$ 29,292	\$ 352,507	\$ 44,542
Asia Pacific	258,127	221,567	634,854	433,191
Europe	8,387	9,016	22,829	23,074
	<u>427,285</u>	<u>259,875</u>	<u>1,010,190</u>	<u>500,807</u>
Total revenue	\$ 427,285	\$ 259,875	\$ 1,010,190	\$ 500,807

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

	Three Months Ended		Six Months Ended	
	July 28, 2002	July 29, 2001	July 28, 2002	July 29, 2001
		(As restated -see Note 2)		(As restated - see Note 2)
Revenue:				
Customer A	29%	1%	25%	—
Customer B	18%	21%	17%	26%
Customer C	16%	10%	15%	8%
Customer D	7%	11%	8%	12%
Customer E	—	11%	1%	10%

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

	As of July 28, 2002	As of January 27, 2002
Accounts Receivable:		
Customer A	—	—
Customer B	12%	14%
Customer C	25%	16%
Customer D	11%	9%
Customer E	1%	6%

Note 10—Microsoft Agreement

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

The Company is engaged with Microsoft in discussions related to pricing and volumes of the Xbox chipset. These discussions and the Company's agreement contemplated use of a third party to resolve matters and on April 23, 2002 Microsoft submitted the matter to binding arbitration. Microsoft requested that the arbitration panel require that the Company supply chipsets in whatever quantities are ordered by Microsoft. The arbitration panel has issued an interim ruling that the Company must supply Microsoft's reasonable requirements of chipsets, but no minimum or maximum amount has been set overall or for any particular period. Microsoft has also asked for damages for alleged violations of the agreement and requested that the arbitration panel reduce chipset prices paid by Microsoft. The Company has also requested pricing relief regarding the Company's chipsets and asserted claims for damages. The arbitration panel will consider all these claims during the arbitration. For sales of the Xbox processors, the Company has deferred revenue in an amount equal to the difference between the price being paid by Microsoft and the price Microsoft claims it should be paying. The Company expects that it will continue to defer revenue related to the disputed pricing and volume discount for future sales of these processors until final resolution of the matter. This amount was approximately \$46.2 million as of July 28, 2002. The arbitration is being conducted in New York by a panel under the rules of the American Arbitration Association. The Company expects to conclude the arbitration before June 30, 2003.

Note 11—Litigation

On February 19, 2002 an NVIDIA stockholder, Dominic Castaldo, on behalf of himself and purportedly on behalf of a class of Company stockholders, filed an action in the United States District Court for the Northern District of California, or the Northern District, against the Company and certain officers of the Company, alleging violations of the federal securities laws arising out of the Company's announcement on February 14, 2002 of an internal investigation of certain accounting matters. As of July 28, 2002, approximately 13 similar actions (the "Federal Class Actions") were filed in the Northern District, one additional individual action was filed in the Southern District, along with three related derivative actions against the Company, certain of its executive officers, directors and its independent auditors, KPMG LLP, in California Superior Court and in Delaware Chancery Court, collectively the Actions. The two related derivative actions filed in California Superior Court have been consolidated. The Actions allege claims in connection with various alleged statements and omissions to the public and to the securities markets and seek damages together with interest and reimbursement of costs and expenses of the litigation. The derivative actions also seek disgorgement of alleged profits from insider trading by officers and directors. The Actions are in the preliminary stages. The Federal Class Actions have been consolidated and lead plaintiffs appointed. The consolidated amended complaint should be filed by

NVIDIA CORPORATION AND SUBSIDIARIES

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

September 10, 2002. The Company is obligated to indemnify its officers and directors in connection with the Actions to the extent permitted by the law, and has insurance for such individuals, to the extent of the limits of the applicable insurance policies and subject to potential reservations of rights. The Company intends to vigorously defend these Actions. The Company is unable, however, to predict the ultimate outcome of the Actions. There can be no assurance the Company will be successful in defending the Actions and if the Company is unsuccessful the Company may be subject to significant damages. Even if the Company is successful, defending the Actions is likely to be expensive and may divert management's attention from other business concerns and harm the Company's business.

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

The Company is engaged with Microsoft in discussions related to pricing and volumes of the Xbox chipset. These discussions and the Company's agreement contemplated use of a third party to resolve matters and on April 23, 2002 Microsoft submitted the matter to binding arbitration. Microsoft requested that the arbitration panel require that the Company supply chipsets in whatever quantities are ordered by Microsoft. The arbitration panel has issued an interim ruling that the Company must supply Microsoft's reasonable requirements of chipsets, but no minimum or maximum amount has been set overall or for any particular period. Microsoft has also asked for damages for alleged violations of the agreement and requested that the arbitration panel reduce chipset prices paid by Microsoft. The Company has also requested pricing relief regarding the Company's chipsets and asserted claims for damages. The arbitration panel will consider all these claims during the arbitration. For sales of the Xbox processors, the Company has deferred revenue in an amount equal to the difference between the price being paid by Microsoft and the price Microsoft claims it should be paying. The Company expects that it will continue to defer revenue related to the disputed pricing and volume discount for future sales of these processors until final resolution of the matter. This amount was approximately \$46.2 million as of July 28, 2002. The arbitration is being conducted in New York by a panel under the rules of the American Arbitration Association. The Company expects to conclude the arbitration before June 30, 2003.

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

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

NVIDIA CORPORATION AND SUBSIDIARIES

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

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

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

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

Restatement

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

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

Overview

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

We have five major product brands: GeForce, nForce, GeForce Go, Quadro and TNT2. The GeForce family represents our desktop GPUs. In addition, we develop and sell processors for use in the Xbox video game console. We are recognized for developing the world's first programmable GPUs, the GeForce4 and GeForce3. The GeForce4 and GeForce3 GPUs are designed to deliver the highest performance and cinematic-quality for interactive entertainment, digital image editing and digital video playback applications through the use of highly-programmable processing elements. The nForce and Xbox integrated graphics processor units, or IGPs, and media communications processors, or MCPs, are the industry's first highly-integrated platform processors to incorporate a comprehensive set of multimedia capabilities, such as 2D, 3D, DVD, HDTV, Dolby Digital audio playback and fast broadband and networking communications. Our mobile product family, which consists of the GeForce4 and

[Table of Contents](#)

GeForce2 Go GPUs, are designed to deliver desktop graphics performance and features for multiple laptop configurations from desktop replacements to thin-and-lights. The Quadro family of workstation GPUs consists of an extensive range of products for the high-end, mid-range, entry level, multi-display 2D and digital content creation markets. The NVIDIA TNT2 family of graphics processors delivers high performance 3D and 2D graphics at affordable prices, making them the graphics hardware of choice for a wide range of applications for both consumer and commercial use. Our entire product family provides superior processing and rendering power at competitive prices and is architected to deliver the maximum performance from industry standards such as Microsoft's Direct3D Application Programming Interface, or API, and Silicon Graphics, Inc.'s, or SGI's, OpenGL API on Windows operating systems and Linux platforms.

Currently, all of our product sales and our arrangements with third-party manufacturers provide for pricing and payment in U.S. dollars. We have not engaged in any foreign currency hedging activities, although we may do so in the future. Since the majority of our products are sold into the PC market, our business would suffer if for any reason our graphics processors do not achieve widespread acceptance in the PC market.

A majority of our sales have been to a limited number of customers and sales are highly concentrated. We sell graphics processors to add-in board and motherboard manufacturers and contract equipment manufacturers, or CEMs. These manufacturers incorporate our processors in the boards they sell to PC OEMs, retail outlets and systems integrators. We also sell graphics processors to independent stocking representatives that purchase our products and resell these products to PC OEMs. The average selling prices for our products, as well as our customers' products, vary by distribution channel. The majority of our sales are made on the basis of purchase orders rather than long-term agreements. As a result, we may commit resources to the production of products without having received advance purchase commitments from customers. Our three largest customers accounted for approximately 63% of revenues for the second quarter of fiscal 2003 and 57% of revenues for the first half of fiscal 2003. Sales to Microsoft accounted for 29% and sales to two customers accounted for 34% of our total revenue for the second quarter of fiscal 2003. For the first half of fiscal 2003, sales to Microsoft accounted for 25% and sales to two customers accounted for 32% of our total revenue. For the second quarter of fiscal 2002, sales to three customers accounted for 43% of total revenue. For the first half of fiscal 2002, sales to three customers accounted for 48% of our total revenue. Although a limited number of our customers represent the majority of our revenue, their end customers include Acer Inc., Apple Computer, Inc., Dell Computer Corporation, eMachines Inc., Fujitsu-Siemens Computers, Gateway Inc., Hewlett Packard Company, IBM, Legend Computer, Medion AG, Micron Electronics Inc., NEC Corporation, Packard Bell NEC Inc., Samsung Electronics Co., Sony Corporation, Toshiba and others.

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

Critical Accounting Policies and Estimates

Management's discussion and analysis of financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to customer programs, revenue recognition, sales returns, allowance for doubtful accounts, inventories, investments, intangible assets, income taxes, financing operations and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

[Table of Contents](#)

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

Revenue Recognition

We recognize revenue from product sales when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed and determinable and collection is reasonably assured. Our policy on sales to distributors and stocking representatives is to defer recognition of revenue and related cost of revenue until the distributors and representatives resell the product. We record estimated reductions to revenue for customer programs at the time revenue is recognized. If market conditions decline, we may take actions to increase customer incentive offerings possibly resulting in an incremental reduction of revenue at the time the incentive is offered. We also record a reduction to revenue for estimated product returns at the time revenue is recognized based on historical return rates and analysis.

For all sales, we use a binding purchase order and in certain cases we use a contractual agreement as evidence of an arrangement. We consider delivery to occur upon shipment provided title and risk of loss have passed to the customer. At the point of sale, we assess whether the arrangement fee is fixed and determinable and whether collection is reasonably assured. If we determine that collection of a fee is not reasonably assured, we defer the fee and recognize revenue at the time collection becomes reasonably assured, which is generally upon receipt of cash.

Allowance for Doubtful Accounts

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. This allowance consists of an amount identified for specific customers and an amount based on overall estimated exposure. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required which could adversely affect our operating results.

Inventory

We write down our inventory for estimated lower of cost or market, obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required which could adversely affect our operating results. If actual market conditions are more favorable, we will have higher gross margins when products are sold.

Tax Valuation Allowance

We record a valuation allowance to reduce deferred tax assets to the amount that is more likely than not to be realized. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, in the event we were to determine that we would be able to realize deferred tax assets in the future in excess of net recorded amount, an adjustment to the net deferred tax asset would increase net income in the period such determination was made. Likewise, should we determine that we would not be able to realize all or part of net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Results of Operations

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

	Three Months Ended		Six Months Ended	
	July 28, 2002	July 29, 2001	July 28, 2002	July 29, 2001
		(As restated – see Note 2)		(As restated – see Note 2)
Revenue	100.0%	100.0%	100.0%	100.0%
Cost of revenue	76.8	60.7	69.7	60.8
Gross profit	23.2	39.3	30.3	39.2

[Table of Contents](#)

Operating expenses:

Research and development	13.4	13.0	10.9	13.3
Sales, general and administrative	8.4	7.8	7.3	7.9
Amortization of goodwill	—	1.2	—	0.7
Acquisition related charges	—	0.2	—	2.0
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total operating expenses	21.8	22.2	18.2	23.9
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Operating income	1.4	17.1	12.1	15.3
Interest and other income, net	0.3	1.0	0.3	1.6
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Income before income tax expense	1.7	18.1	12.4	16.9
Income tax expense	0.5	5.4	3.8	5.1
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income	1.2%	12.7%	8.6%	11.8%
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>

Three Months and Six Months Ended July 28, 2002 and July 29, 2001

Revenue

Revenue consists of amounts recognized from the sale of graphics and media communication processors and related software for PCs, workstations and digital entertainment platforms. Revenue increased by 64% to \$427.3 million for the three months ended July 28, 2002 when compared to \$259.9 million for the three months ended July 29, 2001. Revenue of \$1.01 billion for the first half of fiscal 2003 grew 102% over the first half of fiscal 2002. The growth was primarily the result of increased sales of our graphics processors driven by the introduction of our GeForce4 family of products at the beginning of fiscal 2003; the strong overall demand for our products in the PC, workstation and mobile laptop markets; and the introduction of our integrated chipsets and processors.

Revenue from sales outside of the United States accounted for 62% of total revenue for the second quarter ended July 28, 2002 and 65% of total revenue for the first half of fiscal 2003. Revenue from sales outside of the United States accounted for 89% of total revenue for the second quarter ended July 29, 2001 and 91% of total revenue for the first half of fiscal 2002. Revenue by geographical region is allocated to individual countries based on the location to which the products are initially billed even if the foreign CEMs' and add-in board and motherboard manufacturers' revenue is attributable to end customers located in the United States. The decrease in revenue from sales outside of the United States is primarily attributable to increased sales of the graphics and media communication processors used in the Microsoft Xbox product billed to Microsoft in the United States.

Although we achieved substantial growth in product revenue for the second quarter of fiscal 2003 from the same period a year ago, we do not expect to sustain this rate of growth in future periods. In addition, we expect that the average selling prices of our products will decline over the lives of our products. The decline in average selling prices of 3D graphics processors in general may accelerate as the market continues to develop and competition increases.

Gross Profit

Gross profit consists of total revenue, net of allowances, less cost of revenue. Cost of revenue consists primarily of the cost of semiconductors purchased from subcontractors (including assembly, testing and packaging), manufacturing support costs (including labor and overhead associated with such purchases), final test yield fallout, inventory provisions and shipping costs. Our gross profit margin can vary in any period depending on the mix of types of graphics processors sold. Our gross profit margins were 23.2% and 30.3% for the second quarter of fiscal 2003 and the first half of fiscal 2003, respectively. Our gross profit margins were 39.3% and 39.2% for the second quarter of fiscal 2002 and the first half of fiscal 2002, respectively. Gross margins for the second quarter and first half of fiscal 2003 as compared to the same periods of fiscal 2002 decreased primarily due to the shift in mix of business and an inventory write-down of approximately \$21 million related to certain Xbox processors and nForce chipsets. In addition, sales of Xbox processors, which generally have lower margins than our other products, comprised 25% of our overall revenue in the first half of fiscal 2003 as compared to less than 1% in the first half of 2002. Further, the deferral of Xbox revenues discussed in Note 10 to the Condensed Consolidated Financial Statements had a slight adverse effect on margins. As a result, gross profit decreased \$2.9 million, or 3%, as compared to the second quarter of fiscal 2002. As compared to first half of fiscal 2002, gross profit for the first half of fiscal 2003 increased by \$110.0 million, or 56%, due to an increase in unit shipments.

[Table of Contents](#)

In the future, we could be subject to excess or obsolete inventories and be required to take additional write-downs if growth slows or if we incorrectly forecast product demand. A reduction in demand could negatively impact our gross margins. Although we achieved substantial growth in gross profit for the first half of fiscal 2003 from the same period a year ago, we do not expect to sustain this rate of growth in future periods.

Operating Expenses

Research and Development. Research and development expenses consist of salaries and benefits, cost of development tools and software, cost of new product prototypes and consultant costs. Research and development expenses increased by \$23.3 million, or 69%, from the second quarter of fiscal 2002 to the second quarter of fiscal 2003 primarily due to a \$10.4 million increase related to additional personnel, a \$6.8 million increase associated with lab equipment, software licenses, maintenance fees and depreciation charges, a \$3.1 million increase related to engineering costs to develop our next generation products and a \$3.0 million increase in facilities costs due to the move into our new headquarters and other expenses during the period. Research and development expenses increased by \$43.2 million, or 65%, from the first half of fiscal 2002 to the first half of fiscal 2003 primarily due to the addition of personnel, facilities costs, engineering related costs to support our next generation 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 the increased complexity and the greater 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 \$15.6 million, or 77.1%, from the second quarter of fiscal 2002 to the second quarter of fiscal 2003 primarily due to a \$5.1 million increase related to additional personnel and commissions, a \$2.2 million increase in tradeshow and product launch costs, a \$7.2 million increase associated with facilities costs, legal expenses, general administrative activities and travel and entertainment expenses and \$1.1 million incurred in connection with our recent internal accounting review. Sales, general and administrative expenses increased \$34.0 million, or 86%, from the first half of fiscal 2002 to the first half of fiscal 2003 primarily due to costs associated with additional personnel, facilities costs, internal accounting review and legal costs.

We expect sales, general and administrative expenses to continue to increase in absolute dollars as we continue to support our operations, expand our sales and protect our business interests.

Amortization of Goodwill

During fiscal 2002, amortization of goodwill was associated with goodwill from the asset purchase from 3dfx. The initial allocation of the purchase price included \$57.4 million of goodwill, plus approximately \$3.0 million of intangible assets previously allocated to workforce in place, which was reclassified into goodwill as of the beginning of fiscal 2003.

In accordance with SFAS 142, "Goodwill and Other Intangible Assets," we no longer amortize goodwill as of the beginning of fiscal 2003. We have conducted a transitional impairment test on our goodwill and concluded that no impairment charge was required. In the three months and six months ended July 29, 2001, the amortization of goodwill, including workforce in place, was \$3.2 million and \$3.6 million, respectively.

Acquisition Related Charges

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

Interest and Other Income (Expense), Net

Interest income primarily consists of interest earned on cash, cash equivalents and marketable securities. Interest income decreased \$1.3 million from the second quarter of fiscal 2002 to the second quarter of fiscal 2003.

[Table of Contents](#)

and decreased \$5.1 million from the first half of fiscal 2002 to the first half of fiscal 2003 primarily due to the decline in market interest rates.

Interest expense primarily consists of interest incurred as a result of capital lease obligations and interest on our convertible debt. Interest expense remained flat for all periods presented.

Income Taxes

We had income tax expense of \$2.3 million and \$14.1 million for the second quarter of fiscal 2003 and 2002, respectively, and we had \$37.9 million and \$25.5 million of income tax expense for the first half of fiscal 2003 and 2002, respectively. Income tax expense as a percentage of pretax income was 30.0% for the first half of fiscal 2003 and 2002.

Liquidity and Capital Resources

As of July 28, 2002, we had \$826.4 million in cash, cash equivalents and marketable securities, an increase of \$35.0 million from the end of fiscal 2002. We historically have held our cash balances in cash or cash equivalents, such as money market funds. In August 2001, we began to invest our excess cash balances in marketable securities. Our portfolio of cash equivalents and marketable securities is managed by several financial institutions. Our investment policy requires the purchase of top-tier investment grade securities, the diversification of asset type and places certain limits on our portfolio duration.

Operating activities generated cash of \$49.4 million during the first half of fiscal 2003 and \$93.8 million during the first half of fiscal 2002. The decrease from the first half of fiscal 2002 when compared to the same period in fiscal 2003 was primarily due to an increase in net income and depreciation and amortization, offset by inventory growth and the decrease in the 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.

Investing activities used cash of \$159.6 million in the first half of fiscal 2003 compared to \$123.2 million in the first half of fiscal 2002. The increase from the first half of fiscal 2002 was due to the increase in the purchase of marketable securities offset by decreases in both capital expenditures and asset purchases from various businesses. We expect to spend approximately \$80.0 million to \$90.0 million for capital expenditures in fiscal 2003, primarily for software licenses, emulation equipment, computer and engineering workstations, future phases of our enterprise resource planning system implementation, and tenant and leasehold improvements in our new headquarters facility. In addition, we may continue to use cash in connection with the acquisition of businesses or assets.

Financing activities provided cash of \$24.0 million in the first half of fiscal 2003 compared to \$36.2 million in the first half of fiscal 2002. The decrease from the first half of fiscal 2002 was due to a decrease in employee stock purchases.

Microsoft Agreement

On March 5, 2000, we entered into an agreement with Microsoft in which we agreed, under certain terms and conditions, to develop and sell processors for use in the Xbox video game console. In April 2000, Microsoft paid us \$200.0 million under the agreement as an advance against processor purchases. This advance was fully utilized by purchases made by Microsoft through the quarter ended April 28, 2002 and Microsoft is currently paying in advance for processor chipsets sold to it. We are engaged with Microsoft in discussions related to pricing and volumes of the Xbox chipset. These discussions and our agreement contemplated use of a third party to resolve matters and on April 23, 2002 Microsoft submitted the matter to binding arbitration. Microsoft requested that the arbitration panel require that we supply chipsets in whatever quantities are ordered by Microsoft. The arbitration panel has issued an interim ruling that we must supply Microsoft's reasonable requirements of chipsets, but no minimum or maximum amount has been set overall or for any particular period. Microsoft has also asked for damages for alleged violations of the agreement and requested that the arbitration panel reduce chipset prices paid by Microsoft. We have also requested pricing relief regarding our chipsets and asserted claims for damages. The arbitration panel will consider all these claims during the arbitration. For sales of the Xbox processors, we have deferred revenue in an amount equal to the difference between the price being paid by Microsoft and the price Microsoft claims it should be paying. We expect that we will continue to defer revenue related to the disputed pricing and volume discount for future sales of these processors until final resolution of the matter. This amount was approximately \$46.2 million as of July 28, 2002. The arbitration is being conducted in New York by a panel under the rules of the American Arbitration Association. We expect to conclude the arbitration before June 30, 2003.

[Table of Contents](#)

Common Stock and Convertible Subordinated Debenture Offering

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

3dfx Asset Purchase

On April 18, 2001, we completed the purchase of certain assets of 3dfx, including patents and patent applications. Under the terms of the Asset Purchase Agreement, the cash consideration due at the closing was \$70.0 million, less \$15.0 million that was loaned to 3dfx pursuant to a Credit Agreement dated December 15, 2000, between us and 3dfx. Pursuant to the Asset Purchase Agreement, following the closing, we agreed to pay 3dfx as additional consideration for the purchased assets two million shares of NVIDIA common stock, subject to 3dfx certifying to our satisfaction all its debts and other liabilities have been paid or otherwise adequately provided for. If the debts and liabilities of 3dfx can be satisfied for an amount less than \$25.0 million, 3dfx can under the agreement instead elect to receive a cash payment from us in the amount of the liabilities and a reduced number of shares of our common stock, with such reduction calculated by dividing the cash payment by \$25.00 per share. In the event 3dfx cannot satisfy all of its liabilities for less than \$25.0 million, NVIDIA is not obligated under the agreement to pay any additional consideration for the assets. At this time, 3dfx has not provided evidence that its liabilities are less than \$25.0 million.

Contractual Cash Obligations

As of July 28, 2002, our outstanding inventory purchase obligations have decreased to \$181.0 million from \$541.0 million as of January 27, 2002. There were no other material changes in our contractual cash obligations from those disclosed in our Annual Report on Form 10-K for the year ended January 27, 2002. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" in our Annual Report on Form 10-K for the year ended January 27, 2002.

Operating Capital and Capital Expenditure Requirements

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

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

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

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

We account for our investment instruments in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." All of the cash equivalents and marketable securities are treated as "available-for-sale" under SFAS No. 115. Investments in both fixed rate and floating rate interest earning instruments carry a degree of interest rate risk. Fixed rate securities may have their market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may fall short of expectations due to changes in interest rates or we may suffer losses in principal if forced to sell securities that decline in market value due to changes in interest rates. However, because our debt securities are classified as available for sale, no gains or losses are recognized unless such securities are sold. The average holding periods until maturity of our cash equivalents and marketable securities were approximately 10 and 585 days, respectively. The principal amounts and related weighted-average interest rates for our investment portfolio were \$248.3 million and 1.76% for cash equivalents, and \$579.6 million and 4.39% for marketable securities as of July 28, 2002.

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

Exchange Rate Risk

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

Business Risks

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

Risks Related to Our Operations

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

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

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

- demand and market acceptance for our products and/or our customers' products;
- the successful development and volume production of next-generation products;
- new product announcements or product introductions by our competitors;
- our ability to introduce new products in accordance with OEM design requirements and design cycles;
- changes in the timing of product orders due to unexpected delays in the introduction of our customers' products;

Table of Contents

- fluctuations in the availability of manufacturing capacity or manufacturing yields;
- declines in spending by corporations and consumers related to perceptions regarding an economic downturn in the U.S. and international economies;
- competitive pressures resulting in lower than expected average selling prices;
- product rates of return in excess of that forecasted or expected due to quality issues;
- the rescheduling or cancellation of customer orders;
- the loss of a key customer or the termination of a strategic relationship;
- seasonal fluctuations associated with the PC market;
- substantial disruption in our suppliers' operations, either as a result of a natural disaster, equipment failure, terrorism or other cause;
- supply constraints for and changes in the cost of the other components incorporated into our customers' products, including memory devices;
- our ability to reduce the manufacturing costs of our products;
- legal and other costs related to defending intellectual property and other types of lawsuits;
- bad debt write-offs;
- costs associated with the repair and replacement of defective products;
- unexpected inventory write-downs; and
- introductions of enabling technologies to keep pace with faster generations of processors and controllers.

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

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

Most of our operating expenses are relatively fixed in the short term, and we may be unable to adjust spending sufficiently in a timely manner to compensate for any unexpected sales shortfall. Substantially all of our sales are made on the basis of purchase orders rather than long-term agreements. As a result, we may commit resources to the production of products without having received advance purchase commitments from customers. Any inability to sell products to which we have devoted significant resources could harm our business. In addition, cancellation or deferral of product orders could result in our holding excess inventory, which could adversely affect our profit margins and restrict our ability to fund operations. We may build memory and component inventories during periods of anticipated growth and in connection with selling workstation boards directly to major OEMs. We could be subject to excess or obsolete inventories and be required to take corresponding write-downs if growth slows or if we incorrectly forecast product demand. For example, in the second quarter of fiscal 2003, we wrote down approximately \$21 million of inventory related to Xbox processors and nForce chipsets. A reduction in demand could negatively impact our gross margins and financial results.

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

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

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

[Table of Contents](#)

such performance characteristics in order to be included in new system configurations. This requires that we do the following:

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

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

- proper new product definition;
- timely completion and introduction of new product designs;
- the ability of TSMC and any additional third-party manufacturers to effectively manufacture our new products in a timely manner;
- the quality of any new products;
- differentiation of new products from those of our competitors;
- market acceptance of our products and our customers' products; and
- availability of adequate quantity and configurations of various types of memory products.

Our strategy is to utilize the most advanced semiconductor process technology appropriate for our products and available from commercial third-party foundries. Use of advanced processes has in the past resulted in initial yield problems. New products that we introduce may not incorporate the features and functionality demanded by PC OEMs, add-in board and motherboard manufacturers and consumers of 3D graphics. In addition, we may not successfully develop or introduce new products in sufficient volumes within the appropriate time to meet both the PC OEMs' design cycles and market demand. We have in the past experienced delays in the development of some new products. Our failure to successfully develop, introduce or achieve market acceptance for new 3D graphics products would harm our business. In particular, we expect to introduce graphics processors using our next generation technology during the second half of fiscal 2003 and any delays in such introduction or failure of these processors to meet or exceed specifications of competitive products could materially harm our business.

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

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

[Table of Contents](#)

may render our 3D graphics products non-competitive or obsolete or result in our holding excess inventory, any of which would harm our business.

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

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

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

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

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

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

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

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

Our rapid growth has placed, and is expected to continue to place, a significant strain on our managerial, operational and financial resources. As of July 28, 2002, we had 1,414 employees as compared to 1,123 employees as of January 27, 2002. We expect that the number of our employees will increase over the next 12 months. Our future growth, if any, will depend on our ability to continue to implement and improve operational, financial and management information and control systems on a timely basis, as well as our ability to maintain effective cost controls. Further, we will be required to manage multiple relationships with various customers and other third parties. Our systems, procedures or controls may not be adequate to support our operations and our management may be unable to achieve the rapid execution necessary to successfully implement our strategy.

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

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

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

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

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

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

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

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

During the first half of fiscal 2003, we initiated an examination of SAP A.G., our current enterprise resource planning, or ERP, system to enhance our information systems in business, finance, operations and service. We may implement additional functionalities based upon the results of the ERP examination. If we are not able to implement additional functionalities to our current ERP system, the efficiency of our business applications will be harmed. We are heavily dependent upon the proper functioning of our internal systems to conduct our 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 harmed if we encounter unforeseen problems with respect to system operations or future implementations.

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

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

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

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

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

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

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

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

Risks Related to Our Partners

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

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

Our business may be harmed by instability in Asia due to the concentration of customers who are located or have substantial operations in Asia, including Taiwan. The People's Republic of China and Taiwan have in the past experienced strained relations. A worsening of these relationships or the development of hostilities between the two

[Table of Contents](#)

could result in disruptions in Taiwan and possibly other areas of Asia, which could harm our business. In addition, if relations between the U.S. and The People's Republic of China become strained, our business could be harmed. While we believe political instability in Asia has not harmed our business, because of our reliance on companies with operations in Asia, continued economic and political instability in Asia might harm it.

Difficulties in collecting accounts receivable could result in significant charges against income, which could harm our business.

Our accounts receivable are highly concentrated and make us vulnerable to adverse changes in our customers' businesses and to downturns in the economy and the industry. We recorded reserves in our financial statements and may have to record additional reserves or write-offs in the future, which could adversely impact 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.

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

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

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

We are engaged with Microsoft in discussions related to pricing and volumes of the Xbox chipset. These discussions and our agreement contemplated use of a third party to resolve matters and on April 23, 2002 Microsoft submitted the matter to binding arbitration. Microsoft has requested that the arbitration panel require that we supply chipsets in whatever quantities are ordered by Microsoft. The arbitration panel has issued an interim ruling that we must supply Microsoft's reasonable requirements of chipsets, but no minimum or maximum amount has been set overall or for any particular period. Microsoft has also asked for damages for alleged violations of the agreement and requested that the arbitration panel reduce chipset prices paid by Microsoft. We have also requested pricing relief regarding our chipsets and asserted claims for damages. The arbitration panel will consider all these claims during the arbitration. For sales of the Xbox processors, we have deferred revenue in an amount equal to the difference between the price being paid by Microsoft and the price Microsoft claims it should be paying. We expect that we will continue to defer revenue related to the disputed pricing and volume discount for future sales of these processors until final resolution of the matter. This amount was approximately \$46.2 million as of July 28, 2002. The arbitration is being conducted in New York by a panel under the rules of the American Arbitration Association. We expect to conclude the arbitration before June 30, 2003.

There can be no assurance that we will prevail in the arbitration or continue to supply graphics and other processors for the Xbox. If we do not prevail, we may (i) be compelled to deliver Xbox processors at reduced pricing, resulting in reduced gross margins, or a loss, on such processors; (ii) be required to reduce production and delivery of other products in order to satisfy obligations to Microsoft; (iii) be required to pay significant damages to

[Table of Contents](#)

Microsoft; or (iv) be subject to other remedies, such as licenses to our intellectual property, that could have a material adverse impact on our business. Even if we do prevail, there can be no assurance that our business will not be materially harmed.

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

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

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.

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

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

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

Risks Related to Our Competition

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

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

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

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

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

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

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

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

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

We expect Intel to continue to do the following:

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

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

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

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

Risks Related to Financial and Market Conditions

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

During the first half of fiscal 2003, we derived most of our revenue from the sale of products for use in the desktop PC market, from professional workstations to low-cost PCs. We expect to continue to derive most of our revenue from the sale or license of products for use in the desktop PC market in the next several years. The PC market is characterized by rapidly changing technology, evolving industry standards, frequent new product introductions and significant price competition. These factors result in short product life cycles and regular reductions of average selling prices over the life of a specific product. A reduction in sales of PCs, or a reduction in the growth rate of PC sales, will 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. 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, led in the quarter ended July 28, 2002 to reductions in inventory purchases by PC manufacturers and adversely impacted our revenue during the period. Any reduction in the demand for PCs generally, or for a particular product that incorporates our 3D graphic processors, could harm our business.

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

Our success will depend in part upon the demand for performance 3D graphics for business PC applications. The market for performance 3D graphics on business PCs has only recently begun to emerge and is dependent on the future development of, and substantial end-user and OEM demand for, 3D graphics functionality. As a result, the market for business PC 3D graphics computing may not continue to develop or may not grow at a rate sufficient to support our business. The development of the market for performance 3D graphics in business PCs will in turn depend on the development and availability of a large number of business PC software applications that support or

[Table of Contents](#)

take advantage of performance 3D graphics capabilities. Currently, there are only a limited number of software applications like this, most of which are games, and a broader base of software applications may not develop in the near term or at all. Consequently, a broad market for full function performance 3D graphics on business PCs may not develop. Our business prospects will suffer if the market for business PC 3D graphics fails to develop or develops more slowly than expected.

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

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

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

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

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

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

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

The price of our common stock has fluctuated greatly. These price fluctuations have been rapid and severe. The price of our common stock may continue to fluctuate greatly in the future due to factors that are non-company specific, such as the decline in the U.S. economy, or due to a variety of company specific factors, including quarter to quarter variations in our operating results, shortfalls in revenue or earnings from levels expected by securities analysts and the other factors discussed above in these risk factors. In the past, following periods of volatility in the market price of a company's stock, securities class action litigation has been initiated against the issuing company. Since February 2002, multiple securities class action lawsuits and several derivative suits have been filed against us. We expect that this litigation, whether or not resolved favorably, may result in substantial cost and a diversion of management's attention and resources, which could harm our revenues and earnings. Any adverse determination in this litigation could also subject us to significant liabilities. See "Legal Proceedings" and Note 11 of the Notes to Condensed Consolidated Financial Statements for a description of this litigation.

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

For additional information regarding risks associated with the market value of portfolio investments and interest rates, see Item 3 "Quantitative and Qualitative Disclosures About Market Risk—Interest Rate Risk."

Risks Related to Intellectual Property, Litigation and Government Action

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

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

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

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

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

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

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

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

ITEM 4. CONTROLS AND PROCEDURES

We have recently evaluated our internal controls. During the three month period ending July 28, 2002 there were no significant corrective actions taken by us or other changes made to these internal controls, nor do we believe there were changes in other factors that could significantly affect these controls subsequent to the date of our evaluation.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On February 19, 2002 an NVIDIA stockholder, Dominic Castaldo, on behalf of himself and purportedly on behalf of a class of our stockholders, filed an action in the United States District Court for the Northern District of California, or the Northern District, against NVIDIA and certain NVIDIA officers, alleging violations of the federal securities laws arising out of our announcement on February 14, 2002 of an internal investigation of certain accounting matters. As of July 28, 2002, approximately 13 similar actions, or the Federal Class Actions, were filed in the Northern District, one additional individual action was filed in the Southern District, along with three related derivative actions against us, certain of our executive officers, directors and our independent auditors, KPMG LLP, in California Superior Court and in Delaware Chancery Court, collectively the Actions. The two related derivative actions filed in California Superior Court have been consolidated. The Actions allege claims in connection with various alleged statements and omissions to the public and to the securities markets and seek damages together with interest and reimbursement of costs and expenses of the litigation. The derivative actions also seek disgorgement of alleged profits from insider trading by officers and directors. The Actions are in the preliminary stages. The Federal Class Actions have been consolidated and lead plaintiffs appointed. The consolidated amended complaint should be filed by September 10, 2002. We are obligated to indemnify our officers and directors, to the extent permitted by the law, in connection with the Actions and have insurance for such individuals, to the extent of the limits of the applicable insurance policies and subject to potential reservations of rights. We intend to vigorously defend these Actions. We are unable, however, to predict the ultimate outcome of the Actions. There can be no assurance we will be successful in defending the Actions and if we are unsuccessful we may be subject to significant damages. Even if we are successful, defending the Actions is likely to be expensive and may divert management's attention from other business concerns and harm our business.

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

We are engaged with Microsoft in discussions related to pricing and volumes of the Xbox chipset. These discussions and our agreement contemplated use of a third party to resolve matters and on April 23, 2002 Microsoft submitted the matter to binding arbitration. Microsoft requested that the arbitration panel require that we supply chipsets in whatever quantities are ordered by Microsoft. The arbitration panel has issued an interim ruling that we must supply Microsoft's reasonable requirements of chipsets, but no minimum or maximum amount has been set overall or for any particular period. Microsoft has also asked for damages for alleged violations of the agreement and requested that the arbitration panel reduce chipset prices paid by Microsoft. We have also requested pricing relief regarding our chipsets and asserted claims for damages. The arbitration panel will consider all these claims during the arbitration. For sales of the Xbox processors, we have deferred revenue in an amount equal to the difference between the price being paid by Microsoft and the price Microsoft claims it should be paying. We expect that we will continue to defer revenue related to the disputed pricing and volume discount for future sales of these processors until final resolution of the matter. This amount was approximately \$46.2 million as of July 28, 2002. The arbitration is being conducted in New York by a panel under the rules of the American Arbitration Association. We expect to conclude the arbitration before June 30, 2003.

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

[Table of Contents](#)

material adverse impact on our business. Even if we do prevail, there can be no assurance that our business will not be materially harmed.

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

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

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

At the Annual Meeting of Stockholders held on July 11, 2002, the following proposals were adopted by the margin indicated. Proxies for the Annual Meeting were solicited pursuant section 14(a) of the Securities Exchange Act of 1934, as amended, and there was no solicitation in opposition of managements' solicitation.

- (a) To elect two directors, Harvey C. Jones and William J. Miller, to hold office until the 2005 Annual Meeting of Stockholders.

<u>Nominee</u>	<u>For</u>	<u>Withheld</u>
Harvey C. Jones	134,957,180	805,809
William J. Miller	134,082,932	1,680,057

- (b) To approve an amendment to our Amended and Restated Certificate of Incorporation to increase the authorized number of shares of Common Stock from 500,000,000 to 1,000,000,000.

For	108,169,702
Against	27,132,337
Abstain	460,950

- (c) To ratify the selection of KPMG LLP as our independent accountants for our fiscal year ended January 26, 2003.

For	132,687,367
Against	2,625,068
Abstain	450,554

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) *Exhibits*

- | | |
|------|---|
| 3.4 | Certificate of Amendment of Amended and Restated Certificate of Incorporation. |
| 99.1 | Certification of Chief Executive Officer pursuant to Section 906 of the Public Company Accounting Reform and Investor Protection Act of 2002. |
| 99.2 | Certification of Chief Financial Officer pursuant to Section 906 of the Public Company Accounting Reform and Investor Protection Act of 2002. |

(b) *Reports on Form 8-K*

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

SIGNATURE

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on September 10, 2002.

NVIDIA CORPORATION

By: /s/ MARV BURKETT

Marv Burkett
Chief Financial Officer
(Principal Financial and Accounting Officer)

CERTIFICATIONS

I, Jen-Hsun Huang, certify that:

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

Date: September 10, 2002

/s/ JEN-HSUN HUANG

Jen-Hsun Huang
President and Chief Executive Officer

[Table of Contents](#)

I, Marv Burkett, certify that:

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

Date: September 10, 2002

/s/ MARVBURKETT

Marv Burkett
Chief Financial Officer