

NVIDIA CORP  
Form 10-Q  
November 21, 2007

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

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**FORM 10-Q**

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

**For the quarterly period ended October 28, 2007**

**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, and telephone number,  
including area code, of principal executive offices)**

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

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

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

The number of shares of common stock, \$.001 par value, outstanding as of November 14, 2007 was 555,571,452.

**NVIDIA CORPORATION  
FORM 10-Q  
FOR THE QUARTER ENDED OCTOBER 28, 2007**

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**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)**

**NVIDIA CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**(UNAUDITED)**

(In thousands, except per share data)

|  | <b>Three Months Ended</b> |                | <b>Nine Months Ended</b> |                |
|--|---------------------------|----------------|--------------------------|----------------|
|  | <b>October</b>            | <b>October</b> | <b>October</b>           | <b>October</b> |
|  | <b>28,</b>                | <b>29,</b>     | <b>28,</b>               | <b>29,</b>     |
|  | <b>2007</b>               | <b>2006</b>    | <b>2007</b>              | <b>2006</b>    |
| Revenue  | \$ 1,115,597              | \$ 820,572     | \$ 2,895,130             | \$ 2,189,898   |
| Cost of revenue  | 600,044                   | 486,630        | 1,575,447                | 1,275,155      |
| Gross profit   | 515,553                   | 333,942        | 1,319,683                | 914,743        |
| Operating expenses:  |                           |                |                          |                |
| Research and development                                     | 179,529                   | 140,732        | 495,802                  | 391,191        |
| Sales, general and administrative                            | 88,183                    | 75,597         | 250,034                  | 208,614        |
| Total operating expenses                                     | 267,712                   | 216,329        | 745,836                  | 599,805        |
| Operating income   | 247,841                   | 117,613        | 573,847                  | 314,938        |
| Interest income  | 17,416                    | 10,652         | 46,250                   | 28,278         |
| Interest expense   | —                         | (22)           | —                        | (29)           |
| Other income (expense), net                                  | 1,542                     | 84             | 1,342                    | (266)          |
| Income before income tax expense                             | 266,799                   | 128,327        | 621,439                  | 342,921        |
| Income tax expense   | 31,138                    | 21,816         | 80,787                   | 58,297         |
| Income before change in accounting principle                 | 235,661                   | 106,511        | 540,652                  | 284,624        |
| Cumulative effect of change in accounting principle          | —                         | —              | —                        | 704            |
| Net income   | \$ 235,661                | \$ 106,511     | \$ 540,652               | \$ 285,328     |
| Basic net income per share:                                  |                           |                |                          |                |
| Prior to cumulative effect of change in accounting principle | \$ 0.42                   | \$ 0.20        | \$ 0.99                  | \$ 0.55        |
| Cumulative effect of change in accounting principle          | —                         | —              | —                        | —              |
| Basic net income per share                                   | \$ 0.42                   | \$ 0.20        | \$ 0.99                  | \$ 0.55        |
| Shares used in basic per share computation                   | 554,966                   | 528,986        | 547,796                  | 514,112        |
| Diluted net income per share:                                |                           |                |                          |                |
| Prior to cumulative effect of change in accounting principle | \$ 0.38                   | \$ 0.18        | \$ 0.89                  | \$ 0.50        |
| Cumulative effect of change in accounting principle          | —                         | —              | —                        | —              |
| Diluted net income per share                                 | \$ 0.38                   | \$ 0.18        | \$ 0.89                  | \$ 0.50        |
| Shares used in diluted per share computation                 | 612,985                   | 586,733        | 605,733                  | 570,422        |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

|  | October<br>28,<br>2007 | January<br>28,<br>2007 |
|--|------------------------|------------------------|
| <b>ASSETS</b>                                |                        |                        |
| Current assets:                              |                        |                        |
| Cash and cash equivalents                    | \$ 1,056,702           | \$ 544,414             |
| Marketable securities                        | 796,251                | 573,436                |
| Accounts receivable, net                     | 552,407                | 518,680                |
| Inventories                                  | 306,143                | 354,680                |
| Prepaid expenses and other current assets    | 44,551                 | 40,560                 |
| Total current assets                         | 2,756,054              | 2,031,770              |
| Property and equipment, net                  | 322,946                | 260,828                |
| Goodwill                                     | 292,934                | 301,425                |
| Intangible assets, net                       | 78,173                 | 45,511                 |
| Deposits and other assets                    | 25,156                 | 35,729                 |
| Total assets                                 | \$ 3,475,263           | \$ 2,675,263           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                        |                        |
| Current liabilities:                         |                        |                        |
| Accounts payable                             | \$ 449,792             | \$ 272,075             |
| Accrued liabilities                          | 406,650                | 366,732                |
| Total current liabilities                    | 856,442                | 638,807                |
| Deferred tax and other long-term liabilities | 140,895                | 29,537                 |
| Commitments and contingencies - see Note 13  |                        |                        |
| Stockholders' equity:                        |                        |                        |
| Preferred stock                              | —                      | —                      |
| Common stock                                 | 615                    | 583                    |
| Additional paid-in capital                   | 1,598,291              | 1,295,455              |
| Treasury stock, at cost                      | (861,547)              | (487,120)              |
| Accumulated other comprehensive income, net  | 3,350                  | 1,436                  |
| Retained earnings                            | 1,737,217              | 1,196,565              |
| Total stockholders' equity                   | 2,477,926              | 2,006,919              |
| Total liabilities and stockholders' equity   | \$ 3,475,263           | \$ 2,675,263           |

See accompanying Notes to Condensed Consolidated Financial Statements.

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

|   | <b>Nine Months Ended</b> |                |
|---|--------------------------|----------------|
|   | <b>October</b>           | <b>October</b> |
|   | <b>28,</b>               | <b>29,</b>     |
|   | <b>2007</b>              | <b>2006</b>    |
| Cash flows from operating activities:   |                          |                |
| Net income  | \$ 540,652               | \$ 285,328     |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |                |
| Stock-based compensation  | 98,868                   | 83,244         |
| Depreciation and amortization   | 96,256                   | 73,270         |
| Deferred income taxes   | 67,279                   | 25,617         |
| Payments under patent licensing arrangement                                       | (49,634)                 | —              |
| Excess tax benefits from stock-based compensation                                 | —                        | (22,559)       |
| Cumulative effect of change in accounting principle                               | —                        | (704)          |
| In-process research and development   | —                        | 602            |
| Other   | 618                      | 262            |
| Changes in operating assets and liabilities net of acquisitions:                  |                          |                |
| Accounts receivable   | (32,943)                 | (112,335)      |
| Inventories   | 48,590                   | (112,540)      |
| Prepaid expenses and other current assets   | (4,327)                  | (10,502)       |
| Deposits and other assets   | 3,193                    | (13,670)       |
| Accounts payable  | 175,096                  | 82,573         |
| Accrued liabilities   | 74,077                   | 78,130         |
| Net cash provided by operating activities   | 1,017,725                | 356,716        |
| Cash flows from investing activities:   |                          |                |
| Purchases of marketable securities  | (739,706)                | (179,050)      |
| Sales and maturities of marketable securities                                     | 521,712                  | 146,745        |
| Purchases of property and equipment and intangible assets                         | (117,406)                | (69,564)       |
| Acquisition of businesses, net of cash and cash equivalents                       | —                        | (67,037)       |
| Investments in non-affiliates   | —                        | (8)            |
| Net cash used in investing activities   | (335,400)                | (168,914)      |
| Cash flows from financing activities:   |                          |                |
| Common stock issued under employee stock plans                                    | 204,390                  | 154,607        |
| Stock repurchase  | (374,427)                | (174,978)      |
| Excess tax benefits from stock-based compensation                                 | —                        | 22,559         |
| Net cash provided by (used in) financing activities                               | (170,037)                | 2,188          |
| Change in cash and cash equivalents   | 512,288                  | 189,990        |
| Cash and cash equivalents at beginning of period                                  | 544,414                  | 551,756        |
| Cash and cash equivalents at end of period  | \$ 1,056,702             | \$ 741,746     |
| Supplemental disclosures of cash flow information:                                |                          |                |
| Cash paid for income taxes, net   | \$ 4,299                 | \$ 27,226      |

Other non-cash activities:

|   |    |        |    |        |
|---|----|--------|----|--------|
| Unrealized gains from marketable securities     | \$ | 2,571  | \$ | 1,052  |
| Assets acquired by assuming related liabilities | \$ | 16,348 | \$ | 51,463 |
| Deferred compensation                           | \$ | —      | \$ | 3,604  |

See accompanying Notes to Condensed Consolidated Financial Statements

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

**Note 1 - Summary of Significant Accounting Policies**

*Basis of Presentation*

The accompanying unaudited condensed consolidated 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 statement of results of operations and financial position 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 our Annual Report on Form 10-K for the year ended January 28, 2007.

*Fiscal year*

We operate on a 52 or 53-week year, ending on the Sunday in January nearest January 31. Each quarter in fiscal years 2008 and 2007 was a 13-week quarter.

*Stock Split*

On August 9, 2007, we announced that our Board approved a three-for-two stock split of our outstanding shares of common stock on Monday, August 20, 2007 to be effected in the form of a stock dividend. The stock split was effective on Monday, September 10, 2007 and entitled each stockholder of record to receive one additional share for every two outstanding shares of common stock held and cash in lieu of fractional shares. All share and per-share numbers contained herein have been retroactively adjusted to reflect this stock split.

*Reclassifications*

Certain prior fiscal year balances have been reclassified to conform to the current fiscal year presentation.

*Principles of Consolidation*

Our condensed consolidated financial statements include the accounts of NVIDIA Corporation and its wholly owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, accounts receivable, inventories, income taxes, goodwill, stock-based compensation expense and contingencies. These estimates are based on historical facts and various other assumptions that we believe are reasonable.

*Revenue Recognition*

Product Revenue

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. For most 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 based on the shipping terms. 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 payment.



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

Our policy on sales to distributors, who have rights of return, is to defer recognition of revenue and related cost of revenue until the distributors resell the product.

We record estimated reductions to revenue for customer programs at the time revenue is recognized. Our customer programs primarily involve rebates, which are designed to serve as sales incentives to resellers of our products in various target markets. We account for rebates in accordance with Emerging Issues Task Force Issue 01-9, or EITF 01-09, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)* and, as such, we accrue for 100% of the potential rebates and do not apply a breakage factor. Rebates typically expire six months from the date of the original sale, unless we reasonably believe that the customer intends to claim the rebate. Unclaimed rebates are reversed to revenue upon expiration of the rebate.

Our customer programs also include marketing development funds, or MDFs. We account for MDFs as either a reduction of revenue or an operating expense in accordance with EITF 01-09. MDFs represent monies paid to retailers, system builders, original equipment manufacturers, or OEMs, distributors and add-in card partners that are earmarked for market segment development and expansion and typically are designed to support our partners' activities while also promoting NVIDIA products. Depending on market conditions, we may take actions to increase amounts offered under customer programs, possibly resulting in an incremental reduction of revenue at the time such programs are offered.

We also record a reduction to revenue by establishing a sales return allowance for estimated product returns at the time revenue is recognized, based primarily on historical return rates. However, if product returns for a particular fiscal period exceed historical return rates we may determine that additional sales return allowances are required to properly reflect our estimated exposure for product returns.

**License and Development Revenue**

For license arrangements that require significant customization of our intellectual property components, we generally recognize this license revenue using the percentage-of-completion method of accounting over the period that services are performed. For all license and service arrangements accounted for under the percentage-of-completion method, we determine progress to completion based on actual direct labor hours incurred to date as a percentage of the estimated total direct labor hours required to complete the project. We periodically evaluate the actual status of each project to ensure that the estimates to complete each contract remain accurate. A provision for estimated losses on contracts is made in the period in which the loss becomes probable and can be reasonably estimated. To date, we have not recorded any such losses. Costs incurred in advance of revenue recognized are recorded as deferred costs on uncompleted contracts. If the amount billed exceeds the amount of revenue recognized, the excess amount is recorded as deferred revenue. Revenue recognized in any period is dependent on our progress toward completion of projects in progress. Significant management judgment and discretion are used to estimate total direct labor hours. Any changes in or deviations from these estimates could have a material effect on the amount of revenue we recognize in any period.

*Recently Issued Accounting Pronouncements*

In September 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 157, or SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. The changes to current practice resulting from the application of SFAS No. 157 relate to the definition of fair value, the methods used to measure fair value,

and the expanded disclosures about fair value measurements. We are required to adopt the provisions of SFAS No. 157 beginning with our fiscal quarter ending April 27, 2008. We are currently evaluating the impact that SFAS No. 157 will have on our consolidated financial position, results of operations and cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, or SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. We are required to adopt the provisions of SFAS No. 159 beginning with our fiscal quarter ending April 27, 2008, although earlier adoption is permitted. We are currently evaluating the impact that SFAS No. 159 will have on our consolidated financial position, results of operations and cash flows.

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

In June 2007, the FASB ratified Emerging Issues Task Force Issue No. 07-3, or EITF 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities*. EITF 07-3 requires non-refundable advance payments for goods and services to be used in future research and development activities to be recorded as an asset and the payments to be expensed when the research and development activities are performed. We are required to adopt the provisions of EITF 07-3 beginning with our fiscal quarter ending April 27, 2008. The adoption of EITF 07-3 is not expected to have a significant impact on our consolidated financial position, results of operations and cash flows.

*Adoption of FASB Interpretation No. 48*

On January 29, 2007, we adopted FASB Interpretation No. 48, or FIN 48, *Accounting for Uncertainty in Income Taxes*, issued in July 2006. FIN 48 applies to all tax positions related to income taxes subject to FASB Statement of Financial Accounting Standards No. 109, or SFAS No. 109, *Accounting for Income Taxes*. Under FIN 48 we recognize the benefit from a tax position only if it is more-likely-than-not that the position would be sustained upon audit based solely on the technical merits of the tax position. The cumulative effect of adoption of FIN 48 did not result in a material adjustment to our tax liability for unrecognized income tax benefits. Our policy to include interest and penalties related to unrecognized tax benefits as a component of income tax expense did not change as a result of implementing the FIN 48. Please refer to Note 3 of these Notes to Condensed Consolidated Financial Statements for additional information.

**Note 2 - Stock-Based Compensation**

At the beginning of fiscal year 2007, we adopted the provisions of Statement of Financial Accounting Standards No. 123(R), or SFAS No. 123(R), *Share-Based Payment*. SFAS No. 123(R) establishes accounting for stock-based awards exchanged for employee services. Accordingly, we measure stock-based compensation at grant date, based on the fair value of the awards, and we recognize that compensation as expense using the straight-line attribution method over the requisite employee service period, which is typically the vesting period of each award. We elected to adopt the modified prospective application method provided by SFAS No. 123(R). Our estimates of the fair values of employee stock options are calculated using a binomial model.

For option grants prior to our adoption of SFAS No. 123(R), we record stock-based compensation expense equal to the amount that would have been recognized if the fair value method provided in accordance with Statement of Financial Accounting Standards No. 123, or SFAS No. 123, *Accounting for Stock-Based Compensation*, as amended by Statement of Financial Accounting Standards No. 148, or SFAS No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosures*, had been used.

*Cumulative Effect of Change in Accounting Principle*

Our adoption of SFAS No. 123(R) resulted in a cumulative benefit from the accounting change of \$0.7 million during fiscal year 2007, which reflects the net cumulative impact of estimating forfeitures in the determination of period expense by reversing the previously recognized cumulative compensation expense related to those forfeitures, rather than recording forfeitures when they occur as previously permitted.

Our condensed consolidated income statements include stock-based compensation expense, net of amounts capitalized as inventory, as follows:

|                                   | <b>Three Months Ended</b> |                | <b>Nine Months Ended</b> |                |
|-----------------------------------|---------------------------|----------------|--------------------------|----------------|
|                                   | <b>October</b>            | <b>October</b> | <b>October</b>           | <b>October</b> |
|                                   | <b>28,</b>                | <b>29,</b>     | <b>28,</b>               | <b>29,</b>     |
|                                   | <b>2007</b>               | <b>2006</b>    | <b>2007</b>              | <b>2006</b>    |
|                                   | <b>(In thousands)</b>     |                |                          |                |
| Cost of revenue                   | \$ 2,566                  | \$ 2,305       | \$ 8,077                 | \$ 5,278       |
| Research and development          | \$ 18,650                 | \$ 18,730      | \$ 57,471                | \$ 49,744      |
| Sales, general and administrative | \$ 10,787                 | \$ 10,700      | \$ 33,320                | \$ 27,804      |

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

During the three and nine months ended October 28, 2007, we granted approximately 7.3 million and 15.9 million stock options, respectively, with an estimated total grant-date fair value of \$117.8 million and \$187.6 million, respectively, and a per option weighted average grant-date fair value of \$16.03 and \$11.79, respectively. Of the estimated total grant-date fair value, we estimated that the stock-based compensation expense related to the awards that are not expected to vest was \$22.7 million and \$36.2 million for the three and nine months ended October 28, 2007, respectively.

During the three and nine months ended October 29, 2006, we granted approximately 5.9 million and 16.1 million stock options, respectively, with an estimated total grant-date fair value of \$49.5 million and \$123.1 million, respectively, and a per option weighted average grant date fair value of \$12.62 and \$11.44, respectively. Of the estimated total grant-date fair value, we estimated that the stock-based compensation expense related to the awards that are not expected to vest was \$9.6 million and \$23.8 million for the three and nine months ended October 29, 2006, respectively.

As of October 28, 2007 and October 29, 2006, the aggregate amount of unearned stock-based compensation expense related to our stock options was \$244.7 million and \$175.5 million, respectively, adjusted for estimated forfeitures. We will recognize the unearned stock-based compensation expense related to stock options over an estimated weighted average amortization period of 2.2 years and 2.1 years for the nine months ended October 28, 2007 and October 29, 2006, respectively.

*Valuation Assumptions*

In fiscal year 2006, we transitioned from a Black-Scholes model to a binomial model for calculating the estimated fair value of new stock-based compensation awards granted under our stock option plans. We reevaluated the assumptions we used to estimate the value of employee stock options and shares issued under our employee stock purchase plan, beginning with stock options granted and shares issued under our employee stock purchase plan. At that time, our management also determined that the use of implied volatility is expected to be more reflective of market conditions and, therefore, could reasonably be expected to be a better indicator of our expected volatility than historical volatility. We also segregated options into groups for employees with relatively homogeneous exercise behavior in order to calculate the best estimate of fair value using the binomial valuation model. As such, the expected term assumption used in calculating the estimated fair value of our stock-based compensation awards using the binomial model is based on detailed historical data about employees' exercise behavior, vesting schedules, and death and disability probabilities. Our management believes the resulting binomial calculation provides a more refined estimate of the fair value of our employee stock options. For our employee stock purchase plan we continue to use the Black-Scholes model.

SFAS No. 123(R) also requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures are estimated based on historical experience. If factors change and we employ different assumptions in the application of SFAS No. 123(R) in future periods, the compensation expense that we record under SFAS No. 123(R) may differ significantly from what we have recorded in the current period.

The fair value of stock options granted under our stock option plans and shares issued under our employee stock purchase plan have been estimated at the date of grant using a straight-line attribution method with the following assumptions:

*Stock Options:*

|  | <b>Three Months Ended</b>       |                | <b>Nine Months Ended</b> |                |
|--|---------------------------------|----------------|--------------------------|----------------|
|  | <b>October</b>                  | <b>October</b> | <b>October</b>           | <b>October</b> |
|  | <b>28,</b>                      | <b>29,</b>     | <b>28,</b>               | <b>29,</b>     |
|  | <b>2007</b>                     | <b>2006</b>    | <b>2007</b>              | <b>2006</b>    |
|  | <i>(using a binomial model)</i> |                |                          |                |
| Weighted average expected life of stock options (in years) | 3.8 - 5.8                       | 3.6 - 5.1      | 3.8 - 5.8                | 3.6 - 5.1      |
|  | 4.1%                            |                | 4.1%                     | 4.7%           |
| Risk free interest rate                                    | -4.7%                           | 4.7 %          | -5.0%                    | -5.1%          |
|  | 45% -                           | 44% -          | 37% -                    | 39% -          |
| Volatility   | 54%                             | 47%            | 54%                      | 51%            |
| Dividend yield   | -                               | -              | -                        | -              |

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

*Employee Stock Purchase Plan:*

|  | <b>Three Months Ended</b>              |                | <b>Nine Months Ended</b> |                |
|--|--|----------------|--------------------------|----------------|
|  | <b>October</b>                         | <b>October</b> | <b>October</b>           | <b>October</b> |
|  | <b>28,</b>                             | <b>29,</b>     | <b>28,</b>               | <b>29,</b>     |
|  | <b>2007</b>                            | <b>2006</b>    | <b>2007</b>              | <b>2006</b>    |
|  | <i>(using the Black Scholes model)</i> |                |                          |                |
| Weighted average expected life of stock options (in years) | 0.5 - 2.0                              | 0.5 - 2.0      | 0.5 - 2.0                | 0.5 - 2.0      |
|  | 3.7%                                   | 2.3%           | 3.5%                     | 1.6%           |
| Risk free interest rate                                    | -5.1%                                  | -5.2%          | -5.2%                    | -5.2%          |
|  |  | 30% -          | 38% -                    | 30% -          |
| Volatility   | 38%-54%                                | 47%            | 54%                      | 47%            |
| Dividend yield   | -                                      | -              | -                        | -              |

*Equity Incentive Program*

We consider equity compensation to be long term compensation and an integral component of our efforts to attract and retain exceptional executives, senior management and world-class employees. We believe that properly structured equity compensation aligns the long-term interests of stockholders and employees by creating a strong, direct link between employee compensation and stock appreciation, as stock options are only valuable to our employees if the value of our common stock increases after the date of grant.

*2007 Equity Incentive Plan*

At the Annual Meeting of Stockholders held on June 21, 2007, our stockholders approved the NVIDIA Corporation 2007 Equity Incentive Plan, or the 2007 Plan.

The 2007 Plan authorizes the issuance of incentive stock options, nonstatutory stock options, restricted stock, restricted stock unit, stock appreciation rights, performance stock awards, performance cash awards, and other stock-based awards to employees, directors and consultants. Only our employees may receive incentive stock options. The 2007 Plan succeeds our 1998 Equity Incentive Plan, our 1998 Non-Employee Directors' Stock Option Plan, our 2000 Nonstatutory Equity Incentive Plan, and the PortalPlayer, Inc. 2004 Stock Incentive Plan, or the Prior Plans. All options and stock awards granted under the Prior Plans shall remain subject to the terms of the Prior Plans with respect to which they were originally granted. Up to 101,845,177 shares, which due to the subsequent stock split now totals 152,767,766 shares, of our common stock may be issued pursuant to stock awards granted under the 2007 Plan.

Our Board of Directors, or the Board, or its duly authorized committee determines the terms of each stock option granted under our 2007 Plan, including the exercise price, the form of consideration paid on exercise, the vesting schedule, restrictions on transfer and the term. The exercise price of a stock option granted under the 2007 Plan may not be less than 100% of the fair market value of the stock subject to the option on the date of grant (for an incentive stock option, not less than 110% if the optionee is a 10% holder of our outstanding stock). The term of an option will not be longer than ten years (although options generally expire prior to such time in connection with a termination of continued service) and may be subject to restrictions on transfer.

Unless terminated sooner, the 2007 Plan is scheduled to terminate on April 23, 2017. Our Board may suspend or terminate the 2007 Plan at any time. No awards may be granted under the 2007 Plan while the 2007 Plan is suspended or after it is terminated. The Board may also amend the 2007 Plan at anytime. However, if legal, regulatory or listing requirements require stockholder approval, the amendment will not go into effect until the stockholders have approved the amendment.

*PortalPlayer, Inc. 1999 Plan and 1998 Employee Stock Purchase Plan*

The description of the key features of the PortalPlayer, Inc. 1999 Stock Option Plan, or 1999 Plan, and 1998 Employee Stock Purchase Plan, may be read in conjunction with the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended January 28, 2007.



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

The following summarizes the transactions under our equity incentive plans:

|                            | <b>Options<br/>Available<br/>for Grant</b> | <b>Options<br/>Outstanding</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price Per<br/>Share</b> |
|----------------------------|--|--------------------------------|--|
| Balances, January 28, 2007 | 32,672,486                                 | 110,988,289                    | \$ 8.87  |
| Additional shares reserved | 25,114,550                                 | -                              | -  |
| Granted                    | (15,920,384)                               | 15,920,384                     | \$ 26.80   |
| Exercised                  |  | (29,893,595)                   | \$ 5.84  |
| Cancelled                  | 2,314,552                                  | (2,314,552)                    | \$ 17.56   |
| Balances, October 28, 2007 | 44,181,204                                 | 94,700,526                     | \$ 12.62   |

The aggregate intrinsic value of stock options exercised for the three and nine months ended October 28, 2007 was \$253.9 million and \$639.4 million, respectively. The aggregate intrinsic value of stock options exercised for the three and nine months ended October 29, 2006 was \$97.3 million and \$293.9 million, respectively.

### **Note 3 - Income Taxes**

On January 29, 2007, we adopted FIN 48. The cumulative effect of adoption of FIN 48 did not result in a material adjustment to our tax liability for unrecognized income tax benefits. At the adoption date of January 29, 2007, we had \$63.8 million of unrecognized tax benefits, \$61.1 million of which would affect our effective tax rate if recognized. As of October 28, 2007, we had \$81.6 million of unrecognized tax benefits, \$78.9 million of which would affect our effective tax rate if recognized. The recognition of the remaining unrecognized tax benefits of \$2.7 million, at the adoption date and as of October 28, 2007, would be reported as an adjustment to goodwill as it relates to pre-acquisition unrecognized tax benefits.

We have historically classified certain unrecognized tax benefits as income taxes payable, which was included within the current liabilities section of our Condensed Consolidated Balance Sheet. As a result of our adoption of FIN 48, we now classify an unrecognized tax benefit as a current liability, or as a reduction of the amount of a net operation loss carryforward or amount refundable, to the extent that we anticipate payment or receipt of cash for income taxes within one year. Likewise, the amount is classified as a long-term liability if we anticipate payment or receipt of cash for income taxes during a period beyond a year. As of January 30, 2007, we reclassified unrecognized tax benefits of \$33.1 million to income taxes payable and deferred tax liability, which is included within the deferred tax and other long-term liabilities section of our Condensed Consolidated Balance Sheet.

Our policy to include interest and penalties related to unrecognized tax benefits as a component of income tax expense did not change as a result of implementing FIN 48. At the adoption date of January 29, 2007, we had accrued \$6.2 million for the payment of interest related to unrecognized tax benefits, which is included as a component of our unrecognized tax benefits. There have been no significant changes to these amounts during the nine months ended October 28, 2007.

While we believe that we have adequately provided for all tax positions, amounts asserted by tax authorities could be greater or less than our accrued position. Accordingly, our provisions on federal, state and foreign tax-related matters to be recorded in the future may change as revised estimates are made or the underlying matters are settled or otherwise resolved. As of October 28, 2007, we do not believe that our estimates, as otherwise provided for, on such tax positions will significantly increase or decrease within the next twelve months.

We are subject to taxation by a number of taxing authorities both in the United States and throughout the world. As of October 28, 2007, the material tax jurisdictions that are subject to examination include the United States, Hong Kong, Taiwan, China and India and include our fiscal years 2002 through 2007. As of October 28, 2007, the material tax jurisdictions for which we are currently under examination include the U.S. for federal tax purposes for fiscal years 2004 through 2006, Taiwan for fiscal year 2003, and India for fiscal years 2005 and 2006.

We recognized income tax expense of \$31.1 million and \$21.8 million for the three months ended October 28, 2007 and October 29, 2006, respectively, and \$80.8 million and \$58.3 million for the nine months ended October 28, 2007 and October 29, 2006, respectively. Income tax expense as a percentage of income before taxes, or our effective tax rate, was 11.7% and 17.0% for the three months ended October 28, 2007 and October 29, 2006, respectively, and 13.0% and 17.0% for the nine months ended October 28, 2007 and October 29, 2006, respectively. Our effective tax rate is lower than the United States Federal Statutory rate of 35% due primarily to income earned in lower tax jurisdictions and research tax credits. During the quarter ended October 28, 2007, we lowered our estimate of the fiscal year 2008 annual effective tax rate from 14.0% to 13.0%. The revision resulted primarily due to a change in the relative geographical mix of income subject to tax and increased research tax credits due to increased stock option deductions.

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

**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 treasury stock method. Under the treasury stock method, the effect of stock options outstanding is 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                    |            | Nine Months Ended |            |
|---|---------------------------------------|------------|-------------------|------------|
|   | October                               | October    | October           | October    |
|   | 28,                                   | 29,        | 28,               | 29,        |
|   | 2007                                  | 2006       | 2007              | 2006       |
|   | (In thousands, except per share data) |            |                   |            |
| Numerator:  |                                       |            |                   |            |
| Net income  | \$ 235,661                            | \$ 106,511 | \$ 540,652        | \$ 285,328 |
| Denominator:  |                                       |            |                   |            |
| Denominator for basic net income per share, weighted average shares   | 554,966                               | 528,986    | 547,796           | 514,112    |
| Effect of dilutive securities:  |                                       |            |                   |            |
| Stock options outstanding   | 58,019                                | 57,747     | 57,937            | 56,310     |
| Denominator for diluted net income per share, weighted average shares | 612,985                               | 586,733    | 605,733           | 570,422    |
| Net income per share:   |                                       |            |                   |            |
| Basic net income per share  | \$ 0.42                               | \$ 0.20    | \$ 0.99           | \$ 0.55    |
| Diluted net income per share  | \$ 0.38                               | \$ 0.18    | \$ 0.89           | \$ 0.50    |

Diluted net income per share for the three and nine months ended October 28, 2007 does not include the effect of anti-dilutive common equivalent shares from stock options outstanding of 8.5 million and 11.5 million, respectively. Diluted net income per share for the three and nine months ended October 29, 2006 does not include the effect of 9.6 million and 10.6 million anti-dilutive common equivalent shares, respectively.

**Note 5 - 3dfx**

During fiscal year 2002, we completed the purchase of certain assets from 3dfx Interactive, Inc., or 3dfx, for an aggregate purchase price of approximately \$74.2 million. On December 15, 2000, NVIDIA Corporation and one of our indirect subsidiaries entered into an Asset Purchase Agreement, or the APA, which closed on April 18, 2001, to purchase certain graphics chip assets from 3dfx. Under the terms of the APA, 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. The APA also provided, subject to the other provisions thereof, that if 3dfx properly certified that all its debts and other liabilities had been provided for, then we would have been obligated to pay 3dfx one million shares, which due to subsequent stock splits now totals six million shares, of NVIDIA common stock. If 3dfx could not make such a certification, but instead properly certified that its debts and liabilities could be satisfied for less than \$25.0 million,

then 3dfx could have elected to receive a cash payment equal to the amount of such debts and 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. If 3dfx could not certify that all of its debts and liabilities had been provided for, or could not be satisfied, for less than \$25.0 million, we would not be obligated under the APA to pay any additional consideration for the assets.

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

In October 2002, 3dfx filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the Northern District of California. In March 2003, we were served with a complaint filed by the Trustee appointed by the Bankruptcy Court to represent 3dfx's bankruptcy estate. The Trustee's complaint asserts claims for, among other things, successor liability and fraudulent transfer and seeks additional payments from us. On October 13, 2005, the Bankruptcy Court held a hearing on the Trustee's motion for summary adjudication. On December 23, 2005, the Bankruptcy Court denied the Trustee's Motion for Summary Adjudication in all material respects and held that NVIDIA may not dispute that the value of the 3dfx transaction was less than \$108.0 million. The Bankruptcy Court denied the Trustee's request to find that the value of the 3dfx assets conveyed to NVIDIA was at least \$108.0 million. In early November 2005, after several months of mediation, NVIDIA and the Official Committee of Unsecured Creditors, or the Creditors' Committee, agreed to a Plan of Liquidation of 3dfx, which included a conditional settlement of the Trustee's claims against NVIDIA. This conditional settlement was subject to a confirmation process through a vote of creditors and the review and approval of the Bankruptcy Court after notice and hearing. The conditional settlement called for a payment by NVIDIA of approximately \$30.6 million to the 3dfx estate. Under the settlement, \$5.6 million related to various administrative expenses and Trustee fees, and \$25.0 million related to the satisfaction of debts and liabilities owed to the general unsecured creditors of 3dfx. Accordingly, during the three month period ended October 30, 2005, we recorded \$5.6 million as a charge to settlement costs and \$25.0 million as additional purchase price for 3dfx. The Trustee advised that he intended to object to the settlement. However, the conditional settlement never progressed substantially through the confirmation process.

On December 21, 2005, the Bankruptcy Court determined that it would schedule trial of one portion of the Trustee's case against NVIDIA. On January 2, 2007, NVIDIA exercised its right to terminate the settlement agreement on grounds that the Bankruptcy Court had failed to proceed toward confirmation of the Creditors' Committee's plan. A non-jury trial began on March 21, 2007 on valuation issues in the Trustee's constructive fraudulent transfer claims against NVIDIA. Specifically, the Bankruptcy Court tried four questions: (1) what did 3dfx transfer to NVIDIA in the APA?; (2) of what was transferred, what qualifies as "property" subject to the Bankruptcy Court's avoidance powers under the Uniform Fraudulent Transfer Act and relevant bankruptcy code provisions?; (3) what is the fair market value of the "property" identified in answer to question (2)?; and (4) was the \$70 million that NVIDIA paid "reasonably equivalent" to the fair market value of that property? At the conclusion of the evidence, the Bankruptcy Court asked the parties to submit post-trial briefing. That briefing was completed on May 25, 2007, and the Bankruptcy Court's decision is still pending.

The 3dfx asset purchase price of \$95.0 million and \$4.2 million of direct transaction costs were allocated based on fair values presented below. The final allocation of the purchase price of the 3dfx assets is contingent upon the outcome of all of the 3dfx litigation. Please refer to Note 13 of these Notes to Condensed Consolidated Financial Statements for further information regarding this litigation.

|                        | <b>Fair<br/>Market<br/>Value<br/>(In<br/>thousands)</b> | <b>Straight-Line<br/>Amortization<br/>Period<br/>(Years)</b> |
|------------------------|---|--|
| Property and equipment | \$ 2,433  | 1-2  |
| Trademarks             | 11,310  | 5  |
| Goodwill               | 85,418  | --   |

|       |           |
|-------|-----------|
| Total | \$ 99,161 |
|-------|-----------|

**Note 6 - Business Combinations**

On February 20, 2006, we completed our acquisition of ULi Electronics, Inc., or ULi, a core logic developer for the personal computer, or PC, industry. The acquisition represents our ongoing investment in our platform solution strategy and has strengthened our sales, marketing, and customer engineering presence in Taiwan and China. The aggregate purchase price consisted of cash consideration of approximately \$53.1 million.

On March 29, 2006, we completed our acquisition of Hybrid Graphics Ltd., or Hybrid Graphics, a developer of embedded 2D and 3D graphics software for handheld devices. The aggregate purchase price consisted of cash consideration of approximately \$36.7 million.

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

On January 5, 2007, we completed our acquisition of PortalPlayer Inc., or PortalPlayer, a leading supplier of semiconductors, firmware, and software for personal media players, or PMPs, and secondary display-enabled computers to accelerate our ongoing investment in our handheld product strategy. Pursuant to the terms of the acquisition, we paid cash consideration of approximately \$344.9 million in exchange for common stock in PortalPlayer and recognized an additional purchase price of \$2.9 million, the value of approximately 658,000 options, which due to the subsequent stock split now totals 987,000 options, of NVIDIA common stock issued upon conversion of outstanding PortalPlayer stock options. The allocation of the purchase price for the PortalPlayer acquisition has been prepared on a preliminary basis and reasonable changes are expected as additional information becomes available.

We allocated the purchase price of each of these acquisitions to tangible assets, liabilities and identifiable intangible assets acquired, as well as in-process research and development, or IPR&D, if identified, based on their estimated fair values. The excess of purchase price over the aggregate fair values was recorded as goodwill. The fair value assigned to identifiable intangible assets acquired was based on estimates and assumptions determined by management. Purchased intangibles are amortized on a straight-line basis over their respective useful lives.

As of October 28, 2007, the estimated fair values of the purchase price allocated to assets we acquired and liabilities we assumed on the respective acquisition dates were as follows:

|                                     | ULi       | Hybrid<br>Graphics<br>(In thousands) | PortalPlayer |
|-------------------------------------|-----------|--------------------------------------|--------------|
| <b>Fair Market Values</b>           |           |                                      |              |
| Cash and cash equivalents           | \$ 21,551 | \$ 1,180                             | \$ 10,174    |
| Marketable Securities               | -         | -                                    | 176,492      |
| Accounts receivable                 | 8,148     | 808                                  | 16,850       |
| Inventories                         | 4,896     | -                                    | 2,326        |
| Other assets                        | 935       | 73                                   | 12,761       |
| Property and equipment              | 1,010     | 134                                  | 19,996       |
| In-process research and development | -         | 602                                  | 13,400       |
| Goodwill                            | 31,204    | 27,906                               | 106,172      |
| Intangible assets:                  |           |                                      |              |
| Existing technology                 | 2,490     | 5,179                                | 6,700        |
| Customer relationships              | 653       | 2,650                                | 2,700        |
| Backlog                             | -         | -                                    | 2,200        |
| Patents                             | -         | -                                    | 600          |
| Trademark                           | -         | 482                                  | -            |
| Non-compete agreements              | -         | 72                                   | -            |
| Total assets acquired               | 70,887    | 39,086                               | 370,371      |
| Current liabilities                 | (17,031)  | (1,373)                              | (14,380)     |
| Acquisition related costs           | (781)     | (740)                                | (8,101)      |
| Long-term liabilities               | -         | (301)                                | (46)         |
| Total liabilities assumed           | (17,812)  | (2,414)                              | (22,527)     |
| Net assets acquired                 | \$ 53,075 | \$ 36,672                            | \$ 347,844   |

|                        | <b>ULi</b>  | <b>Hybrid Graphics</b> | <b>PortalPlayer</b> |
|------------------------|---|------------------------|---------------------|
|                        | <b>Straight-line depreciation / amortization period</b> |                        |                     |
| Property and equipment | 4 - 49 months   | 1 - 36 months          | 3 - 60 months       |
| Intangible assets:     |   |                        |                     |
| Existing technology    | 3 years   | 3 years                | 3 years             |
| Customer relationships | 3 years   | 3 years                | 1-3 years           |
| Backlog                | -   | -                      | 2 months            |
| Patents                | -   | -                      | 3 years             |
| Trademark              | -   | 3 years                | -                   |
| Non-compete agreements | -   | 3 years                | -                   |



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

The amount of the IPR&D represents the value assigned to research and development projects of Hybrid Graphics and PortalPlayer that had commenced but had not yet reached technological feasibility at the time of the acquisition and for which we had no alternative future use. In accordance with Statement of Financial Accounting Standards No. 2, or SFAS No. 2, *Accounting for Research and Development Costs*, as clarified by FASB issued Interpretation No. 4, or FIN 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method an interpretation of FASB Statement No. 2*, amounts assigned to IPR&D meeting the above-stated criteria were charged to research and development expenses as part of the allocation of the purchase price.

The pro forma results of operations for these acquisitions have not been presented because the effects of the acquisitions, individually or in the aggregate, were not material to our results.

**Note 7 - Goodwill**

The carrying amount of goodwill is as follows:

|                 | <b>October<br/>28,<br/>2007</b> | <b>January 28,<br/>2007</b> |
|-----------------|---------------------------------|-----------------------------|
|                 | <b>(In thousands)</b>           |                             |
| 3dfx            | \$ 75,326                       | \$ 75,326                   |
| MediaQ          | 35,342                          | 35,342                      |
| ULi             | 31,204                          | 31,051                      |
| Hybrid Graphics | 27,906                          | 27,906                      |
| PortalPlayer    | 106,172                         | 114,816                     |
| Other           | 16,984                          | 16,984                      |
| Total goodwill  | \$ 292,934                      | \$ 301,425                  |

During the nine months of fiscal year 2008, goodwill related to PortalPlayer decreased by \$8.6 million primarily as a result of a \$10.3 million increase in the fair value of land acquired based on a third party appraisal which we obtained as a result of our acquisition of PortalPlayer. This decrease in PortalPlayer goodwill was primarily offset by an increase of \$1.2 million in estimates of amounts payable to their employee benefit plan for periods prior to the date of acquisition. Please refer to Note 6 of these Notes to Condensed Consolidated Financial Statements for further information regarding the PortalPlayer acquisition.

**Note 8 - Amortizable Intangible Assets**

We are currently amortizing our intangible assets with definitive lives over periods ranging from one to five years, primarily on a straight-line basis. The components of our amortizable intangible assets are as follows:

| <b>October 28, 2007</b>              |                                     |                                | <b>January 28, 2007</b>              |                                     |                                |
|--------------------------------------|-------------------------------------|--------------------------------|--------------------------------------|-------------------------------------|--------------------------------|
| <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Net Carrying<br/>Amount</b> | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Net Carrying<br/>Amount</b> |
| <b>(In thousands)</b>                |                                     |                                |                                      |                                     |                                |

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|                                |    |         |    |            |    |        |    |         |    |           |    |        |
|--------------------------------|----|---------|----|------------|----|--------|----|---------|----|-----------|----|--------|
| Technology licenses            | \$ | 87,350  | \$ | (29,550 )  | \$ | 57,800 | \$ | 37,516  | \$ | (20,480 ) | \$ | 17,036 |
| Patents                        |    | 35,098  |    | (26,924 )  |    | 8,174  |    | 34,623  |    | (24,569 ) |    | 10,054 |
| Acquired intellectual property |    | 50,812  |    | (38,613 )  |    | 12,199 |    | 50,212  |    | (31,894 ) |    | 18,318 |
| Trademarks                     |    | 11,310  |    | (11,310 )  |    | -      |    | 11,310  |    | (11,310 ) |    | -      |
| Other                          |    | 1,494   |    | (1,494 )   |    | -      |    | 1,494   |    | (1,391 )  |    | 103    |
| Total intangible assets        | \$ | 186,064 | \$ | (107,891 ) | \$ | 78,173 | \$ | 135,155 | \$ | (89,644 ) | \$ | 45,511 |

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

The increase in the gross carrying amount of technology licenses as of October 28, 2007 when compared to January 28, 2007 is primarily related to approximately \$49.6 million in payments under a confidential patent licensing arrangement that we entered into during the third quarter of fiscal year 2007. Our aggregate commitment for license payments under this arrangement could range from \$97.0 million to \$110.0 million over a ten year period; however, the net outlay may be reduced by the occurrence of certain events covered by the arrangement.

Amortization expense associated with intangible assets for the three and nine months ended October 28, 2007 was \$5.7 million and \$18.2 million, respectively. Amortization expense associated with intangible assets for the three and nine months ended October 29, 2006 was \$4.0 million and \$12.1 million, respectively. Future amortization expense related to the net carrying amount of intangible assets at October 28, 2007 is estimated to be \$5.2 million for the remainder of fiscal 2008, \$17.3 million in fiscal 2009, \$11.8 million in fiscal 2010, \$7.6 million in fiscal 2011, \$6.5 million in fiscal 2012 and a total of \$29.8 million in fiscal 2013 and fiscal years subsequent to fiscal 2013.

**Note 9 - Marketable Securities**

We account for our investment instruments in accordance with Statement of Financial Accounting Standards No. 115, or SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. All of our 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 primarily of highly liquid investments with a maturity of greater than three months when purchased and some equity investments. We classify our marketable securities at the date of acquisition in the available-for-sale category as our 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. Realized gains and losses on the sale of marketable securities are determined using the specific-identification method. Net realized and unrealized gains for the three and nine months ended October 28, 2007 were not material.

**Note 10 - Balance Sheet Components**

Certain balance sheet components are as follows:

|                     | October<br>28,<br>2007 | January 28,<br>2007 |
|---------------------|------------------------|---------------------|
|                     | (In thousands)         |                     |
| <b>Inventories:</b> |                        |                     |
| Raw materials       | \$ 40,019              | \$ 56,261           |
| Work in-process     | 121,364                | 111,058             |
| Finished goods      | 144,760                | 187,361             |
| Total inventories   | \$ 306,143             | \$ 354,680          |

At October 28, 2007, we had outstanding inventory purchase obligations totaling approximately \$784.2 million.

| October<br>28,<br>2007 | January 28,<br>2007 |
|------------------------|---------------------|
|------------------------|---------------------|

**(In thousands)****Deposits and other assets:**

|                                 |    |        |    |        |
|---------------------------------|----|--------|----|--------|
| Investment in non-affiliates    | \$ | 9,684  | \$ | 11,684 |
| Long-term prepayments           |    | 6,687  |    | 8,245  |
| Deferred income taxes           |    | -      |    | 7,380  |
| Other                           |    | 8,785  |    | 8,420  |
| Total deposits and other assets | \$ | 25,156 | \$ | 35,729 |

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

|                                      | <b>October<br/>28,<br/>2007</b> | <b>January 28,<br/>2007</b> |
|--------------------------------------|---------------------------------|-----------------------------|
|                                      | <b>(In thousands)</b>           |                             |
| <b>Accrued Liabilities:</b>          |                                 |                             |
| Accrued customer programs            | \$ 237,163                      | \$ 181,182                  |
| Accrued payroll and related expenses | 96,676                          | 81,352                      |
| Accrued legal settlement             | 30,600                          | 30,600                      |
| Deferred rent                        | 11,850                          | 12,551                      |
| Income and other taxes payable       | 7,240                           | 37,903                      |
| Deferred revenue                     | 3,663                           | 1,180                       |
| Other                                | 19,458                          | 21,964                      |
| <b>Total accrued liabilities</b>     | <b>\$ 406,650</b>               | <b>\$ 366,732</b>           |

Please refer to Note 1 of these Notes to Condensed Consolidated Financial Statements for discussion regarding the nature of accrued customer programs and their accounting treatment related to our revenue recognition policies and estimates.

|   | <b>October<br/>28,<br/>2007</b> | <b>January 28,<br/>2007</b> |
|---|---------------------------------|-----------------------------|
|   | <b>(In thousands)</b>           |                             |
| <b>Deferred tax and other long-term liabilities:</b>      |                                 |                             |
| Deferred income tax liability                             | \$ 59,898                       | \$ -                        |
| Income taxes payable                                      | 40,667                          | -                           |
| Other long-term liabilities                               | 25,234                          | 14,180                      |
| Accrued payroll taxes related to stock options            | 8,995                           | 8,995                       |
| Asset retirement obligations                              | 6,101                           | 6,362                       |
| <b>Total deferred tax and other long-term liabilities</b> | <b>\$ 140,895</b>               | <b>\$ 29,537</b>            |

Please refer to Note 3 of these Notes to Condensed Consolidated Financial Statements for discussion regarding the reclassification of income taxes payable from accrued liabilities to deferred tax and other long-term liabilities as a result of the adoption of FIN 48.

**Note 11 - Comprehensive Income**

Comprehensive income consists of net income and other comprehensive income or loss. Other comprehensive income or loss components include unrealized gains or losses on available-for-sale securities, net of tax. The components of comprehensive income, net of tax, were as follows:

| <b>Three Months Ended<br/>October<br/>28,</b> | <b>October<br/>29,</b> | <b>Nine Months Ended<br/>October<br/>28,</b> | <b>October<br/>29,</b> |
|---|------------------------|--|------------------------|
|---|------------------------|--|------------------------|

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|   | 2007           | 2006       | 2007       | 2006       |
|---|----------------|------------|------------|------------|
|   | (In thousands) |            |            |            |
| Net income  | \$ 235,661     | \$ 106,511 | \$ 540,652 | \$ 285,328 |
| Net change in unrealized gains on available-for-sale securities, net of tax   | 1,830          | 1,078      | 2,071      | 684        |
| Reclassification adjustments for net realized gains on available-for-sale securities included in net income, net of tax | (67)           | (28)       | (157)      | (52)       |
| Total comprehensive income  | \$ 237,424     | \$ 107,561 | \$ 542,566 | \$ 285,960 |

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

**Note 12 - Guarantees**

FASB Interpretation No. 45, or FIN 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, requires that upon issuance of a guarantee, the guarantor must recognize a liability for the fair value of the obligation it assumes under that guarantee. In addition, FIN 45 requires disclosures about the guarantees that an entity has issued, including a tabular reconciliation of the changes of the entity's product warranty liabilities.

The following table summarizes the changes in the estimated product warranty liabilities for the three and nine months ended October 28, 2007 and October 29, 2006:

|                                | <b>Three Months Ended</b> |                    | <b>Nine Months Ended</b> |                    |
|--------------------------------|---------------------------|--------------------|--------------------------|--------------------|
|                                | <b>October 28,</b>        | <b>October 29,</b> | <b>October 28,</b>       | <b>October 29,</b> |
|                                | <b>2007</b>               | <b>2006</b>        | <b>2007</b>              | <b>2006</b>        |
|                                | <b>(In thousands)</b>     |                    |                          |                    |
| Balance at beginning of period | \$ 20,694                 | \$ 12,381          | \$ 17,958                | \$ 10,239          |
| Additions (1)                  | 7,362                     | 6,697              | 20,810                   | 30,887             |
| Deductions (2)                 | (5,546)                   | (5,567)            | (16,258)                 | (27,615)           |
| Balance at end of period (3)   | \$ 22,510                 | \$ 13,511          | \$ 22,510                | \$ 13,511          |

(1) Includes \$6,584 and \$19,611 for the three and nine months ended October 28, 2007, respectively, and \$6,697 and \$30,887 for the three and nine months ended October 29, 2006, respectively, towards allowance for sales returns estimated at the time revenue is recognized primarily based on historical return rates and is charged as a reduction to revenue.

(2) Includes \$5,546 and \$ 16,258 for the three months and nine months ended October 28, 2007, respectively, and \$5,567 and \$27,615 for the three and nine months ended October 29, 2006, respectively, written off against the allowance for sales returns.

(3) Includes \$17,830 as of October 28, 2007 and \$13,511 as of October 29, 2006 relating to allowance for sales returns.

In connection with certain agreements that we have executed in the past, we have at times provided indemnities to cover the indemnified party for matters such as tax, product and employee liabilities. We have also on occasion included intellectual property indemnification provisions in our technology related agreements with third parties. Maximum potential future payments cannot be estimated because many of these agreements do not have a maximum stated liability. As such, we have not recorded any liability in our Condensed Consolidated Financial Statements for such indemnifications.

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

**Note 13 - Commitments and Contingencies**

*Litigation*

*3dfx*

On December 15, 2000, NVIDIA Corporation and one of our indirect subsidiaries entered into the APA to purchase certain graphics chip assets from 3dfx which closed on April 18, 2001.

In May 2002, we were served with a California state court complaint filed by the landlord of 3dfx's San Jose, California commercial real estate lease, Carlyle Fortran Trust, or Carlyle. In December 2002, we were served with a California state court complaint filed by the landlord of 3dfx's Austin, Texas commercial real estate lease, CarrAmerica Realty Corporation. The landlords' complaints both asserted claims for, among other things, interference with contract, successor liability and fraudulent transfer. The landlords' sought to recover money damages, including amounts owed on their leases with 3dfx in the aggregate amount of approximately \$15 million. In October 2002, 3dfx filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the Northern District of California. In January 2003, the landlords' actions were removed to the United States Bankruptcy Court for the Northern District of California and consolidated, for purposes of discovery, with a complaint filed against NVIDIA by the Trustee in the 3dfx bankruptcy case. Upon motion by NVIDIA in 2005, the District Court withdrew the reference to the Bankruptcy Court for the landlords' actions, which were removed to the United States District Court for the Northern District of California. The Trustee's lawsuit remained in the Bankruptcy Court. On November 10, 2005, the District Court granted our motion to dismiss the landlords' respective amended complaints and allowed the landlords until February 4, 2006 to amend their complaints. The landlords re-filed claims against NVIDIA in early February 2006, and NVIDIA again filed motions requesting the District Court to dismiss those claims. On September 29, 2006, the District Court dismissed the CarrAmerica action in its entirety and without leave to amend. The District Court found, among other things, that CarrAmerica lacked standing to bring the lawsuit and that standing rests exclusively with the bankruptcy Trustee. On October 27, 2006, CarrAmerica filed a notice of appeal from that order. On December 15, 2006, the District Court also dismissed the Carlyle action in its entirety, finding that Carlyle also lacked standing to pursue its claims, and that certain claims were substantively unmeritorious. Carlyle filed a notice of appeal from that order on January 9, 2007. Both landlords' appeals are pending before the United States Court of Appeals for the Ninth Circuit, and briefing on both appeals has been consolidated. NVIDIA has filed motions to recover its litigation costs and attorneys fees against both Carlyle and CarrAmerica. The District Court has postponed consideration of those motions until after the appeals are resolved.

In March 2003, we were served with a complaint filed by the Trustee appointed by the Bankruptcy Court to represent 3dfx's bankruptcy estate. The Trustee's complaint asserts claims for, among other things, successor liability and fraudulent transfer and seeks additional payments from us. On October 13, 2005, the Bankruptcy Court held a hearing on the Trustee's motion for summary adjudication. On December 23, 2005, the Bankruptcy Court denied the Trustee's Motion for Summary Adjudication in all material respects and held that NVIDIA may not dispute that the value of the 3dfx transaction was less than \$108.0 million. The Bankruptcy Court denied the Trustee's request to find that the value of the 3dfx assets conveyed to NVIDIA was at least \$108.0 million. In early November 2005, after several months of mediation, NVIDIA and the Official Committee of Unsecured Creditors, or the Creditors' Committee, agreed to a Plan of Liquidation of 3dfx, which included a conditional settlement of the Trustee's claims against us. This conditional settlement was subject to a confirmation process through a vote of creditors and the review and approval of the Bankruptcy Court after notice and hearing. The conditional settlement called for a payment by NVIDIA of



approximately \$30.6 million to the 3dfx estate. Under the settlement, \$5.6 million related to various administrative expenses and Trustee fees, and \$25.0 million related to the satisfaction of debts and liabilities owed to the general unsecured creditors of 3dfx. Accordingly, during the three month period ended October 30, 2005, we recorded \$5.6 million as a charge to settlement costs and \$25.0 million as additional purchase price for 3dfx. The Trustee advised that he intended to object to the settlement. However, the conditional settlement never progressed substantially through the confirmation process.

On December 21, 2005, the Bankruptcy Court determined that it would schedule trial of one portion of the Trustee's case against NVIDIA. On January 2, 2007, NVIDIA exercised its right to terminate the settlement agreement on grounds that the Bankruptcy Court had failed to proceed toward confirmation of the Creditors' Committee's plan. A non-jury trial began on March 21, 2007 on valuation issues in the Trustee's constructive fraudulent transfer claims against NVIDIA. Specifically, the Bankruptcy Court tried four questions: (1) what did 3dfx transfer to NVIDIA in the APA?; (2) of what was transferred, what qualifies as "property" subject to the Bankruptcy Court's avoidance powers under the Uniform Fraudulent Transfer Act and relevant bankruptcy code provisions?; (3) what is the fair market value of the "property" identified in answer to question (2)?; and (4) was the \$70 million that NVIDIA paid "reasonably equivalent" to the fair market value of that property? At the conclusion of the evidence, the Bankruptcy Court asked the parties to submit post-trial briefing. That briefing was completed on May 25, 2007, and the Bankruptcy Court's decision is still pending.

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

Following the Trustee's filing of a Form 8-K on behalf of 3dfx, in which the Trustee disclosed the terms of the conditional settlement agreement between NVIDIA and the Creditor's Committee, certain shareholders of 3dfx filed a petition with the Bankruptcy Court to appoint an official committee to represent the claimed interests of 3dfx shareholders. That petition was granted and an Equity Holders' Committee was appointed. Since that appointment, the Equity Holders' Committee has filed a competing plan of reorganization/liquidation. The Equity Holders' Committee's plan assumes that 3dfx can raise additional equity capital that would be used to retire all of 3dfx's debts. The Equity Holders' Committee contends that the commitment by an investor to pay in equity capital is sufficient to trigger NVIDIA's obligations under the APA to pay the stock consideration. NVIDIA contends, among other things, that such a commitment is not sufficient and that its obligation to pay the stock consideration has been extinguished. By virtue of stock splits since the execution of the APA, the stock consideration would now total six million shares of NVIDIA common stock. The Equity Holders' Committee filed a motion with the Bankruptcy Court seeking an order giving it standing to bring a lawsuit to obtain the stock consideration. Over our objection, the Bankruptcy Court granted that motion on May 1, 2006 and the Equity Holders' Committee filed its Complaint for Declaratory Relief against NVIDIA that same day. NVIDIA moved to dismiss the Complaint for Declaratory Relief, and the Bankruptcy Court granted that motion with leave to amend. The Equity Committee thereafter amended its complaint, and NVIDIA moved to dismiss that amended complaint as well. At a hearing on December 21, 2006, the Bankruptcy Court granted the motion as to one of the Equity Holders' Committee's claims, and denied it as to the others. However, the Bankruptcy Court also ruled that NVIDIA would only be required to answer the first three causes of action by which the Equity Holders' Committee seeks a determination that the APA was not terminated before 3dfx filed for bankruptcy protection, that the 3dfx bankruptcy estate still holds some rights in the APA, and that the APA is capable of being assumed by the bankruptcy estate. Because of the trial of the Trustee's fraudulent transfer claims against NVIDIA, the Equity Committee's lawsuit has not progressed substantially in 2007. The next status conference is not scheduled until January 25, 2008. In addition, the Equity Holders Committee filed a motion seeking Bankruptcy Court approval of investor protections for Harbinger Capital Partners Master Fund I, Ltd., an equity investment firm that has conditionally agreed to pay no more than \$51.5 million for preferred stock in 3dfx. The hearing on that motion was held on January 18, 2007, and the Bankruptcy Court approved the proposed protections.

*Proceedings, SEC inquiry and lawsuits related to our historical stock option granting practices*

In June 2006, the Audit Committee of the Board of NVIDIA, or the Audit Committee, began a review of our stock option practices based on the results of an internal review voluntarily undertaken by management. The Audit Committee, with the assistance of outside legal counsel, completed its review on November 13, 2006 when the Audit Committee reported its findings to our full Board. The review covered option grants to all employees, directors and consultants for all grant dates during the period from our initial public offering in January 1999 through June 2006. Based on the findings of the Audit Committee and our internal review, we identified a number of occasions on which we used an incorrect measurement date for financial accounting and reporting purposes.

We voluntarily contacted the SEC regarding the Audit Committee's review. In late August 2006, the SEC initiated an inquiry related to our historical stock option grant practices. In October 2006, we met with the SEC and provided it with a review of the status of the Audit Committee's review. In November 2006, we voluntarily provided the SEC with further documents. We continued to cooperate with the SEC throughout its inquiry. On October 26, 2007, the SEC formally notified us that the SEC's investigation concerning our historical stock option granting practices had been terminated and that no enforcement action was recommended.

Concurrently with our internal review and the SEC's inquiry, since September 29, 2006, ten derivative cases have been filed in state and federal courts asserting claims concerning errors related to our historical stock option granting practices and associated accounting for stock-based compensation expense. These complaints have been filed in various courts, including the California Superior Court, Santa Clara County, the United States District Court for the Northern District of California, and the Court of Chancery of the State of Delaware in and for New Castle County. Plaintiffs filed a consolidated complaint in the United States District Court for the Northern District of California on February 28, 2007. The California Superior Court cases have been consolidated and plaintiffs filed a consolidated complaint on April 23, 2007. All of the cases purport to be brought derivatively on behalf of NVIDIA against members of our Board and several of our current and former officers and directors. Plaintiffs in these actions allege claims for, among other things, breach of fiduciary duty, unjust enrichment, insider selling, abuse of control, gross mismanagement, waste, and constructive fraud. The Northern District of California action also alleges violations of federal provisions, including Sections 10(b), 14(a) and 20(a) of the Securities Exchange Act of 1934. The plaintiffs seek to recover for NVIDIA, among other things, damages in an unspecified amount, rescission, punitive damages, treble damages for insider selling, and fees and costs. Plaintiffs also seek an accounting, a constructive trust and other equitable relief. We intend to take all appropriate action in response to these complaints. Between May 14, 2007 and May 17, 2007, we filed several motions to dismiss the federal, Delaware and Santa Clara actions. All of the motions remain pending.

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

On August 5, 2007, our Board authorized the formation of a Special Litigation Committee to investigate, evaluate, and make a determination as to how NVIDIA should proceed with respect to the claims and allegations asserted in the underlying derivative cases brought on behalf of NVIDIA. Currently, the Special Litigation Committee's investigation is ongoing.

*Department of Justice Subpoena and Investigation, and Civil Cases*

On November 29, 2006, we received a subpoena from the San Francisco Office of the Antitrust Division of the United States Department of Justice, or DOJ, in connection with the DOJ's investigation into potential antitrust violations related to graphics processing units, or GPUs, and cards. No specific allegations have been made against us. We are cooperating with the DOJ in its investigation.

As of November 12, 2007, over 50 civil complaints have been filed against us. The majority of the complaints were filed in the Northern District of California, several were filed in the Central District of California, and other cases were filed in several other Federal district courts. On April 18, 2007, the Judicial Panel on Multidistrict Litigation transferred the actions currently pending outside of the Northern District of California to the Northern District of California for coordination of pretrial proceedings before the Honorable William H. Alsup. By agreement of the parties, Judge Alsup will retain jurisdiction over the consolidated cases through trial or other resolution.

In the consolidated proceedings, two groups of plaintiffs (one representing all direct purchasers of graphic processing units, or GPUs, and the other representing all indirect purchasers) filed consolidated, amended class-action complaints. These complaints purport to assert federal antitrust claims based on alleged price fixing, market allocation, and other alleged anti-competitive agreements between us and ATI Technologies, Inc., or ATI, and Advanced Micro Devices, Inc., or AMD, as a result of its acquisition of ATI. The indirect purchasers' consolidated amended complaint also asserts a variety of state law antitrust, unfair competition and consumer protection claims on the same allegations, as well as a common law claim for unjust enrichment.

Plaintiffs filed their first consolidated complaints on June 14, 2007. On July 16, 2007, we moved to dismiss those complaints. The motions to dismiss were heard by Judge Alsup on September 20, 2007. The Court subsequently granted and denied the motions in part, and gave the plaintiffs leave to move to amend the complaints. On November 7, 2007, the Court granted plaintiffs' motion to file amended complaints, ordered defendants to answer the complaints, lifted a previously entered stay on discovery, and set a trial date for January 12, 2009. We believe the allegations in the complaints are without merit and intend to vigorously defend the cases.

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

**Note 14 - Stockholders' Equity**

*Stock Repurchase Program*

During fiscal year 2005, we announced that our Board had authorized a stock repurchase program to repurchase shares of our common stock, subject to certain specifications, up to an aggregate maximum amount of \$300 million. During fiscal year 2007, the Board further approved an increase of \$400 million to the original stock repurchase program. On May 21, 2007, we announced a stock repurchase program under which we may purchase up to an additional \$1.0 billion of our common stock over a three year period through May 2010. As a result of these increases, we have an ongoing authorization from the Board, subject to certain specifications, to repurchase shares of our common stock up to an aggregate maximum amount of \$1.7 billion.

The repurchases will be made from time to time in the open market, in privately negotiated transactions, or in structured stock repurchase programs, and may be made in one or more larger repurchases, in compliance with the Securities Exchange Act of 1934, or the Exchange Act, Rule 10b-18, subject to market conditions, applicable legal requirements, and other factors. The program does not obligate NVIDIA to acquire any particular amount of common stock and the program may be suspended at any time at our discretion. As part of our share repurchase program, we have entered into, and we may continue to enter into, structured share repurchase transactions with financial institutions. These agreements generally require that we make an up-front payment in exchange for the right to receive a fixed number of shares of our common stock upon execution of the agreement, and a potential incremental number of shares of our common stock, within a pre-determined range, at the end of the term of the agreement.

During the three months ended October 28, 2007, we entered into a structured share repurchase transaction to repurchase 4.0 million shares for \$125.0 million which we recorded on the trade date of the transaction. Through October 28, 2007, we have repurchased 56.0 million shares under our stock repurchase program for a total cost of \$862.5 million.

Subsequent to October 28, 2007, we entered into a structured share repurchase transaction to repurchase shares of our common stock for \$125.0 million that we expect to settle prior to the end of our fourth quarter of fiscal year 2008 ending on January 27, 2008.

*Convertible Preferred Stock*

As of October 28, 2007 and January 28, 2007, no shares of preferred stock were outstanding.

**Note 15 - Segment Information**

Our Chief Executive Officer, who is considered to be our chief operating decision maker, or CODM, reviews financial information presented on an operating segment basis for purposes of making operating decisions and assessing financial performance.

During the first quarter of fiscal year 2008, we reorganized our operating segments. We now report financial information for four operating segments to our CODM: the GPU business, which is comprised primarily of our GeForce products that support desktop and notebook PCs, plus memory products; the professional solutions business, or PSB, which is comprised of our NVIDIA Quadro professional workstation products and other professional graphics products, including our NVIDIA Tesla high-performance computing products; the media and communications

processor, or MCP, business, which is comprised of NVIDIA nForce core logic and motherboard GPU products; and our consumer products business, or CPB, which is comprised of our GoForce brand mobile and consumer products that support handheld personal digital assistants, or PDAs, cellular phones and other handheld devices. CPB also includes license, royalty, other revenue and associated costs related to video game consoles and other digital consumer electronics devices.

In addition to these operating segments, we have the “All Other” category that includes human resources, legal, finance, general administration and corporate marketing expenses, which total \$66.2 million and \$62.0 million for third quarter of fiscal years 2008 and 2007, respectively, and total \$197.0 million and \$170.5 million for the first nine months of fiscal years 2008 and 2007, respectively, that we do not allocate to our other operating segments. “All Other” also includes the results of operations of other miscellaneous operating segments that are neither individually reportable, nor aggregated with another operating segment. Revenue in the “All Other” category is primarily derived from sales of components. All relevant prior period amounts have been revised to conform to the presentation of our current fiscal quarter.

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

Our CODM does not review any information regarding total assets on an operating segment basis. Operating segments do not record intersegment revenue, and, accordingly, there is none to be reported. The accounting policies for segment reporting are the same as for NVIDIA as a whole.

|                                       | GPU            | PSB        | MCP        | CPB        | All Other    | Consolidated |
|---------------------------------------|----------------|------------|------------|------------|--------------|--------------|
|                                       | (In thousands) |            |            |            |              |              |
| Three Months Ended October 28, 2007:  |                |            |            |            |              |              |
| Revenue                               | \$ 689,909     | \$ 152,158 | \$ 198,151 | \$ 65,873  | \$ 9,506     | \$ 1,115,597 |
| Depreciation and amortization expense | \$ 8,834       | \$ 1,926   | \$ 7,219   | \$ 5,676   | \$ 10,054    | \$ 33,709    |
| Operating income (loss)               | \$ 207,938     | \$ 82,182  | \$ 17,005  | \$ 7,788   | \$ (67,072)  | \$ 247,841   |
| Nine Months Ended October 28, 2007:   |                |            |            |            |              |              |
| Revenue                               | \$ 1,752,438   | \$ 420,353 | \$ 507,959 | \$ 195,281 | \$ 19,099    | \$ 2,895,130 |
| Depreciation and amortization expense | \$ 26,051      | \$ 6,073   | \$ 20,656  | \$ 16,775  | \$ 28,926    | \$ 98,481    |
| Operating income (loss)               | \$ 500,182     | \$ 217,852 | \$ 37,245  | \$ 20,724  | \$ (202,156) | \$ 573,847   |
| Three Months Ended October 29, 2006:  |                |            |            |            |              |              |
| Revenue                               | \$ 471,057     | \$ 111,257 | \$ 187,416 | \$ 48,943  | \$ 1,899     | \$ 820,572   |
| Depreciation and amortization expense | \$ 6,929       | \$ 1,799   | \$ 4,577   | \$ 3,774   | \$ 8,162     | \$ 25,241    |
| Operating income (loss)               | \$ 114,851     | \$ 52,320  | \$ 27,897  | \$ 4,989   | \$ (82,444)  | \$ 117,613   |
| Nine Months Ended October 29, 2006:   |                |            |            |            |              |              |
| Revenue                               | \$ 1,248,972   | \$ 328,425 | \$ 444,941 | \$ 162,022 | \$ 5,538     | \$ 2,189,898 |
| Depreciation and amortization expense | \$ 19,389      | \$ 5,286   | \$ 13,262  | \$ 13,347  | \$ 24,423    | \$ 75,707    |
| Operating income (loss)               | \$ 277,418     | \$ 151,901 | \$ 38,743  | \$ 38,751  | \$ (191,875) | \$ 314,938   |

Revenue by geographic region is allocated to individual countries based on the location to which the products are initially billed even if our customers' revenue is attributable to end customers that are located in a different location. The following tables summarize information pertaining to our revenue from customers based on invoicing address in different geographic regions:

|                | Three Months Ended |           | Nine Months Ended |            |
|----------------|--------------------|-----------|-------------------|------------|
|                | October            | October   | October           | October    |
|                | 28,                | 29,       | 28,               | 29,        |
|                | 2007               | 2006      | 2007              | 2006       |
|                | (In thousands)     |           |                   |            |
| Revenue:       |                    |           |                   |            |
| United States  | \$ 82,783          | \$ 81,490 | \$ 257,173        | \$ 238,017 |
| Other Americas | 42,725             | 28,696    | 133,861           | 93,196     |
| China          | 129,454            | 158,478   | 665,197           | 429,657    |
| Taiwan         | 353,558            | 348,600   | 943,515           | 865,580    |

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|                    |              |            |              |              |
|--------------------|--------------|------------|--------------|--------------|
| Other Asia Pacific | 392,798      | 129,866    | 610,237      | 354,822      |
| Europe             | 114,279      | 73,442     | 285,147      | 208,626      |
| Total revenue      | \$ 1,115,597 | \$ 820,572 | \$ 2,895,130 | \$ 2,189,898 |

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

Revenue from significant customers, those representing revenue in excess of 10% of total revenue for the respective periods, is summarized as follows:

|                 | <b>Three Months Ended</b> |                | <b>Nine Months Ended</b> |                |
|-----------------|---------------------------|----------------|--------------------------|----------------|
|                 | <b>October</b>            | <b>October</b> | <b>October</b>           | <b>October</b> |
|                 | <b>28,</b>                | <b>29,</b>     | <b>28,</b>               | <b>29,</b>     |
|                 | <b>2007</b>               | <b>2006</b>    | <b>2007</b>              | <b>2006</b>    |
| <b>Revenue:</b> |                           |                |                          |                |
| Customer A      | 10 %                      | 3%             | 9%                       | 6%             |
| Customer B      | 9 %                       | 13%            | 10%                      | 13%            |

Accounts receivable from a significant customer in excess of 10% of total accounts receivable for the respective periods, is summarized as follows:

|                             | <b>October 28,</b> | <b>January 28,</b> |
|-----------------------------|--------------------|--------------------|
|                             | <b>2007</b>        | <b>2007</b>        |
| <b>Accounts Receivable:</b> |                    |                    |
| Customer A                  | 14 %               | 5%                 |
| Customer B                  | 11 %               | 18%                |
| Customer C                  | 10 %               | 3%                 |

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

**Forward-Looking Statements**

When used in this Quarterly Report on Form 10-Q, the words “believes,” “plans,” “estimates,” “anticipates,” “expects,” “intends,” “allows,” “can,” “will” and similar expressions are intended to identify forward-looking statements. These statements relate to future periods and include, but are not limited to, statements as to: the features, benefits, capabilities, performance, and availability of our technologies and products; seasonality; our taxes and tax rate; stock-based compensation expense; revenue; our expenditures; capital expenditures; our cash flow and cash balances; gross margin; product mix; inventories; our liquidity; uses of cash; our investments; our results of operations; our stock repurchase program; our internal control over financial reporting; our disclosure controls and procedures; recent accounting pronouncements; our foreign currency risk strategy; average selling prices; acquisitions; our strategies and objectives; product cycles; growth and growth factors; competition; our intellectual property; our strategic relationships; customer demand; reliance on a limited number of customers and suppliers; our international operations; our ability to attract and retain qualified personnel; our use of equity compensation; compliance with environmental laws and regulations; the Department of Justice subpoena and investigation; and litigation, including the class action and derivative lawsuits. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected. These risks and uncertainties include, but are not limited to, the risks discussed below as well as difficulties associated with conducting international operations; slower than anticipated growth; unanticipated decreases in average selling prices; increased sales of lower margin products; reliance on third-parties to manufacture, assemble, package and test our products; difficulties in entering new markets; difficulty in collecting accounts receivable; unexpected inventory

*write-downs; entry of new competitors in our established markets; reduction in demand for our products; changes in customer preferences; market acceptance of our competitors' products; product defects; the impact of competitive pricing pressures; disruptions in relationships with our key suppliers; delays in volume production of our products; fluctuations in general economic conditions; loss of design wins; the concentration of sales of our products to a limited number of customers; decreases in demand for our products; delays in the development of new products by us or our partners; inability to realize the benefits of acquisitions; expenses related to litigation; the outcome of litigation or Department of Justice investigation; and the matters set forth under Item 1A. - Risk Factors. These forward-looking statements speak only as of the date hereof. Except as required by law, we expressly disclaim any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.*

*All references to "NVIDIA," "we," "us," "our" or the "Company" mean NVIDIA Corporation and its subsidiaries, except where it is made clear that the term means only the parent company.*

*NVIDIA, GeForce, SLI, GoForce, NVIDIA Quadro, Quadro, NVIDIA nForce, NVIDIA Tesla and the NVIDIA logo are our trademarks or registered trademarks in the United States and other countries that are used in this document. We may also refer to trademarks of other corporations and organizations in this document.*

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with “Item 1A. Risk Factors”, our Condensed Consolidated Financial Statements and related Notes thereto, as well as other cautionary statements and risks described elsewhere in this quarterly report on Form 10-Q, before deciding to purchase, hold or sell shares of our common stock.

## **Overview**

### *Our Company*

NVIDIA Corporation is the worldwide leader in programmable graphics processor technologies. Our products are designed to enhance the end-user experience on consumer and professional computing devices. We have four major product-line operating segments: the graphics processing unit, or GPU, business, the professional solutions business, or PSB, the media and communications processor, or MCP, business, and the consumer products business, or CPB.

Our GPU business is comprised primarily of our GeForce products that support desktop and notebook PCs, plus memory products. Our PSB is comprised of our NVIDIA Quadro professional workstation products and other professional graphics products, including our NVIDIA Tesla high-performance computing products. Our MCP business is comprised of NVIDIA nForce core logic and motherboard GPU products. Our CPB is comprised of our GoForce brand mobile and consumer products that support handheld personal digital assistants, or PDAs, cellular phones and other handheld devices. CPB also includes license, royalty, other revenue and associated costs related to video game consoles and other digital consumer electronics devices.

We were incorporated in California in April 1993 and reincorporated in Delaware in April 1998. Our headquarter facilities are in Santa Clara, California. Our Internet address is [www.nvidia.com](http://www.nvidia.com). The contents of our website are not part of this Form 10-Q.

## **Recent Developments, Future Objectives and Challenges**

### *GPU Business*

During the first nine months of our fiscal year 2008, our GeForce product was the share leader in the Standalone Desktop and Standalone Notebook segments for the first nine months of calendar year 2007 as reported in the latest PC Graphics 2007 Report from Mercury Research.

During the first nine months of fiscal year 2008, we launched several new DirectX10 GPUs, adding the GeForce 8800 GT, GeForce 8800 Ultra, GeForce 8600, GeForce 8500, and GeForce 8300 to our GeForce 8 series of GPUs, which previously included the NVIDIA GeForce 8800 GTX and GeForce 8800 GTS.

During the third quarter of fiscal year 2008, we maintained our leading share in both the DirectX9 and DirectX10 generation of standalone desktop GPUs.

During the second quarter of fiscal year 2008, we launched a new family of GeForce 8M Series notebook GPUs. We also supported the production ramp of top notebook PC OEMs, including Acer, Apple, ASUS, Dell, HP, Lenovo, Samsung, Sony and Toshiba.



### *Professional Solutions Business*

During the third quarter of fiscal year 2008, we began shipments of our Tesla C870 GPU computing processor and D870 desk-side supercomputer products, which we announced during the second quarter of fiscal year 2008. The Tesla family is our entry into the high-performance computing industry and consists of the C870 GPU Computing processor, the D870 Deskside Supercomputer and the S870 1U Computing Server.

During the third quarter of fiscal year 2008, we launched seven new Quadro solutions, including the Quadro FX 370 and 570.

During the second quarter of fiscal year 2008, we introduced a new line of notebook workstation GPUs based on our GeForce 8 series architecture. The new line consists of the NVIDIA Quadro FX 1600M, 570M and 360M.

During the first quarter of fiscal year 2008, we launched the NVIDIA Quadro FX 4600 and NVIDIA Quadro FX 5600 products, which are professional solutions based on our GeForce 8 series unified architecture.

During the first quarter of fiscal year 2008, we expanded our NVIDIA Quadro Plex family with the introduction of the NVIDIA Quadro Plex VCS IV, a new version of the NVIDIA Quadro Plex visual computing system, or VCS, which provides enhanced performance for a wide range of high-performance, graphics-intensive styling and design, oil and gas, and scientific applications.

### *MCP Business*

During the third quarter of fiscal year 2008, we shipped our first single-chip motherboard GPUs, or mGPUs, for Intel-processor-based desktop PCs. The GeForce 7000 mGPU family delivers the performance of an entry-level discrete GPU when compared against traditional integrated graphics solutions.

During the first nine months of fiscal year 2008, our NVIDIA nForce products held the leadership position for the AMD segment in the first nine months of calendar year 2007, as reported in the latest PC Processor and Chipsets report from Mercury Research.

During the first quarter of fiscal year 2008, we shipped the GeForce 7050 motherboard GPU, which targets the lower cost segments of the market.

During the first quarter of fiscal year 2008, we extended the reach of Scalable Link Interface, or SLI, technology into the performance segments with the launch of our NVIDIA nForce 650i SLI, 680i LT SLI and 680i Ultra MCP products for Intel.

### *Consumer Products Business*

During the first quarter of fiscal year 2008, we unveiled our first applications processor. The GoForce 6100 is designed for next generation personal media players, or PMPs, and multimedia smart phones. We began to ship the GoForce 6100 during the second quarter of fiscal year 2008.

### **Gross Margin Improvement**

We continue to remain focused on improving our gross margin. During the third quarter of fiscal year 2008, our gross margin was 46.2%, an increase of 550 basis points from our gross margin of 40.7% for the third quarter of fiscal year 2007.

Our gross margin is significantly impacted by the mix of products that we earn revenue from during each of our fiscal quarters. Product mix is often difficult to estimate with accuracy. Therefore, if we achieve significant revenue growth in our lower margin product lines, or if we are unable to earn as much revenue as we expect from higher margin product lines, our gross margin may be negatively impacted. We plan to continue to focus on improving our gross margin during the fourth quarter of fiscal year 2008.

**Seasonality**

Our industry is largely focused on the consumer products market. Due to the seasonality in this market, we typically expect to see stronger revenue performance in the second half of the calendar year related to the back-to-school and holiday seasons.

## **Financial Information by Business Segment and Geographic Data**

Our Chief Executive Officer, who is considered to be our chief operating decision maker, or CODM, reviews financial information presented on an operating segment basis for purposes of making operating decisions and assessing financial performance.

During the first quarter of fiscal year 2008, we reorganized our operating segments. We now report financial information for four operating segments to our CODM: the graphics processing unit, or GPU, business, which is comprised primarily of our GeForce products that support desktop and notebook PCs, plus memory products, the professional solutions business, or PSB, which is comprised of our NVIDIA Quadro professional workstation products and other professional graphics products, including our NVIDIA Tesla high-performance computing products, the media and communications processor, or MCP, business, which is comprised of NVIDIA nForce core logic and motherboard GPU products, and our consumer products business, or CPB, which is comprised of mobile and consumer products that support handheld personal digital assistants, or PDAs, cellular phones and other handheld devices and license, royalty, other revenue and associated costs related to video game consoles and other digital consumer electronics devices.

In addition to these operating segments, we have the “All Other” category that includes human resources, legal, finance, general administration and corporate marketing expenses, which total \$66.2 million and \$62.0 million for third quarter of fiscal years 2008 and 2007, respectively, and total \$197.0 million and \$170.5 million for the first nine months of fiscal years 2008 and 2007, respectively, that we do not allocate to our other operating segments. “All Other” also includes the results of operations of other miscellaneous operating segments that are neither individually reportable, nor aggregated with another operating segment. Revenue in the “All Other” category is primarily derived from sales of components. All relevant prior period amounts have been revised to conform to the presentation of our current fiscal quarter.

Our CODM does not review any information regarding total assets on an operating segment basis. Operating segments do not record intersegment revenue, and, accordingly, there is none to be reported. The accounting policies for segment reporting are the same as for NVIDIA as a whole.

## 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 |         | Nine Months Ended |         |
|--|--------------------|---------|-------------------|---------|
|  | October            | October | October           | October |
|  | 28,                | 29,     | 28,               | 29,     |
|  | 2007               | 2006    | 2007              | 2006    |
| Revenue  | 100.0%             | 100.0%  | 100.0%            | 100.0%  |
| Cost of revenue  | 53.8               | 59.3    | 54.4              | 58.2    |
| Gross profit   | 46.2               | 40.7    | 45.6              | 41.8    |
| Operating expenses:  |                    |         |                   |         |
| Research and development   | 16.1               | 17.2    | 17.1              | 17.9    |
| Sales, general and administrative                                      | 7.9                | 9.2     | 8.6               | 9.5     |
| Total operating expenses   | 24.0               | 26.4    | 25.7              | 27.4    |
| Operating income   | 22.2               | 14.3    | 19.9              | 14.4    |
| Interest and other income, net   | 1.7                | 1.3     | 1.6               | 1.3     |
| Income before income tax expense                                       | 23.9               | 15.6    | 21.5              | 15.7    |
| Income tax expense   | 2.8                | 2.6     | 2.8               | 2.7     |
| Cumulative effect of change in accounting principle, net of income tax | —                  | —       | —                 | —       |
| Net income   | 21.1%              | 13.0%   | 18.7%             | 13.0%   |

*Three and Nine Months Ended October 28, 2007 and October 29, 2006*

### Revenue

Revenue was \$1.12 billion for the third quarter of fiscal year 2008, compared to \$820.6 million for the third quarter of fiscal year 2007, which represents an increase of 36%. Revenue was \$2.90 billion for the first nine months of fiscal year 2008 and \$2.19 billion for the first nine months of fiscal year 2007, which represented an increase of 32%. A discussion of our revenue results for each of our operating segments is as follows:

**GPU Business.** GPU Business revenue increased by 46% to \$689.9 million in the third quarter of fiscal year 2008, compared to \$471.1 million for the third quarter of fiscal year 2007. This improvement was primarily due to increased sales of our desktop GPU products and notebook GPU products. Sales of our desktop GPU products increased by approximately 33% compared to the third quarter of fiscal year 2007, primarily due to growth of the Standalone Desktop market as reported in the latest PC Graphics 2007 Report from Mercury Research. Our position in the Standalone Desktop market is driven by our leadership position of our top to bottom GeForce 8-based family. Sales of our NVIDIA notebook GPU products increased by approximately 120% compared to the third quarter of fiscal year 2007. Notebook GPU revenue growth was primarily due to share gains in the Standalone Notebook segment as reported in the latest PC Graphics 2007 Report from Mercury Research. Our share gains in the Standalone Notebook segment were primarily a result of shipments of products used in notebook PC design wins related to Intel's Santa Rosa platform used in notebooks.

GPU Business revenue increased by 40% to \$1.75 billion for the first nine months of fiscal year 2008 compared to \$1.25 billion for the first nine months of fiscal year 2007. The increase was primarily the result of increased sales across all GPU categories. Sales of our desktop GPU products increased approximately 28% and notebook GPU products increased by approximately 110% as compared to the first nine months of fiscal year 2007. This increase was due to a combination of growth of the Standalone Graphics market and share gains in the Standalone Desktop and



the Standalone Notebook segments as reported in the latest PC Graphics 2007 Report from Mercury Research. Our share gains in the Standalone Desktop segment were primarily driven by the leadership position of our GeForce 8-based products and our share gains in the Standalone Notebook segment were primarily as a result of shipments of products used in notebook PC design wins related to Intel's new Santa Rosa platform.

*PSB.* PSB revenue increased by 37% to \$152.2 million in the third quarter of fiscal year 2008, compared to \$111.3 million for the third quarter of fiscal year 2007. PSB revenue increased by 28% to \$420.4 million for the first nine months of fiscal year 2008 as compared to \$328.4 million for the first nine months of fiscal year 2007. Our NVIDIA professional workstation product sales increased due to an overall increase in shipments of boards and chips as compared to the third quarter and first nine months of fiscal year 2007. This increase in shipments was primarily driven by our transition from previous generations of NVIDIA Quadro professional workstation products to GeForce 8-based products.

*MCP Business.* MCP Business revenue increased by 6% to \$198.2 million in the third quarter of fiscal year 2008, compared to \$187.4 million for the third quarter of fiscal year 2007. The increase was driven by sales of our Intel-based platform products offset by a slight drop in sales of our AMD-based platform products as compared to the third quarter of fiscal year 2007. We began ramping up shipments of our Intel-based platform products after the third quarter of fiscal year 2007. The increase was also offset by a decline in sales of products related to our acquisition of ULi Electronics, Inc. in February 2006.

MCP business revenue increased by 14% to \$508.0 million for the first nine months of fiscal year 2008 as compared to \$444.9 million for the first nine months of fiscal year 2007. The increase resulted from an approximately 7% increase in sales of our AMD-based platform products and over a 400% increase in sales of our Intel-based platform products as compared to the first nine months of fiscal year 2007. The increase in our AMD-based platform products was led by notebook graphics products and we began ramping up shipments of our Intel-based platform products after the third quarter of fiscal year 2007. These increases were offset by a decline in sales of products related to our acquisition of ULi Electronics, Inc. in February 2006.

*CPB.* CPB revenue increased by 35% to \$65.9 million for the third quarter of fiscal year 2008, compared to \$48.9 million for the third quarter of fiscal year 2007. CPB revenue increased by 21% to \$195.3 million for the first nine months of fiscal year 2008 as compared to \$162.0 million for the first nine months of fiscal year 2007. The overall increase in CPB revenue is primarily due to increased royalties from Sony Computer Entertainment, or SCE, but was offset by decreases in revenue from our cell phone products and our contractual development arrangements with SCE.

### ***Concentration of Revenue***

Revenue from sales to customers outside of the United States and other Americas accounted for 89% and 87% of total revenue for the third quarter of fiscal years 2008 and 2007, respectively, and 86% and 85% for the first nine months of fiscal years 2008 and 2007, respectively. Revenue by geographic 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', add-in board and motherboard manufacturers' revenue is attributable to end customers in a different location.

Sales to significant customers, representing revenue in excess of 10% of our total revenue, accounted for approximately 10% and 13%, of our total revenue for the third quarter and for the first nine months of fiscal years 2008 and 2007, respectively.

### ***Gross Profit and Gross Margin***

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 wafer fabrication, assembly, testing and packaging, manufacturing support costs, including labor and overhead associated with such purchases, final test yield fallout, inventory provisions and shipping costs. Cost of revenue also includes development costs for license and service arrangements.

Gross margin is the percentage of gross profit to revenue. Our gross margin can vary in any period depending on the mix of types of products sold. Our gross margin was 46.2% and 40.7% for the third quarter of fiscal years 2008 and 2007, respectively. The improvement in our gross margin reflects our continuing focus on delivering cost effective product architectures, enhancing business processes and delivering profitable growth. Our gross margin also improved in the third quarter of fiscal year 2008 because it did not include the \$16.0 million charge to cost of revenue we recorded in third quarter of fiscal year 2007 as a result of entering into a confidential patent licensing agreement that was related to past usage of certain patents subject to the arrangement.

Our gross margin is significantly impacted by the mix of products we sell. Product mix is often difficult to estimate with accuracy and, thus, if we achieve significant revenue growth in our lower margin product lines, or if we are unable to earn as much revenue as we expect from higher margin product lines, our gross margin may be negatively impacted. We expect gross margin to remain relatively flat during the fourth quarter of fiscal year 2008 as compared to the third quarter of fiscal year 2008. A discussion of our gross margin results for each of our operating segments is as follows:

*GPU Business.* The gross margin of our GPU Business increased during the third quarter of fiscal year 2008 as compared to the third quarter of fiscal year 2007, as well as during the first nine months of fiscal year 2008 as compared to the first nine months of fiscal year 2007. This increase was primarily due to increased sales of our GeForce 8 series GPUs, which began selling in the third quarter of fiscal year 2007. Our GeForce 8 series GPUs generally have higher gross margins than our previous generations of GPUs. Additionally, the cost of memory purchases were more favorable during the third quarter and first nine months of fiscal year 2008.

**PSB.** The gross margin of our PSB increased during the third quarter of fiscal year 2008 as compared to the third quarter fiscal year 2007, as well as during the first nine months of fiscal year 2008 as compared to the first nine months of fiscal year 2007. This increase was primarily due to increased sales of our GeForce 8-based NVIDIA Quadro products, which began selling in the fourth quarter of fiscal year 2007 and generally have higher gross margins than our previous generations of NVIDIA Quadro products.

**MCP Business.** The gross margin of our MCP Business increased during the third quarter of fiscal year 2008 as compared to the third quarter fiscal year 2007, as well as during the first nine months of fiscal year 2008 as compared to the first nine months of fiscal year 2007. This increase was primarily due to a shift in product mix towards Intel-based platform products, which we began to ramp up shipment after the third quarter of fiscal year 2007, and inventory reserves that we recorded as a charge to cost of revenue during the first quarter of fiscal 2007 of approximately \$4.1 million related to certain NVIDIA nForce purchase commitments that we believed had exceeded future demand.

**CPB.** The gross margin of our CPB was flat during the third quarter of fiscal year 2008 as compared to the third quarter fiscal year 2007, but decreased during the first nine months of fiscal year 2008 as compared to the first nine months of fiscal year 2007. This decrease was primarily due to a drop in gross profit realized from sales of our high-end feature cellular phone and other handheld devices. Offsetting these decreases was increased royalties from SCE during the third quarter of fiscal year 2008.

### **Operating Expenses**

#### **Research and Development**

|                                       | Three Months Ended  |                     |                |             | Nine Months Ended   |                     |                 |             |
|---------------------------------------|---------------------|---------------------|----------------|-------------|---------------------|---------------------|-----------------|-------------|
|                                       | October 28,<br>2007 | October 29,<br>2006 | \$<br>Change   | %<br>Change | October 28,<br>2007 | October 29,<br>2006 | \$<br>Change    | %<br>Change |
|                                       | (In millions)       |                     |                |             | (In millions)       |                     |                 |             |
| <b>Research and Development:</b>      |                     |                     |                |             |                     |                     |                 |             |
| Salaries and benefits                 | \$ 99.0             | \$ 70.5             | \$ 28.5        | 40%         | \$ 276.5            | \$ 205.5            | \$ 71.0         | 35%         |
| Stock-based compensation              | 18.7                | 18.7                | -              | -%          | 57.5                | 49.7                | 7.8             | 16%         |
| Depreciation and amortization         | 17.9                | 14.5                | 3.4            | 23%         | 51.6                | 44.6                | 7.0             | 16%         |
| Computer software and lab equipment   | 17.6                | 15.2                | 2.4            | 16%         | 48.1                | 41.5                | 6.6             | 16%         |
| Facility expense                      | 14.5                | 10.1                | 4.4            | 44%         | 38.9                | 27.0                | 11.9            | 44%         |
| New product development               | 7.5                 | 10.9                | (3.4)          | (31)%       | 14.3                | 25.7                | (11.4)          | (44)%       |
| License and development project costs | (1.4)               | (3.9)               | 2.5            | 64%         | (5.3)               | (14.6)              | 9.3             | 64%         |
| Other                                 | 5.7                 | 4.7                 | 1.0            | 21%         | 14.2                | 11.8                | 2.4             | 20%         |
| <b>Total</b>                          | <b>\$ 179.5</b>     | <b>\$ 140.7</b>     | <b>\$ 38.8</b> | <b>28%</b>  | <b>\$ 495.8</b>     | <b>\$ 391.2</b>     | <b>\$ 104.6</b> | <b>27%</b>  |
|                                       | 16%                 | 17%                 |                |             | 17%                 | 18%                 |                 |             |

## Research and development as a percentage of net revenue

Research and development expenses were \$179.5 million and \$140.7 million in the third quarter of fiscal years 2008 and 2007, respectively, an increase of \$38.8 million, or 28%. The increase is primarily due to a \$28.5 million increase in salaries and benefits, which was related to having approximately 700 additional personnel in research and development. Additionally, the increase is also attributable to accruals for payments pursuant to our variable compensation programs as a result of our improved financial performance and outlook for the current fiscal year. Despite an increase in headcount, stock-based compensation expense remained comparable between the third quarters of fiscal years 2008 and 2007 primarily because the increase in compensation expense related to stock options granted since the third quarter of fiscal year 2007 was offset by a combination of the reduction in compensation expense related to older awards that were almost completely vested and amortized by the end of the first quarter of fiscal year 2008 and the transition from the Black-Scholes model to the binomial model. Depreciation and amortization expense increased \$3.4 million due to additional hardware, machinery and equipment purchased during the year. Facility expenses increased \$4.4 million due to increased facility expense allocation, and computer software and equipment increased \$2.4 million primarily due to increased allocation of information technology expenses, both of which were based on the growth in headcount in departments related to research and development functions when compared to the growth in headcount related to sales, general and administrative functions. License and development project costs increased by \$2.5 million primarily related to decreased development costs related to our collaboration with SCE and other engineering costs related to a different development contract. Certain of our personnel who usually devote their time to research and development efforts have spent time working on these development projects. The cost associated with the time these individuals spend working on development projects is allocated from research and development to cost of revenue or is capitalized on our balance sheet. During the third quarter of fiscal year 2008, less time was spent working on development projects, so less cost was allocated to cost of revenue or capitalized and, therefore, more cost remained in research and development. These increases were offset by a decrease of \$3.4 million in new product development costs as a result of lower engineering consumption and non-recurring engineering costs in the current year.

Research and development expenses were \$495.8 million and \$391.2 million in the first nine months of fiscal years 2008 and 2007, respectively, an increase of \$104.6 million, or 27%. The increase is primarily due to a \$71.0 million increase in salaries and benefits which was related to having approximately 700 additional personnel. Additionally, the increase is also attributable to accruals for payments pursuant to our variable compensation programs as a result of our improved financial performance and outlook for the current fiscal year. Stock-based compensation expense increased by \$7.8 million primarily due to an increase in headcount, offset by a combination of the reduction in compensation expense related to older awards that were almost completely vested and amortized by the end of the first quarter of fiscal year 2008 and the transition from the Black-Scholes model to the binomial model. Depreciation and amortization expense increased \$7.0 million due to emulation hardware and software programs that were purchased during fiscal year 2007, resulting in a full period of depreciation in the first nine months of fiscal year 2008 compared to a partial period of depreciation in the first nine months of fiscal year 2007. Facility expenses increased \$11.9 million due to increased facilities expense allocation, and computer software and equipment increased \$6.6 million primarily due to increased allocation of information technology expenses, both of which were based on the growth in headcount in departments related to research and development functions when compared to the growth in headcount related to sales, general and administrative functions. License and development project costs increased by \$9.3 million primarily related to decreased development costs related to our collaboration with SCE and other engineering costs related to a different development contract. Certain of our personnel who usually devote their time to research and development efforts have spent time working on these development projects. The cost associated with the time these individuals spend working on development projects is allocated from research and development to cost of revenue or is capitalized on our balance sheet. During the first nine months of fiscal year 2008, less time was spent working on development projects, so less cost was allocated to cost of revenue or capitalized and, therefore, more cost remained in research and development. These increases were offset by a decrease of \$11.4 million in new product development costs as a result of decreases in product tape-outs, engineering consumption and non-recurring engineering costs during the first nine months of fiscal year 2008.

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, anticipated increase in headcount and the greater number of products under development. However, 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 revenue.

*Sales, General and Administrative*

|  | Three Months Ended  |                              |         |       | Nine Months Ended |                              |         |       |
|--|---------------------|------------------------------|---------|-------|-------------------|------------------------------|---------|-------|
|  | October             |                              | \$      | %     | October           |                              | \$      | %     |
|  | October 28,<br>2007 | 29,<br>2006<br>(In millions) |         |       | 28,<br>2007       | 29,<br>2006<br>(In millions) |         |       |
| <b>Sales, General and Administrative:</b>                        |                     |                              |         |       |                   |                              |         |       |
| Salaries and benefits  | \$ 45.3             | \$ 35.2                      | \$ 10.1 | 29%   | \$ 126.3          | \$ 100.4                     | \$ 25.9 | 26%   |
| Advertising and promotions                                       | 19.2                | 15.3                         | 3.9     | 25%   | 47.2              | 45.0                         | 2.2     | 5%    |
| Stock-based compensation   | 10.8                | 10.7                         | 0.1     | 1%    | 33.3              | 27.8                         | 5.5     | 20%   |
| Legal and accounting fees  | 7.3                 | 8.9                          | (1.6)   | (18)% | 23.7              | 15.5                         | 8.2     | 53%   |
| Depreciation and amortization                                    | 2.5                 | 0.6                          | 1.9     | 317%  | 8.0               | 5.1                          | 2.9     | 57%   |
| Facility expense   | 1.0                 | 3.4                          | (2.4)   | (71)% | 6.5               | 11.7                         | (5.2)   | (44)% |
| Other  | 2.1                 | 1.5                          | 0.6     | 40%   | 5.0               | 3.1                          | 1.9     | 61%   |
| Total  | \$ 88.2             | \$ 75.6                      | \$ 12.6 | 17%   | \$ 250.0          | \$ 208.6                     | \$ 41.4 | 20%   |
| Sales, general and administrative as a percentage of net revenue |                     |                              |         |       |                   |                              |         |       |
|  | 8%                  | 9%                           |         |       | 9%                | 10%                          |         |       |

Sales, general and administrative expenses were \$88.2 million and \$75.6 million in the third quarter of fiscal years 2008 and 2007, respectively, an increase of \$12.6 million, or 17%, primarily due to a \$10.1 million increase in salaries and benefits related to our having approximately 170 additional personnel. Additionally, the increase is also attributable to accruals for payments pursuant to our variable compensation programs as a result of our improved financial performance and outlook for the current fiscal year. Despite an increase in headcount, stock-based compensation expense remained comparable between the third quarters of fiscal years 2008 and 2007, primarily because the increase in compensation expense related to stock options granted since the third quarter of fiscal year 2007 was offset by a combination of the reduction in compensation expense related to older awards that were almost completely vested and amortized by the end of the first quarter of fiscal year 2008 and the transition from the Black-Scholes model to the binomial model. Advertising and promotions increased by \$3.9 million primarily due to expenses incurred due to conferences, sponsorships and employee events held during the quarter and increased advertising campaign costs. These increases were offset by a decrease of \$2.4 million in facility expense due to decreased facilities expense allocation to sales, general and administrative functions, which was driven by greater incremental headcount growth within the research and development functions. Legal and accounting fees also decreased by \$1.6 million primarily due to a decrease in legal fees related to the stock option investigation, offset by legal fees related to the Department of Justice, or DOJ investigation which was initiated in the fourth quarter of fiscal year 2007 and 3dfx matters described in Note 13 of the Notes to Condensed Consolidated Financial Statements.

Sales, general and administrative expenses were \$250.0 million and \$208.6 million for the first nine months of fiscal years 2008 and 2007, respectively, an increase of \$41.4 million, or 20%. The increase was primarily due to a \$25.9 million increase in salaries and benefits which related to our having added approximately 170 additional personnel. Additionally, the increase is also attributable to accruals for payments pursuant to our variable compensation programs as a result of our improved financial performance and outlook for the current fiscal year. Stock-based

compensation expense increased by \$5.5 million primarily due to an increase in headcount, offset by a combination of the reduction in compensation expense related to older awards that were almost completely vested and amortized by the end of the first quarter of fiscal year 2008 and the transition from the Black-Scholes model to the binomial model. Advertising and promotions expenses increased by \$2.2 million primarily due to increase in sponsorship, employee events and advertising campaign costs. Legal and accounting fees increased by \$8.2 million primarily due to legal fees related to the 3dfx and DOJ matters. Depreciation and amortization expense increased by \$2.9 million primarily due to additions of hardware, machinery and equipment during fiscal year 2008. These increases in sales, general and administrative expenses were offset by a decrease of \$5.2 million in facility expenses due to decreased facilities expense allocation to sales, general and administrative functions, which was driven by greater incremental headcount growth within the research and development functions.



### *Operating Expenses*

We expect operating expenses to increase by 3% to 5% in the fourth quarter of fiscal year 2008 as a result of continued hiring and associated salaries and benefits expenses.

### *Interest Income and Interest Expense*

Interest income consists of interest earned on cash, cash equivalents and marketable securities. Interest income was \$17.4 million and \$10.7 million in the third quarter of fiscal years 2008 and 2007, respectively, an increase of \$6.8 million. Interest income was \$46.3 million and \$28.3 million for the first nine months of fiscal years 2008 and 2007, respectively, an increase of \$18.0 million. These increases were primarily the result of higher average balances of cash, cash equivalents, and marketable securities during the first nine months of fiscal year 2008 when compared to the first nine months of fiscal year 2007.

### *Income Taxes*

We recognized income tax expense of \$31.1 million and \$21.8 million for the third quarter of fiscal years 2008 and 2007, respectively, and \$80.8 million and \$58.3 million for the first nine months of fiscal years 2008 and 2007, respectively. Income tax expense as a percentage of income before taxes, or our effective tax rate, was 11.7% and 17.0% for the third quarter of fiscal years 2008 and 2007, respectively, and 13.0% and 17.0% for the first nine months of fiscal years 2008 and 2007, respectively. Our effective tax rate is lower than the United States Federal Statutory rate of 35.0% due primarily to income earned in lower tax jurisdictions and research tax credits. During the quarter ended October 28, 2007, we lowered our estimate of the fiscal year 2008 annual effective tax rate from 14.0% to 13.0%. The revision resulted primarily due to a change in the relative geographical mix of income subject to tax and increased research tax credits due to increased stock option deductions.

Please refer to Note 3 of the Notes to Condensed Consolidated Financial Statements for additional information regarding income taxes.

**Liquidity and Capital Resources**

|   | <b>As of<br/>October<br/>28, 2007</b> | <b>As of<br/>January<br/>28, 2007</b> |
|---|---------------------------------------|---------------------------------------|
|   | <b>(In millions)</b>                  |                                       |
| Cash and cash equivalents                         | \$ 1,056.7                            | \$ 544.4                              |
| Marketable securities                             | 796.3                                 | 573.4                                 |
| Cash, cash equivalents, and marketable securities | \$ 1,853.0                            | \$ 1,117.8                            |

|   | <b>As of<br/>October<br/>28, 2007</b> | <b>As of<br/>October<br/>29, 2006</b> |
|---|---------------------------------------|---------------------------------------|
|   | <b>(In millions)</b>                  |                                       |
| Net cash provided by operating activities           | \$ 1,017.7                            | \$ 356.7                              |
| Net cash used in investing activities               | \$ (335.4)                            | \$ (168.9)                            |
| Net cash provided by (used in) financing activities | \$ (170.0)                            | \$ 2.2                                |

As of October 28, 2007, we had \$1.85 billion in cash, cash equivalents and marketable securities, an increase of \$735.1 million from the end of fiscal year 2007. 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 certain limits on our portfolio duration.

Operating activities generated cash of \$1.02 billion and \$356.7 million during the first nine months of fiscal years 2008 and 2007, respectively. The cash provided by operating activities increased due to an increase in our net income during the comparable periods. Additionally, operating activities have generated cash in amounts greater than net income primarily due to non-cash charges such as stock-based compensation expense, depreciation and amortization. The improvement in days sales in inventory correlates to the incremental inflow from inventory sell through in excess of purchases. Additionally, timing of payment to vendors also contributed to increased operating cash flows. During the first nine months of fiscal year 2008, these operating cash inflows were offset by cash outflows related to accounts receivable due to an increase in sales compensated by strong collections related to the increased linearity in the profile of shipments in the year. Additionally, during the nine months of fiscal year 2008, approximately \$49.6 million in payments were made related to a confidential patent licensing arrangement that we entered into during fiscal year 2007.

Investing activities have consisted primarily of purchases and sales of marketable securities, purchases of property and equipment and purchases of intangible assets. Investing activities used cash of \$335.4 million during the first nine months of fiscal year 2008, primarily due to \$117.4 million for capital expenditures. Capital expenditures included purchases of new research and development equipment, testing equipment that are consigned to partners located in Asia to support our increased production, purchase of land in anticipation of building additional space, and purchases of other hardware equipment, technology licenses, software and intangible assets. Investing activities also used cash of \$218.0 million towards the net purchases of marketable securities, primarily due to the increased cash balances in the first nine months of the fiscal year 2008. Investing activities used cash of \$168.9 million during the first nine months of fiscal year 2007, primarily due to \$69.6 million for capital expenditures and \$67.0 million towards acquisition of businesses. Investing activities also used cash of \$32.3 million towards the net purchases of marketable securities in the first nine months of the fiscal year 2007.

We expect to spend approximately \$30.0 million to \$50.0 million for capital expenditures unrelated to acquisitions during the fourth quarter of fiscal year 2008. In addition, we may continue to use cash in connection with the

acquisition of businesses or assets.

Financing activities used cash of \$374.4 million towards our stock repurchase program for the first nine months of fiscal year 2008 and provided cash of \$204.4 million from common stock issued under employee stock plans during the first nine months of fiscal year 2008. Financing activities provided cash of \$2.2 million during the first nine months of fiscal year 2007, primarily as a result of \$154.6 million of common stock issued under employee stock plans, offset by \$175.0 million of cash used towards our stock repurchase program.

### *Stock Repurchase Program*

During fiscal year 2005, we announced that our Board had authorized a stock repurchase program to repurchase shares of our common stock, subject to certain specifications, up to an aggregate maximum amount of \$300 million. During fiscal year 2007, the Board further approved an increase of \$400 million to the original stock repurchase program. In fiscal year 2008, on May 21, 2007, we announced a stock repurchase program under which we may purchase up to an additional \$1.0 billion of our common stock over a three year period through May 2010. As a result of these increases, we have an ongoing authorization from the Board, subject to certain specifications, to repurchase shares of our common stock up to an aggregate maximum amount of \$1.7 billion.

The repurchases will be made from time to time in the open market, in privately negotiated transactions, or in structured stock repurchase programs, and may be made in one or more larger repurchases, in compliance with the Securities Exchange Act of 1934, or the Exchange Act, Rule 10b-18, subject to market conditions, applicable legal requirements, and other factors. The program does not obligate NVIDIA to acquire any particular amount of common stock and the program may be suspended at any time at our discretion. As part of our share repurchase program, we have entered into, and we may continue to enter into, structured share repurchase transactions with financial institutions. These agreements generally require that we make an up-front payment in exchange for the right to receive a fixed number of shares of our common stock upon execution of the agreement, and a potential incremental number of shares of our common stock, within a pre-determined range, at the end of the term of the agreement.

During the third quarter of fiscal year 2008, we entered into a structured share repurchase transaction to repurchase 4.0 million shares for \$125.0 million which we recorded on the trade date of the transaction. Through October 28, 2007, we have repurchased 56.0 million shares under our stock repurchase program for a total cost of \$862.5 million.

Subsequent to October 28, 2007, we entered into a structured share repurchase transaction to repurchase shares of our common stock for \$125.0 million that we expect to settle prior to the end of our fourth quarter of fiscal year 2008 ending on January 27, 2008.

### *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, acquisition 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 that 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 "Item 1A. Risk Factors - 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, the trading price of our stock could decline."

### *3dfx Asset Purchase*

On December 15, 2000, NVIDIA Corporation and one of our indirect subsidiaries entered into the Asset Purchase Agreement, or the APA, which closed on April 18, 2001, to purchase certain graphics chip assets from 3dfx. Under the terms of the APA, 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. The Asset Purchase Agreement also provided, subject to the other provisions thereof, that if 3dfx properly certified that all its debts and other liabilities had been provided for, then we would have been obligated to pay 3dfx one million shares, which due to subsequent stock splits now totals six million shares, of NVIDIA common stock. If 3dfx could not make such a certification, but instead properly certified that its debts and liabilities could be satisfied for less than \$25.0 million, then 3dfx could have elected to receive a cash payment equal to the amount of such debts and 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. If 3dfx could not certify that all of its debts and liabilities had been provided for, or could not be satisfied, for less than \$25.0 million, we would not be obligated under the agreement to pay any additional consideration for the assets.

In October 2002, 3dfx filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court for the Northern District of California. In March 2003, we were served with a complaint filed by the Trustee appointed by the Bankruptcy Court which sought, among other things, payments from us as additional purchase price related to our purchase of certain assets of 3dfx. In early November 2005, after several months of mediation, NVIDIA and the Official Committee of Unsecured Creditors, or the Creditors' Committee, agreed to a Plan of Liquidation of 3dfx, which included a conditional settlement of the Trustee's claims against us. This conditional settlement was subject to a confirmation process through a vote of creditors and the review and approval of the Bankruptcy Court after notice and hearing. The conditional settlement called for a payment by NVIDIA of approximately \$30.6 million to the 3dfx estate. Under the settlement, \$5.6 million related to various administrative expenses and Trustee fees, and \$25.0 million related to the satisfaction of debts and liabilities owed to the general unsecured creditors of 3dfx. Accordingly, during the three month period ended October 30, 2005, we recorded \$5.6 million as a charge to settlement costs and \$25.0 million as additional purchase price for 3dfx. The Trustee advised that he intended to object to the settlement. However, the conditional settlement never progressed substantially through the confirmation process.

On December 21, 2005, the Bankruptcy Court determined that it would schedule trial of one portion of the Trustee's case against NVIDIA. On January 2, 2007, NVIDIA exercised its right to terminate the settlement agreement on grounds that the Bankruptcy Court had failed to proceed toward confirmation of the Creditors' Committee's plan. A non-jury trial began on March 21, 2007 on valuation issues in the Trustee's constructive fraudulent transfer claims against NVIDIA. Specifically, the Bankruptcy Court tried four questions: (1) what did 3dfx transfer to NVIDIA in the APA?; (2) of what was transferred, what qualifies as "property" subject to the Bankruptcy Court's avoidance powers under the Uniform Fraudulent Transfer Act and relevant bankruptcy code provisions?; (3) what is the fair market value of the "property" identified in answer to question (2)?; and (4) was the \$70 million that NVIDIA paid "reasonably equivalent" to the fair market value of that property? At the conclusion of the evidence, the Bankruptcy Court asked the parties to submit post-trial briefing. That briefing was completed on May 25, 2007, and the Bankruptcy Court's decision is still pending.

Please refer to Note 13 of the Notes to Condensed Consolidated Financial Statements for further information regarding this litigation.

#### *Contractual Obligations*

At October 28, 2007, we had outstanding inventory purchase obligations totaling approximately \$784.2 million. There were no other material changes in our contractual obligations from those disclosed in our Form 10-K for the year ended January 28, 2007. Please see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" in our Form 10-K for a description of our contractual obligations.

#### *Off-Balance Sheet Arrangements*

As of October 28, 2007, we had no material off-balance sheet arrangements as defined in Regulation S-K 303(a) (4) (ii).

## Recently Issued Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 157, or SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 establishes a framework for measuring fair value and expands disclosures about fair value measurements. The changes to current practice resulting from the application of SFAS No. 157 relate to the definition of fair value, the methods used to measure fair value, and the expanded disclosures about fair value measurements. We are required to adopt the provisions of SFAS No. 157 beginning with our fiscal quarter ending April 27, 2008. We are currently evaluating the impact that SFAS No. 157 will have on our consolidated financial position, results of operations and cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, or SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits companies to choose to measure certain financial instruments and certain other items at fair value. The standard requires that unrealized gains and losses on items for which the fair value option has been elected be reported in earnings. We are required to adopt the provisions of SFAS No. 159 beginning with our fiscal quarter ending April 27, 2008, although earlier adoption is permitted. We are currently evaluating the impact that SFAS No. 159 will have on our consolidated financial position, results of operations and cash flows.

In June 2007, the FASB ratified Emerging Issues Task Force Issue No. 07-3, or EITF 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities*. EITF 07-3 requires non-refundable advance payments for goods and services to be used in future research and development activities to be recorded as an asset and the payments to be expensed when the research and development activities are performed. We are required to adopt the provisions of EITF 07-3 beginning with our fiscal quarter ending April 27, 2008. The adoption of EITF 07-3 is not expected to have a significant impact on our consolidated financial position, results of operations and cash flows.

On January 29, 2007, we adopted FASB Interpretation No. 48, or FIN 48, *Accounting for Uncertainty in Income Taxes*, issued in July 2006. FIN 48 applies to all tax positions related to income taxes subject to FASB Statement of Financial Accounting Standards No. 109, or SFAS No. 109, *Accounting for Income Taxes*. Under FIN 48 we recognize the benefit from a tax position only if it is more-likely-than-not that the position would be sustained upon audit based solely on the technical merits of the tax position. The cumulative effect of adoption of FIN 48 did not result in a material adjustment to our tax liability for unrecognized income tax benefits. Our policy to include interest and penalties related to unrecognized tax benefits as a component of income tax expense did not change as a result of implementing the FIN 48. Please refer to Note 3 of the Notes to Condensed Consolidated Financial Statements for additional information.

### 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 United States government and its agencies. These investments are denominated in United States dollars. As of October 28, 2007, we had \$1.85 billion in cash, cash equivalents and marketable securities.

We account for our investment instruments in accordance with Statement of Financial Accounting Standards No. 115, or 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 we are forced to sell securities that decline in market value due to changes in interest rates. However, because we classify our debt securities as “available-for-sale”, no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity or declines in fair value are determined to be other than temporary. 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.

As of October 28, 2007, we performed a sensitivity analysis on our floating and fixed rate financial investments. According to our analysis, parallel shifts in the yield curve of both +/- 0.5% would result in changes in fair market values for these investments of approximately \$3.0 million.

#### Exchange Rate Risk

We consider our direct exposure to foreign exchange rate fluctuations to be minimal. Currently, sales and arrangements with third-party manufacturers provide for pricing and payment in United States dollars, and, therefore, are not subject to exchange rate fluctuations. Increases in the value of the United States’ dollar relative to other currencies would make our products more expensive, which could negatively impact our ability to compete. Conversely, decreases in the value of the United States’ dollar relative to other currencies could result in our suppliers raising their prices in order to continue doing business with us. Fluctuations in currency exchange rates could harm our business in the future.

We may enter into certain transactions such as forward contracts which are designed to reduce the future potential impact resulting from changes in foreign currency exchange rates. There were no forward exchange contracts outstanding at October 28, 2007. Subsequent to October 28, 2007, we have entered into a forward foreign exchange contract to purchase Euros with a notional principal of \$83.2 million.



## ITEM 4. CONTROLS AND PROCEDURES

### Controls and Procedures

#### *Disclosure Controls and Procedures*

Based on their evaluation as of October 28, 2007, our management, including our Chief Executive Officer and Chief Financial Officer, have concluded that our disclosure controls and procedures as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, or the Exchange Act, were effective to ensure that the material information required to be disclosed by us in this Quarterly Report on Form 10-Q was recorded, processed, summarized and reported within the time periods specified in the SEC's rules and instructions for Form 10-Q.

#### *Changes in Internal Control Over Financial Reporting*

There were no changes in our internal controls over financial reporting during our quarter ended October 28, 2007, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

#### *Inherent Limitations on Effectiveness of Controls*

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls, will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within NVIDIA have been detected.

## **PART II: OTHER INFORMATION**

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

Please see Part I, Item 1, Note 13 of the Notes to Condensed Consolidated Financial Statements for a discussion of our legal proceedings.

### **ITEM 1A.RISK FACTORS**

A description of the risk factors associated with our business is set forth below. This description includes any material changes to and supersedes the description of risk factors associated with our business previously disclosed in Part I, Item 1A. “Risk Factors” of our Form 10-K for the fiscal year ended January 28, 2007.

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

***Because our gross margin for any period depends on a number of factors, our failure to forecast changes in any of the factors could adversely affect our gross margin.***

We continue to pursue improved gross margin. Our gross margin for any period depends on a number of factors, including:

- the mix of our products sold;
  - average selling prices;
- introduction of new products;
  - sales discounts;
- unexpected pricing actions by our competitors;
  - the cost of product components; and
- the yield of wafers produced by the foundries that manufacture our products.

If we do not correctly forecast the impact of any of the relevant factors on our business, we may not be able to take action in time to counteract any negative impact on our gross margin. In addition, if we are unable to meet our gross margin target for any period or the target set by analysts, the trading price of our common stock may decline.

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

Our performance is substantially dependent on the performance of our executive officers and key employees. None of our executive officers or employees is bound by an employment agreement, meaning our relationships with our executive 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. The integration of new executives or personnel could disrupt our ongoing operations.

***Our failure to estimate customer demand properly may result in excess or obsolete inventory or, conversely, may result in inadequate inventory levels, either of which could adversely affect our financial results.***

Our inventory purchases are based upon future demand forecasts or orders from our customers and may not accurately predict the quantity or type of products that our customers will want in the future or ultimately end up purchasing. In

forecasting demand, we must make multiple assumptions any of which may prove to be incorrect. Situations that may result in excess or obsolete inventory, which could result in write-downs of the value of our inventory and/or a reduction in average selling prices, and where our gross margin could be adversely affected include:

- if there were a sudden and significant decrease in demand for our products;
- if there were a higher incidence of inventory obsolescence because of rapidly changing technology and customer requirements;
- if we fail to estimate customer demand properly for our older products as our newer products are introduced; or
  - if our competition were to take unexpected competitive pricing actions.

Conversely, if we underestimate our customers' demand for our products, our third party manufacturing partners may not have adequate capacity to increase production for us meaning that we may not be able to obtain sufficient inventory to fill our customers' orders on a timely basis. Even if we are able to increase production levels to meet customer demand, we may not be able to do so in a cost effective or timely manner. Inability to fill our customers' orders on a timely basis, or at all, could damage our customer relationships, result in lost revenue, cause a loss in market share, impact our customer relationships or damage our reputation, any of which could adversely impact our financial results.

***Failure to achieve expected manufacturing yields for existing and/or new products could negatively impact our financial results and damage our reputation.***

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. Resolution of yield problems requires cooperation by and communication between us and the manufacturer.

Because of our potentially limited access to wafer fabrication capacity from our manufacturers, decreases 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, our reputation, our revenue, our gross profit and our gross margin.

***To stay competitive, which may include entering new markets, we may have to invest more resources in research and development than anticipated, which could increase our operating expenses and negatively impact our operating results.***

If new competitors, technological advances by existing competitors, our entry into new markets, or other competitive factors require us to invest significantly greater resources than anticipated in our research and development efforts, our operating expenses would increase. We have increased our engineering and technical resources and had 3,020 full-time employees engaged in research and development as of October 28, 2007 and 2,327 full-time employees as of October 29, 2006. Research and development expenditures were \$179.5 million and \$495.8 million for the three and nine months ended fiscal year 2008, respectively and \$140.7 million and \$391.2 million for the three and nine months ended fiscal year 2007, respectively. Research and development expenses included non-cash stock-based compensation expense of \$18.7 million and \$57.5 million for the three and nine months ended fiscal year 2008, respectively, and \$18.7 million and \$49.7 million for the three and nine months ended fiscal year 2007, respectively. If we are required to invest significantly greater resources than anticipated in research and development efforts without an increase in revenue, our operating results could decline. 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 revenue. In order to remain competitive, which may include entering new markets, 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 as well as hiring additional employees.

***Our operating expenses are relatively fixed and we may not be able to reduce operating expenses quickly in response to any revenue shortfalls.***

Our operating expenses, which are comprised of research and development expenses and sales, general and administrative expenses, represented 24% and 26% of our total revenue during the third quarter of fiscal years 2008 and 2007, respectively and 26% and 27% for the first nine months of fiscal years 2008 and 2007, respectively. Operating expenses included \$29.4 million for the third quarters of fiscal years 2008 and 2007, and \$90.8 million and \$77.5 million for the first nine months of fiscal years 2008 and 2007, respectively, related to non-cash stock-based compensation expense. Since we often recognize a substantial portion of our revenue in the last month of each quarter, we may not be able to adjust our operating expenses in a timely manner in response to any revenue shortfalls. If we are unable to reduce operating expenses quickly in response to any revenue shortfalls, our financial results would be negatively impacted.

***Failure to transition to new manufacturing process technologies could adversely affect our operating results and gross margin.***

Our strategy is to utilize the most advanced manufacturing process technology appropriate for our products and available from commercial third-party foundries. Use of advanced processes may have initial yield problems and higher product cost. 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 0.15 micron, 0.14 micron, 0.13 micron, 0.11 micron, 90 nanometer and 65 nanometer process technologies for our families of graphics processing units, or GPUs, media and communications processors, or MCPs, cellular phones, other handheld devices and other digital consumer electronic devices.

We have experienced difficulty in migrating to new manufacturing processes in the past and, consequently, have suffered reduced yields, delays in product deliveries and increased expense levels. We may face similar difficulties, delays and expenses as we continue to transition our products to smaller geometry processes. Moreover, we are dependent on our third-party manufacturers to migrate to smaller geometry processes successfully. Some of our competitors own their own manufacturing facilities and may be able to move to a new state of the art manufacturing process more quickly than our manufacturing partners. For example, Intel recently released a 45nm chip for desktop computers which it is manufacturing in its foundries. If our suppliers fall behind our competitors in manufacturing processes, the development and customer demand for our products and the use of our products could be negatively impacted. The inability by us or our third-party manufacturers to effectively and efficiently transition to new manufacturing process technologies may adversely affect our operating results and our gross margin.

***The matters relating to the Audit Committee of the Board of Directors, or the Board, review of our historical stock option granting practices and the restatement of our consolidated financial statements have resulted in litigation, which could harm our financial results.***

On August 10, 2006, NVIDIA announced that the Audit Committee of the Board, with the assistance of outside legal counsel, was conducting a review of our stock option practices covering the time from NVIDIA's initial public offering in 1999, our fiscal year 2000, through June 2006. The Audit Committee reached the conclusion that incorrect measurement dates were used for financial accounting purposes for stock option grants in certain prior periods. As a result, NVIDIA recorded additional non-cash stock-based compensation expense, and related tax effects, related to stock option grants.

The Audit Committee's review of NVIDIA's historic stock option practices identified a number of occasions on which the measurement date used for financial accounting and reporting purposes for stock options granted to certain of our employees was different from the actual grant date. To correct these accounting errors, we amended our Annual Report on Form 10-K for the year ended January 29, 2006 and our Quarterly Report on Form 10-Q for the three months ended April 30, 2006 to restate the consolidated financial statements contained in those reports. This review of our historical stock option granting practices and subsequent restatement required us to incur substantial expenses for legal, accounting, tax and other professional services and diverted our management's attention from our business.

Additionally, the review and the resulting restatement of our prior financial statements have exposed us to greater risks associated with litigation. Ten derivative complaints have been filed in state and federal court pertaining to allegations relating to stock option grants. We cannot assure you that these or future similar complaints, or any future litigation or regulatory action will result in the same conclusions reached by the Audit Committee. On August 5, 2007, our Board authorized the formation of a Special Litigation Committee to investigate, evaluate, and make a determination as to how NVIDIA should proceed with respect to the claims and allegations asserted in the underlying derivative cases brought on NVIDIA. The Special Litigation Committee's review is ongoing. The conduct and resolution of these matters will be time consuming, expensive and could distract our management's attention from the conduct of our business which could negatively impact our business. Furthermore, if we are subject to adverse rulings, we could be required to pay damages or penalties or have other remedies imposed upon us which could harm our business, financial condition, results of operations and cash flows.

***Because we order materials in advance of anticipated customer demand our ability to reduce our inventory purchase commitments quickly in response to any revenue shortfalls is limited.***

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. As a result, we may build inventories for anticipated periods of growth which do not occur. Any inability to sell products to which we have devoted significant resources could harm our business. In addition, cancellation or deferral of customer purchase orders could result in our holding excess inventory, which could adversely affect our

gross margin and restrict our ability to fund operations. Additionally, because we often sell a substantial portion of our products in the last month of each quarter, we may not be able to reduce our inventory purchase commitments in a timely manner in response to customer cancellations or deferrals or other revenue shortfalls. We could be subject to excess or obsolete inventories and be required to take corresponding inventory write-downs if growth slows or does not materialize or if we incorrectly forecast product demand, which could negatively impact our financial results.

***Our operating results are unpredictable and may fluctuate, and if our operating results are below the expectations of securities analysts or investors, the trading price of our stock 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. Therefore, it is 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. We believe that our quarterly and annual results of operations may continue to be affected by a variety of factors that could harm our revenue, gross profit and results of operations.

Any one or more of the factors discussed in this Form 10-Q or other factors could prevent us from achieving our expected future revenue or net income. Accordingly, we believe that period-to-period comparisons of our results of operations should not be relied upon as an indication of future performance. Similarly, the results of any quarterly or full fiscal year period are not necessarily indicative of results to be expected for a subsequent quarter or a full fiscal year.

### **Risks Related to Our Products**

***If we are unable to achieve design wins, our products may not be adopted by our target markets or customers either of which could negatively impact our financial results.***

The future success of our business depends to a significant extent on our ability to develop new competitive products for our target markets and customers. We believe achieving design wins, which entails having our existing and future products chosen for hardware components or subassemblies designed by PC original equipment manufacturers, or OEMs, original design manufacturers, or ODMs, and add-in board and motherboard manufacturers, will aid our future success. Our OEM, ODM, and add-in board and motherboard manufacturers' customers typically introduce new system configurations as often as twice per year, typically based on spring and fall design cycles or in connection with trade shows. Accordingly, when our customers are making their design decisions, our existing products must have competitive performance levels or we must timely introduce new products in order to be included in new system configurations. This requires that we do the following:

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

If OEMs, ODMs, and add-in board and motherboard manufacturers do not include our products in their systems, they will typically not use our products in their systems until at least the next design configuration. Therefore, we endeavor to develop close relationships with our OEMs and ODMs, in an attempt to allow us to better anticipate and address customer needs in new products so that our products will achieve design wins.

Our ability to achieve design wins also depends in part on our ability to identify and be compliant 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 Advanced Micro Devices, Inc., or AMD, Intel Corporation, or Intel and Microsoft Corporation, or Microsoft. Such changes would require us to invest significant time and resources to redesign our products to be compliant 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. If we are unable to achieve new design wins for existing or new customers, we may lose market share and our operating results would be negatively impacted.

***Achievement of design wins may not result in the success of our products and could result in a loss of market share.***

The process of being qualified for inclusion in an OEM or ODM 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 result in a loss of market share and harm our business. Even if we do have design wins for OEM and ODM products, we may not be able to successfully develop or introduce new products in sufficient volumes within the appropriate time to meet the OEM, ODM, add-in board and motherboard manufacturers' design cycles as well as other market demand. Additionally, even if we achieve a significant number of design wins, there can be no assurance that our OEM and ODM customers will actually take the design to production or that the design will be commercially successful. Furthermore, there may be changes in the timing of product orders due to unexpected delays in the introduction of our customers' products that could negatively impact the success of our products. Any of these factors could result in a loss of market share and could negatively impact our financial results.

***Our business results could be adversely affected if our product development efforts are unsuccessful.***

In the past, we have experienced delays in the development of new products. Any delay or failure of our GPUs, our other processors, or other technologies to meet or exceed specifications of our customers or competitive products could materially harm our business. The success of our new product introductions will depend on many factors, including the following:

- proper new product definition;
- timely completion and introduction of new product designs;
- availability of next-generation software development tools to design, simulate and verify our products;
- the ability of third-party manufacturers to effectively manufacture our new products in a timely manner;
- dependence on third-party subcontractors for assembly, testing and packaging of our products and in meeting product delivery schedules and maintaining product quality;
  - the quality of 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 failure to successfully develop, introduce or achieve market acceptance for new processors or other technologies would harm our business.

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

As our GPUs and other processors develop and competition increases, we anticipate that product life cycles at the high end will remain short and average selling prices will decline. In particular, we expect average selling prices and gross margins for our 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 or improve overall average selling prices and gross margin. In order for our processors to achieve high volumes, leading PC OEMs, ODMs, and add-in board and motherboard manufacturers must select our processors 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 new products in a timely fashion. In addition, we cannot guarantee that new products we develop will be selected for design into PC OEMs', ODMs', or 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 our products increases, there is an increasing risk that we will experience problems with the performance of our 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 that may delay the introduction or volume sale of new products we develop. In addition, we may be unable to successfully manage the production transition risks with respect to future products. Failure to achieve any of the foregoing with respect to future products or product enhancements could result in rapidly declining average selling prices, reduced margins and reduced demand for products or loss of market share. In addition, technologies developed by others may render our processors non-competitive or obsolete or result in our holding excess inventory, which would harm our business.

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

Products as complex as those we offer may contain defects or experience failures when introduced or when new versions or enhancements to existing products are released. In the past, we have discovered defects and incompatibilities with customers' hardware in some of our products. Similar issues in the future may result in delays or loss of revenue to correct any defects or incompatibilities. Errors in new products or releases and related software

drivers after commencement of commercial shipments could result in failure to achieve market acceptance or loss of design wins. 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. We also face the risk of product recalls or product returns. A significant number of product returns due to a defect or recall could damage our reputation, result in our customers working with our competitors, and could adversely impact our financial results. We may also be required to incur additional research and development costs to find and correct the defect, which could divert the attention of our management and engineers from the development of new products. These costs could be significant and could adversely affect our business and operating results. We may also suffer a loss of reputation, loss of revenues and/or a loss in our market share, any of which could materially harm our financial results.

## Risks Related to Our Partners and Customers

***We depend on 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 are a fabless semiconductor company meaning we do not manufacture the semiconductor wafers used for our products and do not own or operate a wafer fabrication facility. Instead, we utilize industry-leading foundries to produce our semiconductor wafers with their state-of-the-art fabrication equipment and techniques. Therefore, we rely on our manufacturers to produce products of acceptable quality and at acceptable manufacturing yields and deliver wafers to us on a timely basis at acceptable prices. Since we obtain semiconductor wafers on a purchase order basis, the foundries we use have no obligation to provide us with any specified minimum quantities of product so we rely on them to allocate to us a portion of their manufacturing capacity that will be sufficient to meet our needs. Because these suppliers, including the fabrication facility that produces a majority of our products, fabricate wafers for other companies, including some of our competitors, they could choose to prioritize their capacity for other users, reduce or eliminate deliveries to us, or increase the prices that they charge us on short notice. If we are unable to meet customer demand due to reduced or eliminated deliveries, we could lose sales to customers, which would negatively impact our revenue and our reputation.

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. In addition, the time and effort to qualify a new foundry could result in additional expense, diversion of resources or lost sales any of which would negatively impact our financial results. We believe that long-term market acceptance for our products will depend on reliable relationships with the third-party manufacturers we use to ensure adequate product supply and competitive pricing to respond to customer demand.

***We may not be able to realize the potential financial or strategic benefits of business acquisitions, which could hurt our ability to grow our business, develop new products or sell our products.***

We have acquired and invested in other businesses that offered products, services and technologies that we believed would help expand or enhance our existing products and services or help expand our distribution channels. We may enter into future acquisitions of, or investments in, businesses, in order to complement or expand our current businesses or enter into a new business market. For example, in February 2006 we completed the acquisition of ULi Electronics, Inc., or ULi, in March 2006 we completed the acquisition of Hybrid Graphics Ltd., or Hybrid Graphics and in January 2007 we completed the acquisition of PortalPlayer, Inc., or PortalPlayer. If we do consider other acquisitions, a strategic alliance or a joint venture, the negotiations could divert management's attention as well as other resources. Any of the following risks associated with past or future acquisitions or investments could impair our ability to grow our business, develop new products, sell our products, and ultimately could have a negative impact on our growth or our financial results:

- difficulty in combining the technology, products, operations or workforce of the acquired business with our business;
  - difficulty in operating in a new or multiple new locations;
    - disruption of our ongoing businesses;
  - disruption of the ongoing business of the company we invest in or acquire;
- difficulty in realizing the potential financial or strategic benefits of the transaction;
- difficulty in maintaining uniform standards, controls, procedures and policies;
  - disruption of or delays in ongoing research and development efforts;
  - diversion of capital and other resources;
  - assumption of liabilities;
-

diversion of resources and unanticipated expenses resulting from litigation arising from potential or actual business acquisitions or investments;

- difficulties in entering into new markets in which we have limited or no experience and where competitors in such markets have stronger positions; and
- impairment of relationships with employees and customers, or the loss of any of our key employees or customers of our target's key employees or customers, as a result of our acquisition or investment.

In addition, the consideration for any future acquisition could be paid in cash, shares of our common stock, the issuance of convertible debt securities or a combination of cash, convertible debt and common stock. If we pay all or a portion of the purchase price in cash, our cash reserves would be reduced which could negatively impact the growth of our business or our ability to develop new products. We paid for the acquisitions of Hybrid Graphics, ULi and PortalPlayer with primarily cash. If the consideration is paid with shares of our common stock, or convertible debentures, the holdings of our existing stockholders would be diluted. We cannot forecast the number, timing or size of future acquisitions, or the effect that any such acquisitions might have on our operations or financial results.

***We are dependent on third parties for assembly, testing and packaging of our products, which reduces our control over the delivery and quantity of our products.***

Our processors are assembled, tested and packaged by independent subcontractors, such as Advanced Semiconductor Engineering, Inc., or ASE, Amkor Technology, or Amkor, King Yuan Electronics Co., or KYEC, Siliconware Precision Industries Co. Ltd., or SPIL, and ChipPAC. 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. Demand for qualified independent subcontractors to assemble and test products is high. If demand for these subcontractors exceeds the number of qualified subcontractors, we may experience capacity constraints, which could result in product shortages, a decrease in the quality of our products or an increase in product cost. Any of our subcontractors may decide to prioritize the orders of one of our competitors over our orders. Any product shortages or quality assurance problems could increase the costs of manufacture, assembly or testing of our products, which could cause our gross margin to decline. 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, test or package our products or components. Any such delays could result in a loss of reputation or a decrease in sales to our customers.

***There can be no assurance that the PlayStation3 will achieve long term commercial success.***

In April 2005, we finalized our definitive agreement with Sony Computer Entertainment, or SCE, to jointly develop custom GPU for SCE's PlayStation3. Our collaboration with SCE includes license fees and royalties for the PlayStation3 and all derivatives, including next-generation digital consumer electronics devices. In addition, we are licensing software development tools for creating shaders and advanced graphics capabilities to SCE. Contractual arrangements with SCE generated \$32.5 million and \$18.3 million of revenue during the third quarter of fiscal years 2008 and 2007, respectively, and \$77.0 million and \$65.5 million for the first nine months of fiscal years 2008 and 2007, respectively. Given the intense competition in the game console market, there can be no assurance that the PlayStation3 will achieve long term commercial success. If we do not receive royalties as we anticipate, our revenue and gross margin may be adversely affected.

***Any difficulties in collecting accounts receivable, including from foreign customers, could harm our operating results and financial condition.***

Our accounts receivable are highly concentrated. Three customers that had individual balances in excess of 10% of total accounts receivable, accounted for approximately 35% and 26% of our total accounts receivable balance as at October 28, 2007 and January 28, 2007, respectively, and make us vulnerable to adverse changes in our customers' businesses and to downturns in the economy and the industry. In addition, difficulties in collecting accounts receivable or the loss of any significant customer could materially and adversely affect our financial condition and results of operations. We continue to work directly with more foreign customers and it may be difficult to collect accounts receivable from them. 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, we may be required to defer revenue recognition on sales to affected customers and we may be required to pay higher credit insurance premiums, any of which could adversely affect our operating results. In the future, we may have to record additional reserves or write-offs and/or defer revenue on certain sales transactions which could negatively impact our financial results.

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

When we design and develop new products or product enhancements, we rely on third-party software development tools to assist us in the design, simulation and verification of new products or enhancements to existing products. If the software development tools available at the time that we are designing, simulating or verifying a product are not sophisticated enough or technologically advanced enough for our purposes, we may be unable to bring our products, or enhancements to existing products, to market in a timely manner, or at all. In the past, we have experienced delays in the introduction of products as a result of the inability of then available software development tools to fully simulate the complex features and functionalities of our products. In the future, the design requirements necessary to meet consumer demands for more features and greater functionality from our processors may exceed the capabilities of the software development tools that are available to us. If the software development tools we use become unavailable or fail to produce designs that meet consumer demands, we may miss design cycles or lose design wins which could result in a loss of market share, a decrease in revenue or negatively impact our operating results.

Because of the importance of software development tools to the development of our products, a critical component of our product development efforts is our partnerships with leaders in the computer-aided design industry, including Cadence Design Systems, Inc. and Synopsys, Inc. We have invested significant resources to develop relationships with these industry leaders and have often assisted them in the definition of their new products. We believe that forming these relationships and utilizing next-generation development tools to design, simulate and verify our products will help us remain at the forefront of the 3D graphics, communications and networking segments and develop products that utilize leading-edge technology on a rapid basis. We believe this approach assists us in meeting the new design schedules of our customers. If these relationships are not successful, we may not be able to develop new products or enhancements for existing products in a timely manner, which could result in a loss of market share, a decrease in revenue and a negative impact on our operating results.

***We sell our products to a small number of customers and our business could suffer if we lose any of these customers.***

We have only a limited number of customers and our sales are highly concentrated. Sales to significant customers, representing revenue in excess of 10% of our total revenue, accounted for approximately 10% and 13%, of our total revenue for the third quarter and the first nine months of fiscal years 2008 and 2007, respectively. Although a small number of our other customers represents the majority of our revenue, their end customers include a large number of OEMs and system integrators throughout the world who, in many cases, specify the graphics supplier. Our sales process involves achieving key design wins with leading PC OEMs and major system builders and supporting the product design into high volume production with key contract equipment manufacturers, or CEMs, ODMs, add-in board and motherboard manufacturers. These design wins in turn influence the retail and system builder channel that is serviced by CEMs, ODMs, add-in board and motherboard manufacturers. Our distribution strategy is to work with a small number of leading independent CEMs, ODMs, add-in board and motherboard manufacturers, and distributors, each of which has relationships with a broad range of system builders and leading PC OEMs. If we were to lose sales to our PC OEMs, CEMs, ODMs, add-in board and motherboard manufacturers and were unable to replace the lost sales with sales to different customers, or if they were to significantly reduce the number of products they order from us, our revenue may not reach or exceed the expected level in any period, which could harm our financial condition and our results of operations.

### **Risks Related to Our Competition**

***As Intel and AMD continue to pursue platform solutions, we may not be able to successfully compete and our business would be negatively impacted.***

We expect substantial competition from both Intel's and AMD's strategy of selling platform solutions, such as the success Intel achieved with its Centrino platform solution. AMD has also announced a platform solution. Additionally, we expect that Intel and AMD will extend this strategy to other segments, including the possibility of successfully integrating a CPU and a GPU on the same chip. If AMD and Intel continue to pursue platform solutions, we may not be able to successfully compete and our business would be negatively impacted.

***The market for our products is highly competitive and we may be unable to compete.***

The market for our products is highly competitive and is characterized by rapid technological change, new product introductions, evolving industry standards and declining average selling prices. We believe that the principal competitive factors in this market are:

- performance;
- breadth and frequency of product offerings;
- access to customers and distribution channels;



- backward-forward software support;
- conformity to industry standard application programming interfaces;
  - manufacturing capabilities;
  - price of processors; and
- total system costs of add-in boards and motherboards.

We believe that our ability to remain competitive will depend on how well we are able to anticipate the features and functions that customers will demand and whether we are able to deliver consistent volumes of our products at acceptable levels of quality. We expect competition to increase both from existing competitors and new market entrants with products that may be less costly than ours, or may provide better performance or additional features not provided by our products, either of which could harm our business.

For example, we are the largest supplier of AMD 64 chipsets with 61% segment share in the third quarter of calendar year 2007, as reported in the latest PC Processor and Chipset report from Mercury Research. Decline in demand for our chipsets in the AMD segment would harm our business.

An additional significant source of competition is from companies that provide or intend to provide competing product solutions. Some of our competitors may have or be able to obtain greater marketing, financial, distribution and manufacturing resources than we do and may be more able to adapt to customer or technological changes. For example, Intel is working on a multi-core architecture code-named Larrabee, which may compete with our products in various markets. Intel may also release an enthusiast level discrete GPU based on the Larrabee architecture. If Intel devotes more resources to the development of Larrabee as well as future architectures and GPU products than we do, it may produce products that out perform our current and future generations of technology and products.

Our current competitors include the following:

- suppliers of discrete MCPs that incorporate a combination of networking, audio, communications and input/output, or I/O, functionality as part of their existing solutions, such as AMD, Broadcom, Silicon Integrated Systems Corporation, or SIS, VIA Technologies, Inc., or VIA, and Intel;
- suppliers of GPUs, including MCPs that incorporate 3D graphics functionality as part of their existing solutions, such as AMD, Intel, Matrox Electronics Systems Ltd., XGI Technology, Inc., SIS and VIA;
- suppliers of GPUs or GPU intellectual property for handheld and digital consumer electronics devices that incorporate advanced graphics functionality as part of their existing solutions, such as AMD, Broadcom, Fujitsu Limited, Imagination Technologies Ltd., ARM Holdings plc, Marvell Technology Group Ltd., or Marvell, NEC Corporation, Qualcomm Incorporated, or Qualcomm, Renesas Technology, Seiko-Epson, Texas Instruments Incorporated, and Toshiba America, Inc.; and
- suppliers of application processors for handheld and digital consumer electronics devices that incorporate multimedia processing as part of their existing solutions such as Broadcom, Texas Instruments Inc., Qualcomm, Marvell, Freescale Semiconductor Inc., Samsung and ST Microelectronics.

If and to the extent we offer products outside of the consumer and enterprise PC, notebook, workstation, personal digital assistant, or PDA, cellular phone, and video game console markets, 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. If we are unable to compete in our current or new markets, our financial results will suffer.

## **Risks Related to Market Conditions**

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

Our semiconductor wafers are manufactured, assembled, tested and packaged by third-parties located outside of the United States. Additionally, we generated 89% and 87% of total revenue for the third quarter of fiscal years 2008 and 2007, respectively, and 86% and 85% for the first nine months of fiscal years 2008 and 2007, respectively, from sales to customers outside the United States and other Americas. The manufacture, assembly, test and packaging of our products outside of the United States, operation of offices outside of the United States, and sales to customers outside of the United States and other Americas subjects us to a number of risks associated with conducting business outside of the United States and other Americas, including, but not limited to:

- international economic and political conditions;
- unexpected changes in, or impositions of, legislative or regulatory requirements;
  - labor issues in foreign countries;
  - cultural differences in the conduct of business;
  - inadequate local infrastructure;
- delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers and restrictions;
  - transportation delays;

- longer payment cycles;
  - difficulty in collecting accounts receivable;
  - fluctuations in currency exchange rates;
- impact of currency exchange rate fluctuations on the price of our products to our customers, or on the supplies that we buy;
  - imposition of additional taxes and penalties;
  - different legal standards with respect to protection of intellectual property;
    - the burdens of complying with a variety of foreign laws; and
- other factors beyond our control, including terrorism, civil unrest, war and diseases such as severe acute respiratory syndrome and the Avian flu.

If sales to any of our customers outside of the United States and other Americas are delayed or cancelled because of any of the above factors, our revenue may be negatively impacted.

We have offices outside of the United States, including offices in Taiwan, Japan, Korea, China, Hong Kong, India, France, Russia, Germany, Finland and England. Our operations in our international locations are subject to many of the risks contained in the above list. We intend to continue to expand our existing operations and expect to open other international offices. Difficulties with our international operations, including finding appropriate staffing and office space, may divert management's attention and other resources any of which could negatively impact our operating results.

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

We derive the majority of our revenue from the sale of products for use in the desktop PC and notebook PC markets, including professional workstations. We expect to continue to derive most of our revenue from the sale or license of products for use in the desktop PC and notebook PC markets in the next several years. 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 incorrectly forecast product transitions. In these cases, PC manufacturers may abruptly suspend substantially all purchases of additional inventory from suppliers like us until their excess inventory has been absorbed, which would have a negative impact on our business.

***If our products do not continue to be adopted by the consumer and enterprise desktop PC, notebook PC, workstation, high-performance computing, personal digital assistant, or PDA, cellular handheld devices, and video game console markets or if the demand in these markets for new and innovative products decreases, our business and operating results would suffer.***

Our success depends in part upon continued broad adoption of our processors for 3D graphics and multimedia in consumer and enterprise PC, notebook PC, workstation, high-performance computing, PDA, cellular handheld devices, and video game console applications. The market for 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 pricing of dynamic random-access memory devices 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. Broad market acceptance is difficult to achieve and such market acceptance, if achieved, is difficult to sustain due to intense competition and frequent new technology and product introductions. Our GPU and MCP businesses together comprised of approximately 80% of revenue for each of the third quarter of fiscal years 2008 and 2007 and 78% and 77% of revenue during first nine months of fiscal years 2008 and 2007, respectively. As such, our financial results would suffer if for any reason our current or future GPUs or MCPs do not continue to achieve widespread adoption by the PC market. If we are unable to complete the timely development of products or if we were unable to successfully and cost-effectively manufacture and deliver products that meet the requirements of the consumer and enterprise PC, notebook, workstation, high-performance computing, PDA, cellular phone, and video game console markets, we may experience a decrease in revenue which could negatively impact our operating results. Additionally, there can be no assurance that the industry will continue to demand new products with improved standards, features or performance. If our customers, OEMs, ODMs, add-in-card and motherboard manufacturers, system builders and consumer electronics companies, do not continue to design products that require more advanced or efficient processors and/or the market does not continue to demand new products with increased performance, features, functionality or standards, sales of our products could decline. Decreased sales of our products for these markets could negatively impact our financial results.

***Our failure to comply with any applicable environmental regulations could result in a range of consequences, including fines, suspension of production, excess inventory, sales limitations, and criminal and civil liabilities.***

We may be subject to various state, federal and international laws and regulations governing the environment, including restricting the presence of certain substances in electronic products and making producers of those products financially responsible for the collection, treatment, recycling and disposal of those products. The European Union Directive on Restriction of Hazardous Substances Directive, or RoHS Directive, is European legislation that restricts the use of a number of substances, including lead, and other hazardous substances in electrical and electronic equipment in the market in the European Union which became effective on July 1, 2006. Similarly, the State of California has adopted certain restrictions, which go into effect in 2007, that restrict the use of certain materials in electronic products, which are intended to harmonize with the RoHS directive and other states are contemplating similar legislation. China has adopted similar legislation to the RoHS directive which began to go into effect on March 1, 2007.

Also, we could face significant costs and liabilities in connection with the European Union Directive on Waste Electrical and Electronic Equipment, or WEEE. The WEEE directs members of the European Union to enact laws, regulations, and administrative provisions to ensure that producers of electric and electronic equipment are financially responsible for the collection, recycling, treatment and environmentally responsible disposal of certain products sold into the market after August 15, 2005. Implementation in certain European Union member states has been delayed into 2007. Similar legislation has been or may be enacted in other jurisdictions, including the United States, Canada, Mexico, China and Japan, the cumulative impact of which could be significant. We continue to evaluate the impact of specific registration and compliance activities required by WEEE.

It is possible that unanticipated supply shortages, delays or excess non-compliant inventory may occur as a result of such regulations. Failure to comply with any applicable environmental regulations could result in a range of consequences including costs, fines, suspension of production, excess inventory, sales limitations, criminal and civil liabilities and could impact our ability to conduct business in the countries that have adopted these types of regulations.

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

At October 28, 2007 and January 28, 2007, we had \$1.85 billion and \$1.12 billion in cash, cash equivalents and marketable securities. We invest our cash 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 United States government and its agencies. These investments are denominated in U.S. dollars.

We account for our investment instruments in accordance with Statement of Financial Accounting Standards No. 115, or 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 debt 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 if the decline in fair value of our publicly traded equity investments is judged to be other-than-temporary. We may suffer losses in principal if we are forced to sell securities that decline in market value due to changes in interest rates. However, because any debt securities we hold are classified as “available-for-sale,” no gains or losses are recognized due to changes in interest rates unless such securities are sold prior to maturity.

Recent U.S. sub-prime mortgage defaults have had a significant impact across various sectors of the financial markets, causing global credit and liquidity issues. The short-term funding markets experienced issues during the third quarter of calendar 2007, leading to liquidity disruption in asset-backed commercial paper and failed auctions in the auction rate market. If the global credit market continues to deteriorate, our investment portfolio may be impacted and we could determine some of our investments are impaired which could adversely impact our financial results.

***Our business is cyclical in nature and an industry downturn could harm our financial results.***

Our business is directly affected by market conditions in the highly cyclical semiconductor industry, including alternating periods of overcapacity and capacity constraints, variations in manufacturing costs and yields, significant expenditures for capital equipment and product development and rapid technological change. If we are unable to respond to changes in our industry, which can be unpredictable and rapid, in an efficient and timely manner, our operating results could suffer. In particular, from time to time, the semiconductor industry has experienced significant and sometimes prolonged downturns characterized by diminished product demand and accelerated erosion of average selling prices. If we cannot take appropriate actions such as reducing our manufacturing or operating costs to sufficiently offset declines in demand during a downturn, our revenue and earnings will suffer.

***Political instability in Taiwan and in The People's Republic of China or elsewhere could harm our business.***

Because of our reliance on foundries and independent contractors located in Taiwan and The People's Republic of China, and because we have offices in these locations, 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.

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

### ***The pending investigation by the United States Department of Justice regarding investigation into the market for Graphics Processors could adversely affect our business.***

On November 29, 2006, we received a subpoena from the San Francisco Office of the Antitrust Division of the United States Department of Justice, or DOJ, in connection with the DOJ's investigation into potential antitrust violations related to graphics processing units, or GPUs, and cards. No specific allegations have been made against us. We are cooperating with the DOJ in its investigation.

As of November 12, 2007, over 50 civil complaints have been filed against us. The majority of the complaints were filed in the Northern District of California, several were filed in the Central District of California, and other cases were filed in several other Federal district courts. On April 18, 2007, the Judicial Panel on Multidistrict Litigation transferred the actions currently pending outside of the Northern District of California to the Northern District of California for coordination of pretrial proceedings before the Honorable William H. Alsup. By agreement of the parties, Judge Alsup will retain jurisdiction over the consolidated cases through trial or other resolution.

In the consolidated proceedings, two groups of plaintiffs (one representing all direct purchasers of graphic processing units, or GPUs and the other representing all indirect purchasers) filed consolidated, amended class-action complaints.. These complaints purport to assert federal antitrust claims based on alleged price fixing, market allocation, and other alleged anti-competitive agreements between us and ATI Technologies, Inc., or ATI, and Advanced Micro Devices, Inc., or AMD as a result of its acquisition of ATI. The indirect purchasers' consolidated amended complaint also asserts a variety of state law antitrust, unfair competition and consumer protection claims on the same allegations, as well as a common law claim for unjust enrichment.

Plaintiffs filed their first consolidated complaints on June 14, 2007. On July 16, 2007, we moved to dismiss those complaints. The motions to dismiss were heard by Judge Alsup on September 20, 2007. The Court subsequently granted and denied the motions in part, and gave the plaintiffs leave to move to amend the complaints. On November 7, 2007, the Court granted plaintiffs' motion to file amended complaints, ordered defendants to answer the complaints, lifted a previously entered stay on discovery, and set a trial date for January 12, 2009. Discovery associated with these cases will be expensive. We believe the allegations in the complaints are without merit and intend to vigorously defend the cases. Costs of defense and any damages resulting from a ruling against us or a settlement of the litigation could adversely affect our business.

### ***Expensing employee stock options materially and adversely affects our reported operating results and could also adversely affect our competitive position.***

Since inception, we have used stock options and our employee stock purchase program as fundamental components of our compensation packages. We believe that these incentives directly motivate our employees and, through the use of vesting, encourage our employees to remain with us. As a result of adjustments arising from our restatement related to stock option grant dates, our operating results for fiscal years prior to fiscal year 2007 contain recorded amounts of stock-based compensation expense. For our fiscal years 2000 through 2006, this stock-based compensation expense was calculated using primarily the intrinsic value-based method under Accounting Principles Board Opinion No. 25, or APB 25, *Accounting for Stock Issued to Employees and related interpretations*.

In December 2004, the Financial Accounting Standards Board, or FASB, issued SFAS No. 123(R) which requires the measurement and recognition of compensation expense for all stock-based compensation payments. SFAS No. 123(R) requires that we record compensation expense for stock options and our employee stock purchase plan using the fair value of those awards. During the third quarter of fiscal years 2008 and 2007 we recorded \$32.0 million and \$31.7 million, respectively, and \$98.9 million and \$82.8 million for the first nine months of fiscal years 2008 and



2007, respectively, related to non-cash stock-based compensation, resulting from our compliance with SFAS 123 (R), which negatively impacted our operating results. We believe that SFAS No. 123(R) will continue to negatively impact our operating results.

To the extent that SFAS No. 123(R) makes it more expensive to grant stock options or to continue to have an employee stock purchase program, we may decide to incur increased cash compensation costs. In addition, actions that we may take to reduce stock-based compensation expense that may be more severe than any actions our competitors may implement may make it difficult to attract retain and motivate employees, which could adversely affect our competitive position as well as our business and operating results.

***We are a party to litigation, which, if determined adversely to us, could harm our business and financial condition.***

We are a party to litigation. There can be no assurance that actions that have been brought against us or any brought by us will be resolved in our favor. Any claim that is successfully asserted against us may cause us to pay substantial damages and other related fees. Regardless of whether these lawsuits are resolved in our favor or if we are the plaintiff or the defendant in the litigation, any lawsuits to which we are a party will likely be expensive and time consuming to defend or resolve. Such lawsuits could also harm our relationships with existing customers and result in the diversion of management's time and attention away from business operations, which could harm our business. Costs of defense and any damages resulting from litigation a ruling against us or a settlement of the litigation could adversely affect our cash flow and financial results.

***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 in the United States and internationally. We have numerous patents issued, allowed and pending in the United States and in foreign countries. Our patents and pending patent applications primarily relate to technology used by us in connection with our products. We also rely on international treaties and organizations and foreign laws to protect our intellectual property. 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 the laws of the United States. This makes the possibility of piracy of our technology and products more likely. We continuously assess whether and where to seek formal protection for particular innovations and technologies based on such factors as:

- the commercial significance of our operations and our competitors' operations in particular countries and regions;
  - the location in which our products are manufactured;
  - our strategic technology or product directions in different countries; and
- the degree to which intellectual property laws exist and are meaningfully enforced in different jurisdictions.

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 digital media processors and for defensive reasons, and expect to continue to enter into such license agreements. 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.

***Litigation to defend against alleged infringement of intellectual property rights or to enforce our intellectual property rights and the outcome of such litigation could result in substantial costs to us.***

We expect that as the number of issued hardware and software patents increases and as competition intensifies, the volume of intellectual property infringement claims and lawsuits may increase. We may become involved in lawsuits or other legal proceedings alleging patent infringement or other intellectual property rights violations by us or by our customers that we have agreed to indemnify them for certain claims of infringement. An unfavorable ruling could include significant damages, invalidation of a patent or family of patents, indemnification of customers, payment of lost profits, or, when it has been sought, injunctive relief.

In addition, we may need to commence litigation or other legal proceedings in order to:

- assert claims of infringement of our intellectual property;
  - enforce our patents;
  - protect our trade secrets or know-how; or
- determine the enforceability, scope and validity of the propriety rights of others.

If we have to initiate litigation in order to protect our intellectual property, our operating expenses may increase which could negatively impact our operating results. Our failure to effectively protect our intellectual property could harm our business.

If infringement claims are made against us or we are found to infringe a third parties' patent, we may seek licenses under the third parties' patents or other intellectual property rights. In addition, an indemnified customer may be required to obtain a license to a third parties' patents or intellectual property. However, licenses may not be offered to us at all or on terms acceptable to us, particularly by competitors. If we fail to obtain a license from a third party for technology that we use or that is used in one of our products that is used by an indemnified customer, we could be subject to substantial liabilities or have to suspend or discontinue the manufacture and sale of one or more of our products which could reduce our revenue and harm our business. Furthermore, the indemnification of a customer may increase our operating expenses which could negatively impact our operating results.

***Our operating results may be adversely affected if we are subject to unexpected tax liabilities.***

We are subject to taxation by a number of taxing authorities both in the United States and throughout the world. Tax rates vary among the jurisdictions in which we operate. Significant judgment is required in determining our provision for our income taxes as there are many transactions and calculations where the ultimate tax determination is uncertain. Although we believe our tax estimates are reasonable, any of the below could cause our effective tax rate to be materially different than that which is reflected in historical income tax provisions and accruals:

- the jurisdictions in which profits are determined to be earned and taxed;
- adjustments to estimated taxes upon finalization of various tax returns;
  - changes in available tax credits;
  - changes in share-based compensation expense;
- changes in tax laws, the interpretation of tax laws either in the United States or abroad or the issuance of new interpretative accounting guidance related to uncertain transactions and calculations where the tax treatment was previously uncertain; and
- the resolution of issues arising from tax audits with various tax authorities.

Should additional taxes be assessed as a result of any of the above, our operating results could be adversely affected. In addition, our future effective tax rate could be adversely affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in tax laws or changes in the interpretation of tax laws.

***While we believe that we currently have adequate internal control over financial reporting, we are exposed to risks from legislation requiring companies to evaluate those internal controls.***

Section 404 of the Sarbanes-Oxley Act of 2002 requires our management to report on, and our independent registered public accounting firm to attest to, the effectiveness of our internal control structure and procedures for financial reporting. We have an ongoing program to perform the system and process evaluation and testing necessary to comply with these requirements. However, the manner in which companies and their independent public accounting firms apply these requirements and testing companies' internal controls, remains subject to some uncertainty. To date, we have incurred, and we expect to continue to incur increased expense and to devote additional management resources to Section 404 compliance. Despite our efforts, if we identify a material weakness in our internal controls, there can be no assurance that we will be able to remediate such material weakness identified in a timely manner, or that we will be able to maintain all of the controls necessary to determine that our internal control over financial reporting is effective. In the event that our chief executive officer, chief financial officer or our independent registered public accounting firm determine that our internal control over financial reporting is not effective as defined under Section 404, investor perceptions of us may be adversely affected and could cause a decline in the market price of our stock.

***Changes in financial accounting standards or interpretations of existing standards could affect our reported results of operations.***

We prepare our consolidated financial statements in conformity with generally accepted accounting principles in the United States. These principles are constantly subject to review and interpretation by the SEC and various bodies formed to interpret and create appropriate accounting principles. A change in these principles can have a significant effect on our reported results and may even retroactively affect previously reported transactions.

## Risks Related to our Common Stock

*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 to create and issue preferred stock without prior stockholder approval;
  - the prohibition of stockholder action by written consent;
  - a classified Board; 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. Under the agreement, if 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 may have first and last rights of refusal to purchase the stock. The Microsoft provision and the other factors listed above could also delay or prevent a change in control of NVIDIA.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

During fiscal year 2005, we announced that our Board of Directors, or Board, had authorized a stock repurchase program to repurchase shares of our common stock, subject to certain specifications, up to an aggregate maximum amount of \$300 million. During fiscal year 2007, the Board further approved an increase of \$400 million to the original stock repurchase program. In fiscal year 2008, on May 21, 2007, we announced a stock repurchase program under which we may purchase up to an additional \$1.0 billion of our common stock over a three year period through May 2010. As a result of these increases, we have an ongoing authorization from the Board, subject to certain specifications, to repurchase shares of our common stock up to an aggregate maximum amount of \$1.7 billion.

The repurchases will be made from time to time in the open market, in privately negotiated transactions, or in structured stock repurchase programs, and may be made in one or more larger repurchases, in compliance with the Securities Exchange Act of 1934, or the Exchange Act, Rule 10b-18, subject to market conditions, applicable legal requirements, and other factors. The program does not obligate NVIDIA to acquire any particular amount of common stock and the program may be suspended at any time at our discretion. As part of our share repurchase program, we have entered into, and we may continue to enter into, structured share repurchase transactions with financial institutions. These agreements generally require that we make an up-front payment in exchange for the right to receive a fixed number of shares of our common stock upon execution of the agreement, and a potential incremental number of shares of our common stock, within a pre-determined range, at the end of the term of the agreement.

During the three months ended October 28, 2007, we entered into a structured share repurchase transaction to repurchase 4.0 million shares for \$125.0 million which we recorded on the trade date of the transaction. Through October 28, 2007, we have repurchased 56.0 million shares under our stock repurchase program for a total cost of \$862.5 million.

Subsequent to October 28, 2007, we entered into a structured share repurchase transaction to repurchase shares of our common stock for \$125.0 million that we expect to settle prior to the end of our fourth quarter of fiscal year 2008 ending on January 27, 2008.

| <b>Period</b>                               | <b>Total<br/>Number of<br/>Shares<br/>Purchased</b> | <b>Average<br/>Price Paid<br/>per Share<br/>(2)</b> | <b>Total<br/>Number of<br/>Shares<br/>Purchased<br/>as Part of<br/>Publicly<br/>Announced<br/>Plans of<br/>Programs<br/>(3)</b> | <b>Approximate<br/>Dollar Value<br/>of Shares that<br/>May Yet Be<br/>Purchased<br/>Under the<br/>Plans or<br/>Programs (1)</b> |
|---|---|---|---|---|
| July 30, 2007 through August 26, 2007       | -   | \$ -  | -   | \$ 962,482,529  |
| August 27, 2007 through September 26, 2007  | -   | \$ -  | -   | \$ 962,482,529  |
| September 27, 2007 through October 28, 2007 | 3,989,363   | \$ 31.34  | 3,989,363   | \$ 837,441,904  |
| Total                                       | 3,989,363   | \$ 31.34  | 3,989,363   |   |

(1) On August 9, 2004, we announced that our Board had authorized a stock repurchase program to repurchase shares of our common stock, subject to certain specifications, up to an aggregate maximum amount of \$300.0 million. On March 6, 2006, we announced that the Board had approved a \$400.0 million increase to the original stock repurchase program. Subsequently, on May 21, 2007, we announced a stock repurchase program under which we may purchase up to an additional \$1.0 billion of our common stock over a three year period through May 2010. As a result of these

increases, we have an ongoing authorization from the Board, subject to certain specifications, to repurchase shares of our common stock up to an aggregate maximum amount of \$1.7 billion on the open market, in negotiated transactions or through structured stock repurchase agreements that may be made in one or more larger repurchases.

(2) Represents weighted average price paid per share during the quarter ended October 28, 2007.

(3) As part of our share repurchase program, we have entered into and we may continue to enter into structured share repurchase transactions with financial institutions. During the three months ended October 28, 2007, we entered into a structured share repurchase transaction to repurchase 4.0 million shares for \$125.0 million which we recorded on the trade date of the transaction. Subsequent to October 28, 2007, we entered into a structured share repurchase transaction to repurchase shares of our common stock for \$125.0 million that we expect to settle prior to the end of our fourth quarter of fiscal year 2008 ending on January 27, 2008.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

Not applicable.

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

None.

**ITEM 5. OTHER INFORMATION**

None.

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**ITEM 6. EXHIBITS****EXHIBIT INDEX****Incorporated by Reference**

| <b>Exhibit<br/>No.</b> | <b>Exhibit Description</b>  | <b>Schedule/Form</b> | <b>File Number</b> | <b>Exhibit</b> | <b>Filing Date</b> |
|------------------------|---|----------------------|--------------------|----------------|--------------------|
|                        | Certification of Chief Executive Officer as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 |                      |                    |                |                    |
| 31.1*                  |   |                      |                    |                |                    |
|                        | Certification of Chief Financial Officer as required by Rule 13a-14(a) of the Securities Exchange Act of 1934 |                      |                    |                |                    |
| 31.2*                  |   |                      |                    |                |                    |
|                        | Certification of Chief Executive Officer as required by Rule 13a-14(b) of the Securities Exchange Act of 1934 |                      |                    |                |                    |
| 32.1#*                 |   |                      |                    |                |                    |
|                        | Certification of Chief Financial Officer as required by Rule 13a-14(b) of the Securities Exchange Act of 1934 |                      |                    |                |                    |
| 32.2#*                 |   |                      |                    |                |                    |

\* Filed Herewith

# In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release Nos. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed "filed" for purpose of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

Copies of above exhibits not contained herein are available to any stockholder upon written request to:  
Investor Relations: NVIDIA Corporation, 2701 San Tomas Expressway, Santa Clara, CA 95050.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: November 21, 2007

**NVIDIA Corporation**

By:

/s/ MARVIN D. BURKETT

Marvin D. Burkett

*(Duly Authorized Officer and Principal Financial and  
Accounting Officer)*

**EXHIBIT INDEX****Incorporated by Reference**

| <b>Exhibit<br/>No.</b> | <b>Exhibit Description</b> | <b>Schedule/Form</b> | <b>File Number</b> | <b>Exhibit</b> | <b>Filing Date</b> |
|------------------------|----------------------------|----------------------|--------------------|----------------|--------------------|
|------------------------|----------------------------|----------------------|--------------------|----------------|--------------------|

Certification of Chief Executive Officer as  
required by Rule 13a-14(a) of the Securities  
31.1\* Exchange Act of 1934

Certification of Chief Financial Officer as  
required by Rule 13a-14(a) of the Securities  
31.2\* Exchange Act of 1934

Certification of Chief Executive Officer as  
required by Rule 13a-14(b) of the Securities  
32.1#\* Exchange Act of 1934

Certification of Chief Financial Officer as  
required by Rule 13a-14(b) of the Securities  
32.2#\* Exchange Act of 1934

\* Filed Herewith

# In accordance with Item 601(b)(32)(ii) of Regulation S-K and SEC Release Nos. 33-8238 and 34-47986, Final Rule: Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, the certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed "filed" for purpose of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

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