MARVELL TECHNOLOGY GROUP LTD
Form 10-Q
September 06, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended July 28, 2007

or

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

For the transition period from to

Commission file number: 0-30877

Marvell Technology Group Ltd.

(Exact name of registrant as specified in its charter)

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

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

(441) 296-6395

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

Registrant s telephone number, including area code)

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

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

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

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

The number of shares outstanding of the registrant s common stock outstanding as of August 25, 2007 was 590,473,023 shares.

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PART I: FINANCIAL INFORMATION

Item 1. ***Financial Statements***

MARVELL TECHNOLOGY GROUP LTD.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	July 28, 2007	January 27, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 404,179	$ 568,008
Short-term investments	92,269	28,372
Accounts receivable, net	358,312	328,283
Inventories	295,292	247,403
Prepaid expenses and other current assets	154,576	170,123
Deferred income taxes	6,049	5,846
Total current assets	1,310,677	1,348,035
Property and equipment, net	426,177	440,943
Goodwill	1,981,517	1,977,805
Acquired intangible assets	507,133	580,558
Other non-current assets	154,998	180,359
Total assets	$ 4,380,502	$ 4,527,700
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 261,208	$ 240,497
Accrued liabilities	128,462	268,849
Accrued employee compensation	110,104	108,895
Income taxes payable	21,138	29,078
Deferred income	54,777	46,459
Current portion of capital lease obligations	4,471	17,408
Total current liabilities	580,160	711,186
Capital lease obligations, net of current portion	9,104	17,096
Non-current income taxes payable	128,645	116,777
Term loan obligations, long-term portion	392,750	394,750
Other long-term liabilities	42,345	60,707
Total liabilities	1,153,004	1,300,516
Commitments and contingencies (Note 6)		
Shareholders equity:		
Common stock	1,176	1,175
Additional paid-in capital	3,911,782	3,802,509
Accumulated other comprehensive income	352	28
Accumulated deficit	(685,812)	(576,528)
Total shareholders equity	3,227,498	3,227,184
Total liabilities and shareholders equity	$ 4,380,502	$ 4,527,700

See accompanying notes to unaudited condensed consolidated financial statements.

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MARVELL TECHNOLOGY GROUP LTD.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	July 28, 2007	July 29, 2006	July 28, 2007	July 29, 2006
Net revenue	$ 656,711	$ 573,985	$ 1,291,761	$ 1,095,181
Operating costs and expenses:				
Cost of goods sold	335,530	279,075	662,947	519,308
Research and development and other	236,194	152,645	470,327	281,873
Selling and marketing	53,942	39,267	104,334	78,129
General and administrative	33,775	19,689	57,763	38,247
Amortization of acquired intangible assets	37,293	27,405	74,613	44,756
Total operating costs and expenses	696,734	518,081	1,369,984	962,313
Operating (loss) income	(40,023)	55,904	(78,223)	132,868
Interest and other income (expense)	3,128	1,714	4,447	9,929
Interest expense	(9,942)	(623)	(19,917)	(1,222)
(Loss) income before income taxes	(46,837)	56,995	(93,693)	141,575
Provision for income taxes	9,619	12,114	15,591	27,977
(Loss) income before change in accounting principle	(56,456)	44,881	(109,284)	113,598
Cumulative effect of change in accounting principle, net of tax effect				8,846
Net (loss) income	$ (56,456)	$ 44,881	$ (109,284)	$ 122,444
Basic (loss) income per share:				
(Loss) income before change in accounting principle	$ (0.10)	$ 0.08	$ (0.19)	$ 0.19
Cumulative effect of change in accounting principle, net of tax effect				0.02
Basic net (loss) income per share	$ (0.10)	$ 0.08	$ (0.19)	$ 0.21
Shares used in basic per share computation	587,534	586,133	587,480	584,918
Diluted (loss) income per share:				
(Loss) income before change in accounting principle	$ (0.10)	$ 0.07	$ (0.19)	$ 0.18
Cumulative effect of change in accounting principle, net of tax effect				0.01
Diluted net (loss) income per share	$ (0.10)	$ 0.07	$ (0.19)	$ 0.19
Shares used in diluted per share computation	587,534	633,533	587,480	636,524

See accompanying notes to unaudited condensed consolidated financial statements.

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MARVELL TECHNOLOGY GROUP LTD.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Six Months Ended July 28, 2007	July 29, 2006
Cash flows from operating activities:		
Net (loss) income	$ (109,284)	$ 122,444
Adjustments to reconcile net (loss) income to net cash (used in) provided by operating activities:		
Cumulative effect of change in accounting principle, net		(8,846)
Depreciation and amortization	52,420	32,558
Stock-based compensation	105,664	104,366
Amortization of acquired intangible assets	74,613	44,756
Gain from sale of asset under construction	(5,122)	
Fair market value adjustment to cost of goods sold from supply contract	(77,641)	
Interest expense related to supply contract	3,023	
Excess tax benefits from stock-based compensation	(235)	(860)
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	(28,702)	(97,616)
Inventories	(88,748)	7,082
Prepaid expenses and other asset	53,992	(28,484)
Accounts payable	22,334	15,521
Accrued liabilities and other	(26,199)	5,113
Accrued employee compensation	855	(6,127)
Income taxes payable	3,928	25,380
Deferred income	8,318	(278)
Net cash (used in) provided by operating activities	(10,784)	215,009
Cash flows from investing activities:		
Cash paid in acquisitions, net	(7,141)	(282,978)
Purchases of short-term investments	(113,651)	(141,418)
Sales and maturities of short-term investments	50,021	265,160
Acquisition costs	(1,138)	(3,480)
Purchases of property and equipment	(64,513)	(71,472)
Proceeds from sale of asset under construction	5,122	
Purchases of technology licenses	(16,850)	(6,600)
Net cash used in investing activities	(148,150)	(240,788)
Cash flows from financing activities:		
Proceeds from the issuance of common stock and other	2,681	33,860
Principal payments on capital lease and debt obligations	(7,811)	(9,057)
Excess tax benefits from stock-based compensation	235	860
Net cash (used in) provided by financing activities	(4,895)	25,663
Net decrease in cash and cash equivalents	(163,829)	(116)
Cash and cash equivalents at beginning of period	568,008	348,431
Cash and cash equivalents at end of period	$ 404,179	$ 348,315
Supplemental cash flow information:		
Utilization of supply agreement liability	$ 75,938	$

See accompanying notes to unaudited condensed consolidated financial statements.

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MARVELL TECHNOLOGY GROUP LTD.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and its Significant Accounting Policies

The Company

Marvell Technology Group Ltd. (the Company), a Bermuda company, is a leading global semiconductor provider of high-performance analog, mixed-signal, digital signal processing and embedded microprocessor integrated circuits. The Company s diverse product portfolio includes switching, transceivers, wireless, PC connectivity, gateways, communications controllers, storage and power management solutions that serve diverse applications used in business enterprise, consumer electronics and emerging markets.

Basis of presentation

The Company s fiscal year is the 52- or 53-week period ending on the Saturday closest to January 31. In a 52-week year, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal year 2008 is comprised of a 53-week period and fiscal year 2007 is comprised of a 52-week period.

On February 21, 2006, the Board of Directors approved a 2 for 1 share split of the Company s common shares, to be effected pursuant to the issuance of additional shares as a share dividend. The share split was subject to shareholder approval of an increase in the Company s authorized share capital at the Company s 2006 Annual General Meeting. On June 9, 2006, shareholders at the Company s 2006 Annual General Meeting approved an increase in the authorized share capital by 500.0 million common shares. Share certificates representing one additional share for each share held were delivered on July 24, 2006 (payment date) to all shareholders of record at the close of business on July 10, 2006 (record date). All share and per share amounts in these consolidated financial statements and related notes have been retroactively adjusted to reflect the share split for all periods presented.

The unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. In the opinion of management, all adjustments consisting of normal and recurring entries considered necessary for a fair statement of the results for the interim periods have been included in the Company s financial position as of July 28, 2007, the results of its operations for the three and six months ended July 28, 2007 and July 29, 2006, and its cash flows for the six months ended July 28, 2007 and July 29, 2006. The January 27, 2007 condensed consolidated balance sheet data was derived from audited consolidated financial statements included in the Company s 2007 Annual Report on Form 10-K but does not include all disclosures required by GAAP.

These condensed consolidated financial statements and related notes are unaudited and should be read in conjunction with the Company s audited financial statements and related notes for the year ended January 27, 2007 included in the Company s Annual Report on Form 10-K, as filed on July 2, 2007 with the Securities and Exchange Commission (SEC). The results of operations for the three and six months ended July 28, 2007 are not necessarily indicative of the results that may be expected for any other interim period or for the full fiscal year.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including property and equipment, investment fair values, goodwill and other intangible assets, income taxes, and contingencies. In addition, the Company uses assumptions when employing the Black-Scholes option valuation model to calculate the fair value of stock-based awards granted. The Company bases its estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, when these carrying values are not readily available from other sources. Actual results could differ from these estimates.

Principles of consolidation

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

Cash and cash equivalents

The Company considers all highly liquid investments with a maturity of three months or less from the date of purchase to be cash equivalents. Cash and cash equivalents also consist of cash on deposit with banks, money market funds and commercial deposits.

Investments

The Company s marketable investments are classified as available-for-sale securities and are reported at fair value. Unrealized gains and losses are reported, net of tax, if any, in accumulated other comprehensive income, a component of shareholders equity. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in interest and other income, net.

The Company also has equity investments in privately-held companies. These investments are recorded at cost and are included in other non-current assets.

Concentration of credit risk

Financial instruments that potentially subject the Company to significant concentration of credit risk consist principally of cash equivalents, short-term investments and accounts receivable. The Company places its cash primarily in checking and money market accounts. Cash equivalents and short-term investment balances are maintained with high quality financial institutions, the composition and maturities of which are regularly monitored by management. The Company believes that the concentration of credit risk in its trade receivables with respect to its served markets, as well as the limited customer base, located primarily in the Far East, are substantially mitigated by the Company s credit evaluation process, relatively short collection terms and the high level of credit worthiness of its customers. The Company performs ongoing credit evaluation of its customers financial condition and limits the amount of credit extended when deemed necessary based upon payment history and the customer s current credit worthiness, but generally require no collateral. The Company regularly reviews the allowance of bad debt and doubtful accounts by considering factors such as historical experience, credit quality, age of the account receivable balances and current economic conditions that may affect a customer s ability to pay.

Inventories

Inventories are stated at the lower of cost or market, cost being determined under the first-in, first-out method. Appropriate consideration is given to obsolescence, excessive levels, deterioration and other factors in evaluating net realizable value.

Property and equipment, net

Property and equipment, including capital leases and leasehold improvements, are stated at cost less accumulated depreciation and amortization. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, which ranges from three to five years. Buildings are depreciated over an estimated useful life of thirty years and building improvements are depreciated over estimated useful lives of fifteen years. Land is not depreciated. Assets held under capital leases and leasehold improvements are amortized over the shorter of term of lease or their estimated useful lives.

Goodwill and acquired intangible assets

Goodwill is recorded when the consideration paid for an acquisition exceeds the fair value of net tangible and intangible assets acquired. Acquisition-related identified intangible assets are amortized on a straight-line basis over their estimated economic lives of one to seven years for purchased technology, one to eight years for core technology and four to seven years for customer contracts.

Goodwill is measured and tested for impairment on an annual basis or more frequently if the Company believes indicators of impairment exist. The performance of the test involves a two-step process. The first step requires comparing the fair value of the reporting unit to its net book value, including goodwill. The Company has one reporting unit. The fair value of the reporting unit is determined by taking the market capitalization of the reporting unit as determined through quoted market prices. A potential impairment exists if the fair value of the reporting unit is lower than its net book value. The second step of the process is only performed if a potential impairment exists, and it involves determining the difference between the fair value of the reporting unit s net assets other than goodwill to the fair value of the reporting unit and if the difference is less than the net book value of goodwill, an impairment exists and is recorded. In the event that the Company determines that the value of goodwill has become impaired, the Company will record an accounting charge for the amount of impairment during the fiscal quarter in which the determination is made. The Company has not been required to perform this second step of the process since its implementation of SFAS 142 because the fair value of the reporting unit has exceeded its net book value at every measurement date.

Impairment of long-lived assets

Long-lived assets include equipment, furniture and fixtures, privately held equity investments and intangible assets. Whenever events or changes in circumstances indicate that the carrying amount of long-lived assets may not be recoverable, the Company estimate the future cash flows, undiscounted and without interest charges, expected to result from the use of those assets and their eventual cash position. If the sum of the expected future cash flows is less than the carrying amount of those assets, the Company recognizes an impairment loss based on the excess of the carrying amount over the fair value of the assets.

Reclassifications

Certain reclassifications have been made to the Balance Sheet for the prior period balances in order to conform to the current period s presentation.

Revenue recognition

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

Product revenue is generally recognized upon shipment of product to customers, net of accruals for estimated sales returns and allowances. However, some of the Company s sales are made through distributors under agreements allowing for price protection and rights of return on product unsold by the distributors. Product revenue on sales made through distributors with rights of return and price protection is deferred until the distributors sell the product to end customers. The Company s sales to direct customers are made primarily pursuant to standard purchase orders for delivery of products. The Company generally allows customers to cancel or change purchase orders with limited notice prior to the scheduled shipment dates and from time to time it also may request a customer to accept a shipment of product before its original requested delivery date, in which case, revenue is not recognized until there is written confirmation from the customer accepting early shipment, delivery has occurred, the fee is fixed or determinable, and collection is reasonably assured. Additionally, collection is not deemed to be reasonably assured if customers receive extended payment terms. As a result, revenue on sales to customers with payment terms substantially greater than the Company s normal payment terms is deferred and is recognized as revenue as the payments become due. Deferred revenue less the related cost of the inventories is reported as deferred income.

The provision for estimated sales returns and allowances on product sales is recorded in the same period the related revenues are recorded. These estimates are based on historical sales returns, analysis of credit memo data and other known factors. Actual returns could differ from these estimates.

The Company also enters into development agreements with some of its customers. Under these development agreements product revenue is recognized under the proportionate performance method. Revenue is recognized as related costs to complete the contract are incurred. These costs are included in research and development expense.

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

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

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

The Company accounts for rebates in accordance with EITF Issue No. 01-9, Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products), and, accordingly, records reductions to revenue for rebates in the same period that the related revenue is recorded. The amount of these reductions is based upon the terms included in the Company s various rebate agreements.

Research and development and other

Research and development and other costs consist primarily of $236.2 million and $152.6 million of research and development costs for the three months periods ended July 28, 2007 and July 29, 2006, respectively, and included $4.1 million and $2.7 million of costs related to patent investigation and filings for the three month periods ended July 28, 2007 and July 29, 2006, respectively.

Research and development and other costs consist primarily of $470.3 million and $281.9 million of research and development costs for the six months periods ended July 28, 2007 and July 29, 2006, respectively, and included $7.1 million and $5.1 million of costs related to patent investigation and filings for the six month periods ended July 28, 2007 and July 29, 2006, respectively. Research and development and other costs are expensed as incurred.

Stock-based compensation

The Company has share-based payment awards to its employees and directors that are fully described in Notes 7 and 8. The stock-based compensation expenses are recorded in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123 (revised 2004), Share Based Payment (SFAS 123R).

Accounting for income taxes

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes (SFAS No. 109). Under this method, the Company determines deferred tax assets and liabilities based upon the difference between the income tax bases of assets and liabilities and their respective financial reporting amounts at enacted tax rates in effect for the periods in which the differences are expected to reverse. The tax consequences of most events recognized in the current year s financial statements are included in determining income taxes currently payable. However, because tax laws and financial accounting standards differ in their recognition and measurement of assets, liabilities, equity, revenues, expenses, gains and losses, differences arise between the amount of taxable income and pretax financial income for a year and between the tax bases of assets or liabilities and their reported amounts in the financial statements. Because it is assumed that the reported amounts of assets and liabilities will be recovered and settled, respectively, a difference between the tax basis of an asset or a liability and its reported amount in the balance sheet will result in a taxable or a deductible amount in some future years when the related liabilities are settled or the reported amounts of assets are recovered, hence giving rise to a deferred tax liability or asset, respectively. The Company then assesses the likelihood that its deferred tax assets will be recovered from future taxable income and to the extent the Company believes that recovery is not likely, the Company establish a valuation allowance. The Company accounts for uncertain tax positions in accordance with FASB Interpretation No. 48 Accounting for Uncertainty in Tax Positions (FIN 48). The Company classifies accrued interest and penalties as part of the accrued FIN No. 48 liability and records the expense within the provision for income taxes.

The application of income tax law is inherently complex. Laws and regulations in this area are voluminous and are often ambiguous. As such, the Company is required to make many subjective assumptions and judgments regarding its income tax exposures. Interpretations of and guidance surrounding income tax laws and regulations are subject to change over time. As such, changes in its subjective assumptions and judgments can materially affect amounts recognized in the consolidated balance sheets and statements of income. See Note 9 - Income Taxes of the consolidated financial statements for additional detail on the Company s uncertain tax positions.

Warranty

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

Note 2. Recent Accounting Pronouncements

In June 2006, the FASB ratified EITF consensus on EITF Issue No. 06-2, Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43 (EITF 06-2). EITF 06-2 requires companies to accrue the cost of such compensated absences over the require service period. The Company currently accrues the cost of compensated absences for sabbatical programs when the eligible employee complete the requisite service period. The Company is required to apply the provision of EITF 06-2 at the beginning of fiscal 2008. EITF 06-02 allows for adoption through retrospective application to all prior periods or through a cumulative effect adjustment to retained earnings if it is impracticable to determine the period specific effects of the change on prior periods presented. The Company adopted EITF 06-2 in the first quarter of fiscal 2008. The adoption did not have a material impact on the Company s financial position and results of operations.

In July 2006, the FASB issued FIN 48, which clarifies the accounting for uncertainty in income tax positions. This Interpretation requires that the Company recognize in its financial statements the impact of a tax position if that position is more likely than not of being sustained on audit, based on the technical merits of the position. The provisions of FIN 48 are effective as of the beginning of the Company s fiscal 2008, with the cumulative effect, if any, of the change in accounting principle recorded as an adjustment to opening retained earnings. On May 2, 2007, the FASB issued FASB Staff Position No. FIN 48-1 Definition of Settlement in FASB Interpretation No. 48-1 (FSP FIN 48-1). FSP FIN 48-1 provides guidance on how an entity should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. Effective January 28, 2007, the Company adopted FIN 48. See Note 9 Income Taxes for further details.

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

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115 which is effective for fiscal years beginning after November 15, 2007. This statement expands the standards under SFAS No. 157 which permits an entity to choose to measure many financial instruments and certain other items at fair value at specified election dates. Subsequent unrealized gains and losses on items for which the fair value option has been elected will be reported in earnings. The Company is currently evaluating the potential impact of this statement.

Note 3. Supplemental Financial Information

Available-for-sale investments (in thousands)

	July 28, 2007			
		Gross	Gross	
	Amortized	Unrealized	Unrealized	Estimated
	Cost	Gains	Losses	Fair Value
Corporate debt securities	$ 3,535	$	$ (23)	$ 3,512
Auction rate securities	68,709			68,709
U.S. Federal, State, county and municipal debt securities	20,265		(217)	20,048
Short-term investments	$ 92,509	$	$ (240)	$ 92,269

	January 27, 2007			
		Gross	Gross	
	Amortized	Unrealized	Unrealized	Estimated
	Cost	Gains	Losses	Fair Value

Corporate debt securities	$ 3,547	$		$ (56)	$ 3,491	
U.S. Federal, State, county and municipal debt securities	25,300			(419)	24,881	
Short-term investments	$ 28,847	$		$ (475)	$ 28,372	

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

The contractual maturities of available-for-sale debt securities classified as short-term investments at July 28, 2007 are presented in the following table (in thousands):

	July 28, 2007 Amortized Cost	Estimated Fair Value	January 28, 2007 Amortized Cost	Estimated Fair Value
Due in one year or less	$ 18,715	$ 18,542	$ 8,581	$ 8,499
Due between one and five years	5,085	5,018	20,266	19,873
Due over five years	68,709	68,709		
	$ 92,509	$ 92,269	$ 28,847	$ 28,372

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

	July 28, 2007					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate debt securities	$	$	$ 3,512	$ (23)	$ 3,512	$ (23)
U.S. Federal, State, county and municipal debt securities			20,048	(217)	20,048	(217)
Total temporarily impaired securities	$	$	$ 23,560	$ (240)	$ 23,560	$ (240)

	January 27, 2007					
	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Corporate debt securities	$	$	$ 3,491	$ (56)	$ 3,491	$ (56)
U.S. Federal, State, county and municipal debt securities			24,881	(419)	24,881	(419)
Total temporarily impaired securities	$	$	$ 28,372	$ (475)	$ 28,372	$ (475)

Inventories (in thousands)

	July 28, 2007	January 27, 2007
Work-in-process	$ 177,786	$ 97,529
Finished goods	117,506	149,874
	$ 295,292	$ 247,403

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Prepaid expenses and other current assets (in thousands)

	July 28, 2007	January 27, 2007
Prepayments for foundry capacity	$ 27,500	$ 40,340
Prepayments for wafers (see Note 6)	49,613	$ 29,973
Receivable from foundry	18,007	19,336
Other	59,456	80,474
	$ 154,576	$ 170,123

Property and equipment (in thousands)

	July 28, 2007	January 27, 2007
Property and equipment:		
Machinery and equipment	$ 308,671	$ 269,586
Computer software	101,417	131,869
Furniture and fixtures	21,596	20,551
Leasehold improvements	32,550	12,283
Buildings	97,720	81,274
Building improvements	29,257	36,098
Land	51,500	51,500
Construction in progress	51,479	78,579
	694,190	681,740
Less: Accumulated depreciation and amortization	(268,013)	(240,797)
	$ 426,177	$ 440,943

Other non-current assets (in thousands)

	July 28, 2007	January 27, 2007
Long-term prepayments for foundry capacity	$ 34,000	$ 46,000
Equity investments in private companies	6,734	11,679
Severance fund	39,131	32,161
Technology licenses	23,128	26,680
Deferred tax assets, non-current	17,950	18,332
Other	34,055	45,507
	$ 154,998	$ 180,359

Accrued liabilities (in thousands)

	July 28, 2007	January 27, 2007
Supply agreement liability (see below)	$ 58,542	$ 174,724
Term loan obligations, current portion	4,000	4,000
Accrued royalties	5,981	7,791
Accrued rebates	17,979	8,877
Accrued legal and professional services	9,158	16,382
Other	32,802	57,075
	$ 128,462	$ 268,849

The following table presents the changes in the supply agreement liability during the three and six months ended July 28, 2007 (in thousands):

	Three Months Ended July 28, 2007	Six Months Ended July 28, 2007
Supply agreement liability (included in accrued liabilities):		
Beginning balance	$ 134,462	$ 174,724
Credit to cost of goods sold	(43,885)	(77,641)
Inventory write-down to fair market value	(33,498)	(41,564)
Interest expense	1,463	3,023
Ending balance	$ 58,542	$ 58,542

Other long-term liabilities (in thousands)

	July 28, 2007	January 27, 2007
Accrued severance	$ 38,965	$ 34,326
Long-term facilities consolidation charge	1,652	2,447
Other	1,728	23,934
	$ 42,345	$ 60,707

Net (loss) income per share

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

	Three Months Ended		Six Months Ended	
	July 28, 2007	July 29, 2006	July 28, 2007	July 29, 2006
Numerator:				
(Loss) income before change in accounting principle	$ (56,456)	$ 44,881	$ (109,284)	$ 113,598
Net (loss) income	$ (56,456)	$ 44,881	$ (109,284)	$ 122,444
Denominator:				
Weighted average shares of common stock outstanding	587,534	586,133	587,480	584,918
Weighted average shares basic	587,534	586,133	587,480	584,918
Effect of dilutive securities-				
Warrants		1,695		1,741
Contingently issuable shares				
Common stock options and other		45,705		49,865
Weighted average shares diluted	587,534	633,533	587,480	636,524
(Loss) income before change in accounting principle				
Basic	$ (0.10)	$ 0.08	$ (0.19)	$ 0.19
Diluted	$ (0.10)	$ 0.07	$ (0.19)	$ 0.18
Net (loss) income per share				
Basic	$ (0.10)	$ 0.08	$ (0.19)	$ 0.21
Diluted	$ (0.10)	$ 0.07	$ (0.19)	$ 0.19

The anti-dilutive effects of warrants, common stock options, restricted stock and other securities totaling 41,056,440 shares were excluded from diluted net loss per share for the three months ended July 28, 2007. Options to purchase 34,197,280 common shares at a weighted average exercise price of $24.77 have been excluded from the computation of diluted net income per share for the three months ended July 29, 2006 using the treasury stock method calculation.

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The anti-dilutive effects of warrants, common stock options, restricted stock and other securities totaling 42,493,261 were excluded from diluted net loss per share for the six months ended July 28, 2007. Options to purchase 26,643,184 common shares at a weighted average exercise price of $24.58 have been excluded from the computation of diluted net income per share for the six months ended July 29, 2006 using the treasury stock method calculation.

Comprehensive (loss) income (in thousands)

	Three Months Ended		Six Months Ended	
	July 28, 2007	July 29, 2006	July 28, 2007	July 29, 2006
Net (loss) income	$ (56,456)	$ 44,881	$ (109,284)	$ 122,444
Other comprehensive (loss) income:				
Unrealized gain on available-for-sale investments and other, net of tax	129	94	324	500
Total comprehensive (loss) income	$ (56,327)	$ 44,975	$ (108,960)	$ 122,944

Accumulated other comprehensive (loss) income, as presented on the accompanying condensed consolidated balance sheets, consists of the unrealized gains and losses on available-for-sale investments and other, net of tax.

Note 4. Business Combinations

The Company acquired the semiconductor division of UTStarcom, Inc (UTStarcom Business), the printer semiconductor division of Avago Technologies Limited (Avago Business), Intel s communications and applications business (ICAP Business) and assets of two other businesses from unrelated parties during fiscal 2007. During the second quarter of fiscal 2008, the Company acquired an unrelated private company that designs and develops software for optical storage applications.

UTStarcom Business

The Company acquired the UTStarcom Business on February 16, 2006. The UTStarcom Business focused on the design and development of personal handyphone systems and next generation cellular communications technology. The primary reasons for the acquisition of the semiconductor division of UTStarcom were to strengthen and augment the Company s software engineering workforce and enhance its technological capabilities for emerging cellular strategies, obtain an established product being utilized in wireless communications technology, reduce the time required to develop new products and bring them to market for next generation cellular technology and to complement the Company s existing wireless offerings. These factors contributed to a purchase price that was in excess of the fair value of the UTStarcom Business net tangible and intangible assets acquired. The Company recorded goodwill, which is not deductible for tax purposes, in connection with this transaction.

Under the terms of the agreement, the Company paid $24.0 million in cash and an additional $16.0 million based on the achievement of certain defined milestones. The purchase price of the acquisition was $40.8 million, including the contingent consideration recognized of $16.0 million, and was determined as follows (in thousands):

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

In the third quarter of fiscal 2007, the Company recorded additional purchase consideration of $16.0 million upon the achievement of the contingent milestones as defined in the purchase agreement. Approximately $8.7 million was preliminarily allocated as negative goodwill, calculated as the excess of the fair value of net tangible and intangible assets acquired over the purchase price. As a result of the contingent consideration, additional goodwill of $7.3 million was recorded.

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

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

The amortizable intangible assets of $30.8 million were determined based on valuation techniques such as discounted cash flows and weighted average cost of capital methods used in the high technology industry using assumptions and estimates from management. The amortizable intangible assets will be amortized over useful lives ranging from three to four years. The existing technology represents personal handyphone systems technology and other technology that UTStarcom has developed. Core technology represents the combination of processes, patents, and trade secrets that are the building blocks for current and planned new products. Customer relationships represent future projected revenue that will be derived from sales of future versions of existing products that will be sold to existing customers. The value determined for the supply contract with UTStarcom represents the fair value of estimated revenues and net operating cash flows to be derived from the supply contract for the duration of the four-year contract.

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

Avago Business

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

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

Cash	$ 259,591
Transaction costs	3,388
Total purchase price	$ 262,979

In the third quarter of fiscal 2007, the Company recorded additional purchase consideration with a corresponding increase in goodwill of $10.0 million based on the achievement of certain levels of revenue of the past year. The remaining contingent consideration of up to $25.0 million is still outstanding and may result in the recognition of additional purchase consideration in the future. The remaining contingent consideration is based on the achievement of a certain level of revenue over a one year period ending October 2007. Additionally, in the third quarter of fiscal 2007, the Company recorded an adjustment of $1.9 million relating to inventory acquired at the acquisition date, resulting in a corresponding reduction in goodwill. In the first quarter of fiscal 2008, the Company recorded an adjustment of $1.3 million relating to a reduction of an accrued liability recorded in the original purchase accounting resulting in a corresponding decrease in goodwill.

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

Accounts receivable	$ 1,871
Current assets	3,704
Deferred tax asset	2,183
Inventories	23,896
Fixed assets	14,305
Other current assets	2,750
Accrued liabilities	(11,940)
Accrued employee benefits	(3,998)
	32,771
Amortizable intangible assets:	
Existing technology	55,800
Core technology	