

NVIDIA CORP  
Form 10-K  
March 16, 2007

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

**FORM 10-K**

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

**For the fiscal year ended January 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)**

**Securities registered pursuant to Section 12(b) of the Act:**

<u><b>Title of each class</b></u>	<u><b>Name of each exchange on which registered</b></u>
Common Stock, \$0.001 par value per share	The NASDAQ Stock Market, LLC (NASDAQ Global Select Market)

**Securities registered pursuant to Section 12(g) of the Act:**

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes x No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  
Yes o No x

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.

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Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, indefinite proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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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 aggregate market value of the voting stock held by non-affiliates of the registrant as of July 30, 2006 was approximately \$7.03 billion (based on the closing sales price of the registrant’s common stock as reported by the NASDAQ Global Select Market, on July 30, 2006). Shares of common stock held by each current executive officer and director and by each person who is known by the registrant to own 5% or more of the outstanding common stock have been excluded from this computation in that such persons may be deemed to be affiliates of the registrant. Share ownership information of certain persons known by the registrant to own greater than 5% of the outstanding common stock for purposes of the preceding calculation is based solely on information on Schedule 13G filed with the Commission and is as of July 30, 2006. This determination of affiliate status is not a conclusive determination for other purposes.

The number of shares of common stock outstanding as of March 2, 2007 was 360,038,303.

**DOCUMENTS INCORPORATED BY REFERENCE**

The Registrant has incorporated by reference portions of its Proxy Statement for its 2007 Annual Meeting of Stockholders to be filed with the Securities and Exchange Commission by May 28, 2007.

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**PART I****ITEM 1. BUSINESS****Forward-Looking Statements**

*When used in this Annual Report on Form 10-K, 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, impact, production and availability of our technologies and products; seasonality; acquisitions and the benefits and results of acquisitions; our strategies and objectives; product cycles; our gross margin; product mix; our inventories; average selling prices; our taxes; growth and factors contributing to growth; anticipated areas of growth; expensing of stock options; the impact of stock-based compensation expense; our critical accounting policies; mix and sources of revenue; anticipated revenue; changes in and reasons for our expenditures; capital expenditures; our cash flow and cash balances; our liquidity; uses of cash; dividends; investments and marketable securities; our stock repurchase program; our results of operations; Microsoft Windows Vista; our competitors' focuses; our competition and our competitive position; our intellectual property; the importance of our strategic relationships; customer demand; reliance on a limited number of customers and suppliers; our internal control over financial reporting; our disclosure controls and procedures; recent accounting pronouncements; our international operations; our ability to attract and retain qualified personnel; our foreign currency risk strategy; compliance with environmental laws and regulations; litigation or regulatory action arising from the review of our stock option grant practices and financial restatements; the Department of Justice subpoena and investigation; litigation, including the class action lawsuits; and the Securities and Exchange Commission inquiry. 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 of a particular product; increased sales of lower margin products; difficulty in collecting accounts receivable; our inability to decrease inventory purchase commitments; difficulties in entering new markets; the write-down of the value of inventory; entry of new competitors in our established markets; reduction in demand for our products; market acceptance of our competitors' products; defects in our products; the impact of competitive pricing pressures; disruptions in our relationships with our key suppliers; fluctuations in general economic conditions; failure to achieve design wins; changes in customers' purchasing behaviors; international and political conditions; 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; delays in volume production of our products; developments in and expenses related to litigation; our inability to realize the benefits of acquisitions; the outcome of litigation or regulatory actions; 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, PureVideo, CUDA, Quadro NVS, Quadro Plex 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.*

**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 units, or GPU Business, media and communications processors, or MCP Business, Handheld GPU Business, and Consumer Electronics Business. Our GPU Business is composed of products that support desktop personal computers, or PCs, notebook PCs, professional workstations and other GPU-based products; our MCP Business is composed of NVIDIA nForce products that operate as a single-chip or chipset that provide system functions, such as high speed storage and network communications, and perform these operations independently from the host central processing unit, or CPU; our Handheld GPU Business is composed of products that support handheld personal digital assistants, or PDAs, cellular phones and other handheld devices; and our Consumer Electronics Business is concentrated in products that support 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).

Original equipment manufacturers, or OEMs, original design manufacturers, or ODMs, add-in-card manufacturers, system builders and consumer electronics companies worldwide utilize NVIDIA processors as a core component of their entertainment and business solutions. Our GPUs are designed to deliver performance and visual quality for PC-based applications such as manufacturing, science, e-business, entertainment and education. Our MCPs perform demanding multimedia processing for secure broadband connectivity, communications and storage. Our handheld GPUs deliver a quality visual experience by accelerating graphics and video applications while implementing design techniques that result in high performance and relatively low power consumption.

### *Our Business*

#### *GPU Business*

The combination of our GeForce 6, GeForce 7 and GeForce 8 series of GPUs and our Scalable Link Interface, or SLI, technology and NVIDIA Quadro professional solutions has created a new class of gaming PCs and professional workstations. SLI technology takes advantage of the increased bandwidth of the peripheral component interconnect, or PCI, Express bus architecture to allow up to four NVIDIA GPUs to operate in a single PC or up to two NVIDIA GPUs to operate in a notebook PC or professional workstation. In fiscal 2007, we announced PureVideo High-Definition, or HD technology, a combination of hardware acceleration from an NVIDIA GPU, high definition movie player integration and High-Bandwidth Digital Content Protection or HDCP, feature support, to enable manufacturers and consumers to build PCs that can play High-Definition Digital Video Disc, or HD DVD, or Blu-ray movies. In November 2006, we launched the GeForce 8800, the industry's first GPU to support the new Microsoft DirectX 10 Application Programming Interface, or API. DirectX 10 is a new API for the Microsoft Windows Vista operating system, or Vista, and includes many new features, such as a geometry shader. GeForce 8800 is the first DirectX 10 GPU based on Unified Shader architecture, which can adapt its computation resources to changing vertex and pixel shading workload from scene to scene. We also announced Compute Unified Device Architecture, or CUDA, a new mode of operation on GPUs where the computational power of the GPU can be utilized for computation-intensive applications.

Technology and market leadership in this generation of GPUs continues to be a key element of our corporate strategy. The combination of the programmable Unified Shader GPU with Microsoft Corporation's, or Microsoft's, DirectX 10 high-level shading language is known as DirectX 10 GPUs. Combined with the ability to directly access the GPU via the new Vista applications from Microsoft Office to Web 2.0 applications can now incorporate 3D effects. In fiscal 2007, our strategy was to extend our architectural and technology advantage with our second-generation GPUs to support DirectX 9.0 Shader Model 3.0, the GeForce 7 Series GPUs. By extending our leadership position in the performance segment with the production release of the GeForce 7900 in June 2006, we grew our market share from 79% to 85%, according to the Mercury Research Fourth Quarter 2005 and 2006 PC Graphics Reports, respectively.

The NVIDIA Quadro brand has become the benchmark of performance and compatibility for the professional industry. NVIDIA Quadro is recognized by many as the standard for professional graphics solutions needed to solve many of the world's most complex visual computing challenges in the manufacturing, entertainment, medical, science, and aerospace industries. In fiscal 2007, we introduced NVIDIA Quadro Plex, a new category of visual computing solutions that brings a level of graphics scalability and processing density. In November 2006, we began seeding the industry with our GeForce 8 GPU, enabled with CUDA, a technology and compiler that, for the first time, allows for programmers to write C language applications for GPUs. GeForce 8 and CUDA will enable a new class of high performance computing we call "GPU Computing." With CUDA-enabled GPUs, engineers and scientists will be able to harness programmable GPUs in PCs to solve mathematically-intensive problems that were previously cost prohibitive.

#### *MCP Business*

The NVIDIA nForce family of products represents our MCPs for Advanced Micro Devices, Inc., or AMD, and Intel Corporation, or Intel,-based desktop, notebook, professional workstations and servers. Our strategy for MCPs aligns



with what we anticipate will drive growth in the MCP segment such as multi-core, ever-increasing-speed networking and storage technologies, and integration of complex features such as virtualization, security processing, network processing and more. The In-Stat Trendy Chipset for the x86 Processor Report projects strong growth for PC chipsets through the end of this decade from \$7.6 billion in calendar 2006 to over \$10 billion in calendar 2009.

In fiscal 2007, we began production shipments of our single-chip motherboard GPUs for AMD-based PCs. We are now the second largest core logic supplier in the world, according to the Mercury Research Fourth Quarter 2006 PC Graphics Report. We are the largest supplier of AMD 64 chipsets with 53% segment share. NVIDIA nForce MCP unit shipments for AMD64-based CPUs increased over 113% calendar year-over-calendar year, based on the Mercury Research Fourth Quarter 2006 PC Processor Forecast Report.

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Also during fiscal 2007, we launched our NVIDIA nForce 680i SLI MCP, which was designed for Intel Core 2 Quad and Core 2 Duo-based PCs. The NVIDIA nForce 680i SLI MCP is a motherboard solution with dual Gigabit Ethernet ports and advanced storage features that is targeted at the hard-core enthusiast and provides support for some of the latest technologies, including NVIDIA SLI multi-GPU technology. We also started to design and released production of our own line of enthusiast-class NVIDIA nForce 680i SLI-based motherboards, which are being offered as a turnkey solution for select channel partners. Our "Designed by NVIDIA" program allows NVIDIA partners to bring NVIDIA nForce 680i SLI-based motherboards to market faster than before, and lets consumers know that the motherboard they are purchasing supports all of the hardware and software features that are offered with the NVIDIA nForce 680i SLI MCP.

In fiscal 2007, we completed our acquisition of ULi Electronics, Inc., or ULi, a core logic developer for the PC industry. This acquisition represents our ongoing investment in our platform solution strategy.

#### *Handheld GPU Business*

Our strategy in our Handheld GPU business is to lead innovation and capitalize on the emergence of the cellular phone as a versatile consumer lifestyle device. Every device in the NVIDIA GoForce product family is designed to provide a high-performance, visually rich multimedia experience on cellular phones and handheld devices. These products deliver an advanced visual experience by accelerating graphics and video applications. NVIDIA GoForce handheld GPUs and application processors implement design techniques, both inside the chips and at the system level, which result in high performance and long battery life. These technologies enhance visual display capabilities, improve connectivity, and minimize chip and system-level power consumption. NVIDIA GoForce products can be found in multimedia cellular phones, PDAs, and other handheld devices.

In March 2006, NVIDIA and Intel announced a collaboration to bring a high-performance 3D gaming and multimedia platform to handheld devices. In addition, in March 2006 we acquired Hybrid Graphics Ltd., or Hybrid Graphics, a developer of embedded 2D and 3D graphics software for handheld devices. In June 2006, we launched our MobileMedia Platform development kit for handheld devices running Windows Mobile 5.0.

In January 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. Until recently, our Handheld GPU strategy has been to focus on establishing ourselves in the market as the leader of multimedia technology by leveraging our expertise in graphics, video, and image processing. With PortalPlayer's expertise in building low power application processors for Personal Media Players, or PMPs, we are now focused on delivering Systems-On-A-Chip, or SOCs, that combine our application processors and GPUs. We expect SOCs such as these to power next generation smart multimedia phone and PMP devices.

#### *Consumer Electronics Business*

Our Consumer Electronics product group is composed of our contractual arrangements with Sony Computer Entertainment, or SCE, to jointly develop a custom GPU for SCE's PlayStation3, sales of our Xbox-related products, revenue from our license agreement with Microsoft relating to the successor product to their initial Xbox gaming console, the Xbox360, and related devices, and digital media processor products. SCE launched sales of its PlayStation 3 computer entertainment system in November 2006. We recognized revenue from the sale of our Xbox-related products to Microsoft for the last time during the second quarter of fiscal 2006.

#### **Our Products**

We have four major product groups: GPUs, MCPs, Handheld GPUs, and Consumer Electronics. Our products are designed to support current standards as determined by each industry segment and to provide features that enhance the overall operation and compatibility of each platform they support.

**GPUs.** Our GPU products support desktop PCs, notebook PCs, professional workstations and other GPU-based products. We have three major families of GPUs: GeForce, Go and NVIDIA Quadro.

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*GeForce*. The GeForce family represents our desktop GPUs and includes the GeForce 8, GeForce7, GeForce 6, and GeForce FX families. During the first quarter of fiscal 2007, we shipped eight new GeForce 7 series GPUs for desktop and notebook PCs, expanding our offering of products in the GeForce 7 GPU family. Also during the first quarter of fiscal 2007, we shipped our first Quad SLI system for desktop PCs, enabling the use of four GPUs per system. During the second quarter of fiscal 2007, we shipped the GeForce 7950 GX2, which provides the resolution of cinematic film and brought the 16:9 panoramic experience of cinema to gaming. We also announced PureVideo HD technology, a combination of hardware acceleration from an NVIDIA GPU, high definition movie player integration and HDCP feature support, to enable manufacturers and consumers to build PCs that can play HD DVD or Blu-ray movies. In the fourth quarter of fiscal 2007, we introduced our flagship GPU series, the GeForce 8800. The GeForce 8800 is the industry's first unified shader GPU to support the new Microsoft DirectX 10 API. The GeForce 8800 unified shader architecture can adapt its computation resources to changing vertex and pixel shading workload from scene to scene, which enables programmers to create more complex effects and imagery while simplifying the actual programming code. Our GeForce 7 GPU family, which is based on the prior Microsoft DirectX 9.0 API, continues to deliver high price-per-performance from the mainstream to enthusiast segments both in desktop and notebook PCs. We maintained our leading share in the desktop standalone GPU segment throughout fiscal 2007.

*GeForce Go and NVIDIA Quadro Go*. The GeForce Go and NVIDIA Quadro Go families represent our notebook GPUs and include the GeForce 7 Go, GeForce 6 Go, and NVIDIA QuadroFX Go GPUs. These GPUs are designed to deliver desktop graphics performance and features for multiple notebook configurations from desktop replacements, multimedia notebooks and thin-and-lights to notebook workstations. The GeForce Go products are designed to serve the needs of both professional and consumer users. The NVIDIA Quadro Go products are designed to serve the needs of workstation professionals in the area of product design and digital content creation. In fiscal 2007, we introduced a complete family of notebook GPUs, the GeForce Go 7900, 7800, 7600 and 7400 families, all based on our second generation Shader Model 3.0 architecture and designed to deliver 3D, HD home theatre-quality video and power management to the notebook segment. In March 2006, we shipped the GeForce Go 7900 and GeForce 7800 GTX notebook products that feature SLI technology for notebook PCs. In early fiscal 2007, we launched our first notebook GPU, the NVIDIA Quadro NVS, targeted specifically for business use. NVIDIA Quadro NVS graphics solutions provide business customers with notebooks that are designed to be easy to deploy and maintain while minimizing total cost of ownership. We also launched the NVIDIA Quadro FX 3500M, a mobile workstation graphic solution for computer aided design, or CAD, Digital Content Creation, and Scientific Visualization. For the first time in our history, we captured the number one position in the notebook standalone GPU segment during the second half of fiscal 2007, according to the Mercury Research Second Quarter 2006 PC Graphics Report.

*NVIDIA Quadro*. The NVIDIA Quadro branded products are professional workstation solutions that are available for high-end, mid-range, entry-level and multi-display product lines. The NVIDIA Quadro family, which consists of the NVIDIA Quadro Plex VCS, NVIDIA Quadro FX, NVIDIA Quadro4 and the NVIDIA Quadro NVS professional workstation processors, is designed to meet the needs of a number of workstation applications such as industrial product design, digital content creation, non-linear video editing, scientific and medical visualization, general purpose business and financial trading. NVIDIA Quadro products are fully certified by several software developers for professional workstation applications and are designed to deliver the graphics performance and precision required by professional applications. In August 2006, we introduced the NVIDIA Quadro Plex 1000, the world's first dedicated Visual Computing System, or VCS. The NVIDIA Quadro Plex 1000 offers scalability in a desktop or dense three unit rackmount configuration for professional applications such as those powering multiple streams of 4K high-definition video, 3D styling and design, scientific and medical visualization, oil and gas exploration, or visual simulation and training.

*MCPs*. Our MCP product family, known as NVIDIA nForce, supports desktop PCs, notebook PCs, professional workstations and servers.

*NVIDIA nForce*. The NVIDIA nForce family represents our MCPs for AMD and Intel-based desktop PCs, notebook PCs, professional workstations and servers and includes the NVIDIA nForce4, NVIDIA nForce Professional,

NVIDIA nForce 500 series for AMD and Intel, NVIDIA nForce 600 series for AMD and Intel, and GeForce 6100 Series GPUs and nForce 400 Series MCP motherboard solutions. We define an MCP as a single-chip or chipset that provides system functions, such as high speed storage and network communications, and performs these operations independently from the host CPU. In fiscal 2006, we introduced the GeForce 6100 Series GPU and NVIDIA nForce 400 Series MCP. We offer the industry's first integrated core logic to feature DirectX 9.0 and Shader Model 3.0 technology. In January 2006, we launched two new MCPs for the Intel platform, the NVIDIA nForce4 SLI XE and NVIDIA nForce4 Ultra, both of which provide the system-builder and do-it-yourself communities with lower cost discrete motherboard solutions for Intel PC platforms. In fiscal 2007, we began production shipments of our single-chip motherboard GPUs for AMD-based PCs. In March 2006, we shipped our first integrated graphics processor, or IGP, core-logic solution for AMD-based notebook PCs, the GeForce Go 6100 GPU and NVIDIA nForce Go 430 MCP. This core logic solution provides hardware accelerated H.264 high-definition video playback. In May 2006, we shipped our NVIDIA nForce 590 SLI, a motherboard solution for x86 PC platforms. SLI can utilize the power of up to one, two, or even four NVIDIA GeForce GPUs for HD gaming. In November 2006, we launched the NVIDIA nForce 680 SLI MCP, which is designed specifically for Intel Core 2 Quad and Core 2 Duo processors.

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**Handheld GPUs.** Our Handheld GPU product family, known as GoForce, supports handheld PDAs and multimedia cellular phones.

*GoForce.* The GoForce family represents our handheld GPUs for a wide range of multimedia cellular phones and handheld devices. The GoForce 2100 and 2150 are two of the first handheld GPUs to offer hardware acceleration engines for 2D graphics to manufacturers that support liquid crystal display, or LCD, screen resolutions up to 320 x 240 pixels. The GoForce 3000 and 4000 offer a host of features for cellular phones and PDAs, including support for up to 3-megapixel image capture, accelerated graphics for gaming, and motion Joint Photographic Experts Group, or JPEG, capture and playback. Our GoForce 3D 4000, 4500 and 4800 handheld GPUs are the first to provide programmable 3D shaders, along with multi-megapixel still image and video processing in a single-chip package. Using dedicated hardware accelerator engines, the GoForce family delivers multimedia applications and drives high-resolution displays, while extending handheld battery life through a variety of power management techniques. In the third quarter of fiscal 2007, Motorola Inc., or Motorola, and Sony Ericsson Mobile Communications AB, or Sony Ericsson, launched Third Generation, or 3G, models of their RAZR and Walkman portable phones, respectively, that are both powered by our GoForce GPUs. Our GoForce handheld GPUs are now shipping in the Motorola 3G RAZR V3X, SLVR L6i, SLVR L7i, MOTORAZR Maxx, and Sony Ericsson Walkman phones. Our newest handheld GPU, the NVIDIA GoForce 5500 GPU, has been designed into Digital Video Broadcast - Handheld, or DVB-H, phones in North America, Europe, and Integrated Services Digital Broadcasting - Terrestrial, or ISDB-T, in Japan.

In February 2007, we unveiled our strategy to target the applications processor market in order to meet the growing multimedia demands of today's mobile phone user by announcing the availability of the NVIDIA GoForce 6100. The NVIDIA GoForce 6100, our first application processor, is a low power consumption multimedia solution that supports computationally intensive multimedia codecs as well as a high quality audio subsystem, integrated WiFi, USB 2.0 and more.

**Consumer Electronics.** Our Consumer Electronics product group is concentrated in products that support video game consoles and other digital consumer electronics devices.

*Playstation3.* In April 2005, we finalized our initial agreement with SCE to jointly develop a custom GPU for SCE's PlayStation3. SCE launched sales of the PlayStation 3 computer entertainment system in November 2006. We record license and development revenue from our initial agreement with SCE, as well as from certain additional agreements with them. In addition, in fiscal 2007, we began to record royalty revenue from SCE based on per unit sales of the PlayStation 3.

*Xbox.* Our Xbox platform processor supported Microsoft's initial Xbox video game console. The Xbox platform processor featured dual-processing architecture, which included our GPU designed specifically for the Xbox, or XGPU, and our MCP to power the Xbox's graphics, audio and networking capabilities. We also have a license agreement with Microsoft relating to the successor product to their initial Xbox gaming console, the Xbox360, and related devices. We recognized revenue from the sale of our Xbox-related products to Microsoft for the last time during the second quarter of fiscal 2006.

## **Our Strategy**

We design our GPUs, MCPs and handheld GPUs to enable our PC OEMs, ODMs, system builders, motherboard and add-in board manufacturers, and cellular phone and consumer electronics OEMs, to build products that deliver state-of-the-art features, performance, compatibility and power efficiency while maintaining competitive pricing and profitability. We believe that by developing 3D graphics, HD video and media communications solutions that provide superior performance and address the key requirements of each of the product segments we serve, we will accelerate the adoption of HD digital media platforms and devices throughout these segments. We combine scalable architectural technology with mass market economies-of-scale to deliver a complete family of products that spans professional workstations, to consumer PCs, to multimedia-rich cellular phones.

Our objective is to be the leading supplier of performance GPUs, MCPs and handheld GPUs and application processors. Our current focus is on the desktop PC, professional workstation, notebook PC, application processor, server, multimedia-rich cellular phone and video game console product lines, and we plan to expand into other product lines. Our strategy to achieve this objective includes the following key elements:

*Build Award-Winning, Architecturally-Compatible 3D Graphics, HD Video, Media Communications and Ultra-Low Power Product Families for the PC, Handheld and Digital Entertainment Platforms.* Our strategy is to achieve market segment leadership in these platforms by providing award-winning performance at every price point. By developing 3D graphics, HD video and media communications solutions that provide superior performance and address the key requirements of these platforms, we believe that we will accelerate the adoption of 3D graphics and rich digital media.

*Target Leading OEMs, ODMs and System Builders.* Our strategy is to enable our leading PC, handheld and consumer electronics OEMs, ODMs and major system builder customers to differentiate their products in a highly competitive marketplace by using our digital media processors. We believe that design wins with these industry leaders provide market validation of our products, increase brand awareness and enhance our ability to penetrate additional leading customer accounts. In addition, we believe that close relationships with OEMs and ODMs will allow us to better anticipate and address customer needs with future generations of our products.

*Sustain Technology and Product Leadership in 3D Graphics and HD Video, and Media Communications and Ultra-Low Power.* We are focused on using our advanced engineering capabilities to accelerate the quality and performance of 3D graphics, HD video, media communications and ultra-low power processing in PCs and handheld devices. A fundamental aspect of our strategy is to actively recruit the best 3D graphics and HD video, networking and communications engineers in the industry, and we believe that we have assembled an exceptionally experienced and talented engineering team. Our research and development strategy is to focus on concurrently developing multiple generations of GPUs, MCPs and handheld GPUs using independent design teams. As we have in the past, we intend to use this strategy to achieve new levels of graphics, networking and communications features and performance and ultra-low power designs, enabling our customers to achieve superior performance in their products.

*Increase Market Share.* We believe that substantial market share will be important to achieving success. We intend to achieve a leading share of the market in areas in which we don't have a leading market share by devoting substantial resources to building families of products for a wide range of applications that offer significant improvement in performance over existing products.

*Use Our Expertise in Digital Multimedia.* We believe the synergy created by the combination of 3D graphics, HD video and the Internet will fundamentally change the way people work, learn, communicate and play. We believe that our expertise in HD graphics and system architecture positions us to help drive this transformation. We are using our expertise in the processing and transmission of high-bandwidth digital media to develop products designed to address the requirements of high-bandwidth concurrent multimedia.

*Use our Intellectual Property and Resources to Enter into License and Development Contracts.* In fiscal 2006, we entered into license arrangements that require significant customization of our intellectual property components and we anticipate that we will enter into additional agreements during fiscal 2008. 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 example, in April 2005, we finalized our definitive agreement with SCE to jointly develop a 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.

## **Sales and Marketing**

Our worldwide sales and marketing strategy is a key part of our objective to become the leading supplier of performance GPUs, MCPs, and handheld GPUs for PCs, handheld devices and consumer electronics platforms. Our sales and marketing teams work closely with each industry's respective OEMs, ODMs, system integrators, motherboard manufacturers, add-in board manufacturers and industry trendsetters, collectively our Channel, to define product features, performance, price and timing of new products. Members of our sales team have a high level of technical expertise and product and industry knowledge to support the competitive and complex design win process. We also employ a highly skilled team of application engineers to assist the Channel in designing, testing and qualifying system designs that incorporate our products. We believe that the depth and quality of our design support are key to improving the Channel's time-to-market, maintaining a high level of customer satisfaction within the Channel and fostering relationships that encourage customers to use the next generation of our products.



In the GPU and MCP segments we serve, the sales process involves achieving key design wins with leading OEMs and major system integrators and supporting the product design into high volume production with key ODMs, motherboard manufacturers and add-in board manufacturers. These design wins in turn influence the retail and system integrator channel that is serviced by add-in board and motherboard manufacturers. Our distribution strategy is to work with a number of leading independent contract equipment manufacturers, or CEMs, ODMs, motherboard manufacturers, add-in board manufacturers and distributors each of which has relationships with a broad range of major OEMs and/or strong brand name recognition in the retail channel. In the handheld GPU segments we serve, the sales process primarily involves achieving key design wins directly with the leading handheld OEMs and supporting the product design into high-volume production. Currently, we sell a significant portion of our digital media processors directly to distributors, CEMs, ODMs, motherboard manufacturers and add-in board manufacturers, which then sell boards and systems with our products to leading OEMs, retail outlets and to a large number of system integrators. Although a small number of our customers represent the majority of our revenue, their end customers include a large number of OEMs and system integrators throughout the world.

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As a result of our channel strategy, our sales are focused on a small number of customers. Sales to Asustek Computer Inc., or Asustek, a CEM, accounted for 12% of our total revenue for fiscal 2007.

To encourage software title developers and publishers to develop games optimized for platforms utilizing our products, we seek to establish and maintain strong relationships in the software development community. Engineering and marketing personnel interact with and visit key software developers to promote and discuss our products, as well as to ascertain product requirements and solve technical problems. Our developer program makes products available to developers prior to volume availability in order to encourage the development of software titles that are optimized for our products.

### **Backlog**

Our sales are primarily made pursuant to standard purchase orders. The quantity of products purchased by our customers as well as shipment schedules are subject to revisions that reflect changes in both the customers' requirements and in manufacturing availability. The semiconductor industry is characterized by short lead time orders and quick delivery schedules. In light of industry practice and experience, we believe that only a small portion of our backlog is non-cancelable and that the dollar amount associated with the non-cancelable portion is not significant. We do not believe that a backlog as of any particular date is indicative of future results.

### **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.

### **Manufacturing**

We do not directly manufacture semiconductor wafers used for our products. Instead we utilize what is known as a fabless manufacturing strategy for all product-line operating segments whereby we employ world-class suppliers for all phases of the manufacturing process, including wafer fabrication, assembly, testing and packaging. This strategy uses the expertise of industry-leading suppliers that are certified by the International Organization for Standardization, or ISO, in such areas as fabrication, assembly, quality control and assurance, reliability and testing. In addition, this strategy allows us to avoid many of the significant c