

MARVELL TECHNOLOGY GROUP LTD
Form 10-Q
September 05, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended August 3, 2013

or

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

For the transition period from _____ to _____

Commission file number: 000-30877

Marvell Technology Group Ltd.

(Exact name of registrant as specified in its charter)

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Bermuda **77-0481679**
(State or other jurisdiction of **(I.R.S. Employer**
incorporation or organization) **Identification No.)**
Canon s Court, 22 Victoria Street, Hamilton HM 12, Bermuda

(441) 296-6395

(Address, including Zip Code, of principal executive offices and registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

The number of common shares of the registrant outstanding as of August 29, 2013 was 492.3 million shares.

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Table of Contents**PART I: FINANCIAL INFORMATION****Item 1. Financial Statements****MARVELL TECHNOLOGY GROUP LTD.****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)**

	August 3, 2013	February 2, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 591,655	\$ 751,953
Short-term investments	1,134,543	1,167,037
Accounts receivable, net	430,874	330,238
Inventories	335,320	250,420
Prepaid expenses and other current assets	57,824	77,282
Deferred income taxes	8,414	8,416
Total current assets	2,558,630	2,585,346
Property and equipment, net	363,486	372,971
Long-term investments	16,299	16,769
Goodwill	2,032,538	2,032,138
Acquired intangible assets, net	71,717	89,655
Other non-current assets	161,574	164,885
Total assets	\$ 5,204,244	\$ 5,261,764
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 355,164	\$ 286,552
Accrued liabilities	121,806	143,991
Accrued employee compensation	121,147	117,195
Deferred income	75,465	60,150
Total current liabilities	673,582	607,888
Non-current income taxes payable	90,502	112,871
Other non-current liabilities	47,650	56,410
Total liabilities	811,734	777,169
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Common shares, \$0.002 par value	988	1,017
Additional paid-in capital	2,801,316	2,945,643
Accumulated other comprehensive (loss) income	(1,572)	1,148
Retained earnings	1,591,778	1,536,787
Total shareholders' equity	4,392,510	4,484,595
Total liabilities and shareholders' equity	\$ 5,204,244	\$ 5,261,764

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See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**MARVELL TECHNOLOGY GROUP LTD.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share amounts)**

	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Net revenue	\$ 807,056	\$ 816,104	\$ 1,541,425	\$ 1,612,455
Operating costs and expenses:				
Cost of goods sold	386,059	381,839	721,497	748,161
Research and development	292,642	264,175	571,694	520,145
Selling and marketing	38,548	41,034	78,537	81,100
General and administrative	27,192	25,718	53,515	51,423
Amortization and write-off of acquired intangible assets	10,638	13,023	21,324	27,378
Total operating costs and expenses	755,079	725,789	1,446,567	1,428,207
Operating income	51,977	90,315	94,858	184,248
Interest and other income, net	8,253	5,864	11,413	6,921
Income before income taxes	60,230	96,179	106,271	191,169
Provision (benefit) for income taxes	(1,596)	3,105	(8,764)	3,552
Net income	\$ 61,826	\$ 93,074	\$ 115,035	\$ 187,617
Net income per share:				
Basic	\$ 0.13	\$ 0.17	\$ 0.23	\$ 0.33
Diluted	\$ 0.12	\$ 0.16	\$ 0.23	\$ 0.32
Weighted average shares:				
Basic	494,293	562,362	498,237	571,193
Diluted	500,625	570,325	503,006	582,532
Cash dividend declared per share	\$ 0.06	\$ 0.06	\$ 0.12	\$ 0.06

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**MARVELL TECHNOLOGY GROUP LTD.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****(In thousands)**

	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Net income	\$ 61,826	\$ 93,074	\$ 115,035	\$ 187,617
Other comprehensive income, net of tax:				
Net change in unrealized gain/loss on marketable securities	(3,586)	584	(2,534)	873
Net change in unrealized gain/loss on auction rate securities	(251)	(112)	(170)	(112)
Net change in unrealized gain/loss on cash flow hedges	89	(1,411)	(16)	(159)
Other comprehensive (loss) income, net	(3,748)	(939)	(2,720)	602
Comprehensive income	\$ 58,078	\$ 92,135	\$ 112,315	\$ 188,219

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

Table of Contents**MARVELL TECHNOLOGY GROUP LTD.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	Six Months Ended	
	August 3, 2013	July 28, 2012
Cash flows from operating activities:		
Net income	\$ 115,035	\$ 187,617
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	50,663	42,484
Share-based compensation	74,604	60,420
Amortization and write-off of acquired intangible assets	21,324	27,378
Other expense, net	4,339	5,175
Excess tax benefits from share-based compensation	(32)	(44)
Changes in assets and liabilities:		
Accounts receivable	(100,636)	16,491
Inventories	(84,293)	8,033
Prepaid expenses and other assets	19,305	15,635
Accounts payable	83,869	27,537
Accrued liabilities and other non-current liabilities	(33,094)	13,939
Accrued employee compensation	3,952	(24,681)
Deferred income	15,315	7,881
Net cash provided by operating activities	170,351	387,865
Cash flows from investing activities:		
Purchases of available-for-sale securities	(471,469)	(646,907)
Sales and maturities of available-for-sale securities	498,680	881,309
Investments in privately-held companies	(750)	(5,750)
Cash paid for acquisition, net	(2,551)	
Purchases of technology licenses	(7,610)	(6,452)
Purchases of property and equipment	(39,061)	(29,734)
Net cash (used in) provided by investing activities	(22,761)	192,466
Cash flows from financing activities:		
Repurchase of common stock	(304,808)	(473,484)
Proceeds from employee stock plans	73,121	57,329
Minimum tax withholding paid on behalf of employees for net share settlement	(9,888)	(9,477)
Dividend payments to shareholders	(60,044)	(33,537)
Payments on technology license obligations	(6,301)	
Excess tax benefits from share-based compensation	32	44
Net cash used in financing activities	(307,888)	(459,125)
Net (decrease) increase in cash and cash equivalents	(160,298)	121,206
Cash and cash equivalents at beginning of period	751,953	784,902
Cash and cash equivalents at end of period	\$ 591,655	\$ 906,108

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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MARVELL TECHNOLOGY GROUP LTD.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Basis of Presentation

The Company

Marvell Technology Group Ltd., a Bermuda company (the Company), is a leading global semiconductor provider of high-performance application specific standard products. The Company's core strength of expertise is the development of complex System-on-a-Chip devices leveraging its extensive technology portfolio of intellectual property in the areas of analog, mixed-signal, digital signal processing and embedded ARM-based microprocessor integrated circuits. The Company also develops platforms that it defines as integrated hardware, along with software that incorporates digital computing technologies designed and configured to provide an optimized computing solution compared to individual components. The Company's broad product portfolio includes devices for data storage, enterprise-class Ethernet data switching, Ethernet physical-layer transceivers, mobile handsets and other consumer electronics, Ethernet-based wireless networking, personal area networking, Ethernet-based PC connectivity, control plane communications controllers, video-image processing and power management solutions.

Reclassification

Certain amounts in the unaudited condensed consolidated financial statements and notes to the unaudited condensed consolidated financial statements for prior years have been reclassified to conform to the fiscal 2014 presentation. Net operating results have not been affected by these reclassifications.

Basis of Presentation

The Company's fiscal year is the 52- or 53-week period ending on the Saturday closest to January 31. In a 52-week year, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal 2014 has a 52-week period and fiscal 2013 had a 53-week period.

The unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for annual financial statements. In the opinion of management, all adjustments consisting of normal and recurring entries considered necessary for a fair statement of the results for the interim periods have been included in the Company's balance sheet as of August 3, 2013, the results of its operations for the three and six months ended August 3, 2013 and July 28, 2012, and its cash flows for the six months ended August 3, 2013 and July 28, 2012. The February 2, 2013 condensed consolidated balance sheet data was derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended February 2, 2013, but does not include all disclosures required for annual periods.

These condensed consolidated financial statements and related notes are unaudited and should be read in conjunction with the Company's audited financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended February 2, 2013 as filed on March 29, 2013 with the Securities and Exchange Commission. The results of operations for the three and six months ended August 3, 2013 are not necessarily indicative of the results that may be expected for any other interim period or for the full fiscal year.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to performance-based compensation, revenue recognition, provisions for sales returns and allowances, inventory excess and obsolescence, investment fair values, goodwill and other intangible assets, income taxes, litigation and other contingencies. In addition, the Company uses assumptions when employing the Monte Carlo simulation and Black-Scholes valuation models to calculate the fair value of share-based awards that are granted. Actual results could differ from these estimates, and such differences could affect the results of operations reported in future periods.

Table of Contents**MARVELL TECHNOLOGY GROUP LTD.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Principles of Consolidation***

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

Note 2. Recent Accounting Pronouncements***Accounting Pronouncements Recently Adopted***

The Company adopted the new accounting standard regarding the testing of indefinite-lived intangible assets for impairment at the beginning of fiscal 2014. This amended guidance allows an entity first to assess qualitative factors to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test in accordance with the guidance on the impairment of intangible assets other than goodwill. The adoption of this guidance had no impact on the Company's financial statements.

The Company adopted the new accounting standard regarding the reporting of amounts reclassified out of accumulated other comprehensive income. The amendments require an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either in the financial statements or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The Company elected to disclose the information in the Notes to Unaudited Condensed Consolidated Financial Statements beginning in fiscal 2014.

Note 3. Investments

The following tables summarize the Company's investments (in thousands):

		As of August 3, 2013		
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Short-term investments:				
Available-for-sale:				
Corporate debt securities	\$ 584,124	\$ 1,929	\$ (1,574)	\$ 584,479
U.S. government and agency debt	316,003	195	(44)	316,154
Time deposits	138,000			138,000
Asset backed securities	72,646		(269)	72,377
Foreign government and agency debt	10,319		(21)	10,298
Municipal debt securities	13,243	6	(14)	13,235
Total short-term investments	1,134,335	2,130	(1,922)	1,134,543
Long-term investments:				
Available-for-sale:				
Auction rate securities	19,150		(2,851)	16,299
Total long-term investments	19,150		(2,851)	16,299
Total investments	\$ 1,153,485	\$ 2,130	\$ (4,773)	\$ 1,150,842

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	Amortized Cost	As of February 2, 2013		Estimated Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
Short-term investments:				
Available-for-sale:				
Corporate debt securities	\$ 577,120	\$ 2,886	\$ (382)	\$ 579,624
U.S. government and agency debt	318,226	258	(5)	318,479
Time deposits	188,000			188,000
Asset backed securities	76,629	50	(64)	76,615
Foreign government and agency debt	4,320		(1)	4,319
Total short-term investments	1,164,295	3,194	(452)	1,167,037
Long-term investments:				
Available-for-sale:				
Auction rate securities	19,450		(2,681)	16,769
Total long-term investments	19,450		(2,681)	16,769
Total investments	\$ 1,183,745	\$ 3,194	\$ (3,133)	\$ 1,183,806

As of August 3, 2013, the Company's investment portfolio included auction rate securities with an aggregate par value of \$19.2 million. Beginning in February 2008, liquidity issues in the global credit markets resulted in a failure of auction rate securities, as the amount of securities submitted for sale in those auctions exceeded the amount of bids. Since this time, many of the issuers have refinanced their debt and paid down the auction rate securities, which have resulted in a smaller pool of outstanding securities. Although these securities have continued to pay interest and show an improvement in the underlying collateralization, there is currently limited trading volume. To estimate the fair value of the auction rate securities, the Company uses a discounted cash flow model based on estimated timing and amount of future interest and principal payments. In developing the cash flow model, the Company considers the credit quality and liquidity of the underlying securities and related issuer, the collateralization of underlying security investments and other considerations. The fair value of the auction rate securities as of August 3, 2013 was \$2.9 million less than the par value and was recorded in long-term investments. Based on the Company's balance of approximately \$1.7 billion in cash, cash equivalents and short-term investments, and the fact that the Company continues to generate positive cash flow from operations on a quarterly basis, the Company does not anticipate having to sell these securities below par value and does not have the intent to sell these auction rate securities until recovery. Since the Company considers the impairment to be temporary, the Company recorded the unrealized loss to accumulated other comprehensive (loss) income, a component of shareholders' equity.

The contractual maturities of available-for-sale securities are presented in the following table (in thousands):

	August 3, 2013		February 2, 2013	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 438,999	\$ 439,334	\$ 519,006	\$ 519,537
Due between one and five years	681,370	681,316	627,769	629,991
Due over five years	33,116	30,192	36,970	34,278
	\$ 1,153,485	\$ 1,150,842	\$ 1,183,745	\$ 1,183,806

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For individual securities that are in an unrealized loss position, the fair value and gross unrealized loss for these securities aggregated by investment category and length of time in an unrealized position are presented in the following tables (in thousands):

	Less than 12 months		August 3, 2013 12 months or more		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Loss	Value	Loss	Value	Loss
Corporate debt securities	\$ 251,224	\$ (1,574)	\$	\$	\$ 251,224	\$ (1,574)
Asset backed securities	65,076	(254)	1,921	(15)	66,997	(269)
U.S. government and agency debt	61,493	(44)			61,493	(44)
Municipal debt securities	7,025	(14)			7,025	(14)
Foreign government and agency debt	5,978	(21)			5,978	(21)
Auction rate securities			16,299	(2,851)	16,299	(2,851)
Total securities	\$ 390,796	\$ (1,907)	\$ 18,220	\$ (2,866)	\$ 409,016	\$ (4,773)

	Less than 12 months		February 2, 2013 12 months or more		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Loss	Value	Loss	Value	Loss
Corporate debt securities	\$ 141,915	\$ (382)	\$	\$	\$ 141,915	\$ (382)
Asset backed securities	43,882	(64)			43,882	(64)
U.S. government and agency debt	14,677	(5)			14,677	(5)
Foreign government and agency debt	4,319	(1)			4,319	(1)
Auction rate securities			16,769	(2,681)	16,769	(2,681)
Total securities	\$ 204,793	\$ (452)	\$ 16,769	\$ (2,681)	\$ 221,562	\$ (3,133)

Note 4. Supplemental Financial Information (in thousands)

	August 3, 2013	February 2, 2013
Inventories:		
Work-in-process	\$ 217,971	\$ 140,805
Finished goods	117,349	109,615
Inventories	\$ 335,320	\$ 250,420
	August 3, 2013	February 2, 2013
Property and equipment, net:		
Machinery and equipment	\$ 547,805	\$ 532,420
Buildings	144,320	144,320

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Computer software	92,332	89,548
Land	53,373	53,373
Building improvements	49,555	49,516
Leasehold improvements	48,576	46,205
Furniture and fixtures	27,454	25,301
Construction in progress	2,455	5,333
	965,870	946,016
Less: Accumulated depreciation and amortization	(602,384)	(573,045)
Property and equipment, net	\$ 363,486	\$ 372,971

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	August 3, 2013	February 2, 2013
Other non-current assets:		
Technology and other licenses	\$ 78,697	\$ 81,523
Deferred tax assets	25,038	26,291
Investments in privately-held companies	13,946	14,486
Prepaid land use rights	13,900	14,056
Deposits	13,104	10,451
Other	16,889	18,078
Other non-current assets	\$ 161,574	\$ 164,885

Prepaid land use rights which were previously included in property and equipment have been reclassified to other non-current assets. The revision to the balance sheet at February 2, 2013 was not considered to be material and it had no impact on total assets, total liabilities, results of operations or cash flows.

	August 3, 2013	February 2, 2013
Accrued liabilities:		
Accrued rebates	\$ 43,755	\$ 51,712
Accrued legal expense	26,807	18,357
Accrued royalties	16,239	12,695
Technology license obligations	8,103	9,865
Accrued share repurchases	144	22,152
Other	26,758	29,210
Accrued liabilities	\$ 121,806	\$ 143,991

	August 3, 2013	February 2, 2013
Other non-current liabilities:		
Technology license obligations	\$ 29,978	\$ 34,270
Long-term accrued employee compensation	6,152	6,205
Other	11,520	15,935
Other non-current liabilities	\$ 47,650	\$ 56,410

Accumulated other comprehensive (loss) income:

The changes in accumulated other comprehensive (loss) income by component are presented in the following tables (in thousands):

Unrealized Gain (Loss) on Marketable	Unrealized Gain (Loss) on Auction Rate	Unrealized Gain (Loss) on Cash	Total
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	Securities	Securities	Flow Hedges	
Balance at February 2, 2013	\$ 2,742	\$ (2,681)	\$ 1,087	\$ 1,148
Other comprehensive income (loss) before reclassifications	(1,991)	(170)	1,921	(240)
Amounts reclassified from accumulated other comprehensive income	(543)		(1,937)	(2,480)
Net current-period other comprehensive loss	(2,534)	(170)	(16)	(2,720)
Balance at August 3, 2013	\$ 208	\$ (2,851)	\$ 1,071	\$ (1,572)

Table of Contents**MARVELL TECHNOLOGY GROUP LTD.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Unrealized Gain (Loss) on Marketable Securities	Unrealized Gain (Loss) on Auction Rate Securities	Unrealized Gain (Loss) on Cash Flow Hedges	Total
Balance at January 28, 2012	\$ 3,702	\$ (1,285)	\$ (1,641)	\$ 776
Other comprehensive income (loss) before reclassifications	1,644	(112)	(1,830)	(298)
Amounts reclassified from accumulated other comprehensive income	(771)		1,671	900
Net current-period other comprehensive income (loss)	873	(112)	(159)	602
Balance at July 28, 2012	\$ 4,575	\$ (1,397)	\$ (1,800)	\$ 1,378

The amounts reclassified from accumulated other comprehensive (loss) income by components are presented in the following table (in thousands):

Affected Line Item in the Statement Where Net Income is Presented	August 3, 2013	
	Three Months Ended	Six Months Ended
Available-for-sale securities:		
Interest and other income, net	\$ 167	\$ 543
Cash flow hedges:		
Cost of goods sold	47	108
Research and development	726	1,671
Selling and marketing	63	145
General and administrative	5	13
Total	\$ 1,008	\$ 2,480

Net income per share:

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

	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Numerator:				
Net income	\$ 61,826	\$ 93,074	\$ 115,035	\$ 187,617
Denominator:				
Weighted average common shares outstanding:	494,293	562,362	498,237	571,193
Effect of dilutive securities:				

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Common share-based awards	6,332	7,963	4,769	11,339
Weighted average shares diluted	500,625	570,325	503,006	582,532
Net income per share:				
Basic	\$ 0.13	\$ 0.17	\$ 0.23	\$ 0.33
Diluted	\$ 0.12	\$ 0.16	\$ 0.23	\$ 0.32

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	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Anti-dilutive potential common shares:				
Weighted average shares outstanding from stock options	44,661	29,488	33,413	26,553
Weighted average exercise price	\$ 14.71	\$ 17.52	\$ 13.48	\$ 17.86

Anti-dilutive potential common shares for stock options are excluded from the calculation of diluted earnings per share for the periods reported above because either their exercise price exceeded the average market price during the period or certain stock options with exercise prices less than the average market price were determined to be anti-dilutive based on applying the treasury stock method. The anti-dilutive shares reported above also include shares from stock options that contain market conditions for vesting since the market value of the Company's stock as of August 3, 2013 and July 28, 2012 was lower than the required market condition. For the three and six months ended August 3, 2013, there were 2.7 million anti-dilutive shares from stock options that contain market conditions. For the corresponding three and six months ended July 28, 2012, there were 3.1 million anti-dilutive shares from stock options that contain market conditions.

Note 5. Derivative Financial Instruments

The Company manages some of its foreign currency exchange rate risk through the purchase of foreign currency exchange contracts that hedge against the short-term effect of currency fluctuations. The Company's policy is to enter into foreign currency forward contracts with maturities generally less than 12 months that mitigate the effect of rate fluctuations on certain local currency denominated operating expenses. All derivative instruments are recorded at fair value in either prepaid expenses and other current assets or accrued liabilities. The Company reports cash flows from derivative instruments in cash flows from operating activities. The Company uses quoted prices to value its derivative instruments.

The notional amounts of outstanding foreign currency forward contracts were as follows (in thousands):

	Buy Contracts	
	August 3, 2013	February 2, 2013
Euro	\$ 5,553	\$
Israeli shekel	36,621	38,249
	\$ 42,174	\$ 38,249

Cash Flow Hedges. The Company designates and documents its foreign currency forward exchange contracts as cash flow hedges for certain operating expenses denominated in Israeli shekels. The Company evaluates and calculates the effectiveness of each hedge at least quarterly. The effective change is recorded in accumulated other comprehensive income and is subsequently reclassified to operating expense when the hedged expense is recognized. Ineffectiveness is recorded in interest and other income, net.

Other Foreign Currency Forward Contracts. The Company enters into foreign currency forward exchange contracts to hedge certain assets and liabilities denominated in various foreign currencies that it does not designate as hedges for accounting purposes. The maturities of these contracts are generally less than 12 months. Gains or losses arising from the remeasurement of these contracts to fair value each period are recorded in interest and other income, net.

The fair value of foreign currency exchange contracts was not significant as of any period presented.

Note 6. Fair Value Measurements

Fair value is an exit price representing the amount that would be received in the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or a liability. As a basis for considering such assumptions, the accounting guidance establishes a three-tier value hierarchy, which prioritizes the inputs used in the valuation methodologies in measuring fair value:

Level 1 Observable inputs that reflect quoted prices for identical assets or liabilities in active markets.

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Level 2 Include other inputs that are directly or indirectly observable in the marketplace.

Level 3 Unobservable inputs that are supported by little or no market activity.

The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company's Level 1 assets include institutional money-market funds that are classified as cash equivalents and marketable investments in U.S. government and agency debt, which are valued primarily using quoted market prices. The Company's Level 2 assets include its marketable investments in time deposits, corporate debt securities, foreign government and agency debt, municipal debt securities and asset backed securities as the market inputs to value these instruments consist of market yields, reported trades and broker/dealer quotes, which are corroborated with observable market data. In addition, forward contracts and the severance pay fund are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments. The Company's Level 3 assets include its investments in auction rate securities, which are classified within Level 3 because there are currently no active markets for the auction rate securities and consequently the Company is unable to obtain independent valuations from market sources. Therefore, the auction rate securities are valued using a discounted cash flow model. Some of the inputs to the cash flow model are unobservable in the market. The total amount of assets measured using Level 3 valuation methodologies represented 0.3% of total assets as of August 3, 2013.

The tables below set forth, by level, the Company's assets that were accounted for at fair value as of August 3, 2013 and February 2, 2013. The tables do not include assets and liabilities that are measured at historical cost or any basis other than fair value (in thousands):

	Level 1	Level 2	Level 3	Portion of Carrying Value Measured at Fair Value at August 3, 2013
Items measured at fair value on a recurring basis:				
Assets				
Cash equivalents:				
Money market funds	\$ 12,348			\$ 12,348
U.S. government and agencies	3,000			3,000
Time deposits		63,035		63,035
Municipal debt securities		6,600		6,600
Corporate debt securities		1,599		1,599
Short-term investments:				
U.S. government and agency debt	316,154			316,154
Corporate debt securities		584,479		584,479
Time deposits		138,000		138,000
Asset backed securities		72,377		72,377
Foreign government and agency debt		10,298		10,298
Municipal debt securities		13,235		13,235
Prepaid expenses and other current assets:				
Forward contracts		1,127		1,127
Long-term investments:				
Auction rate securities			16,299	16,299
Other non-current assets:				
Severance pay fund		2,232		2,232

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Total assets	\$ 331,502	\$ 892,982	\$ 16,299	\$ 1,240,783
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	Level 1	Level 2	Level 3	Portion of Carrying Value Measured at Fair Value at February 2, 2013
Items measured at fair value on a recurring basis:				
Assets				
Cash equivalents:				
U.S. government and agency debt	\$ 27,029			\$ 27,029
Money market funds	21,523			21,523
Time deposits		119,874		119,874
Short-term investments:				
U.S. government and agency debt	318,479			318,479
Corporate debt securities		579,624		579,624
Time deposits		188,000		188,000
Asset backed securities		76,615		76,615
Foreign government and agency debt		4,319		4,319
Prepaid expenses and other current assets:				
Forward contracts		1,144		1,144
Long-term investments:				
Auction rate securities			16,769	16,769
Other non-current assets:				
Severance pay fund		1,977		1,977
Total assets	\$ 367,031	\$ 971,553	\$ 16,769	\$ 1,355,353

The following table summarizes the change in fair value for Level 3 items (in thousands):

	Six Months Ended	
	August 3, 2013	July 28, 2012
Beginning balance	\$ 16,769	\$ 23,215
Sales and redemptions	(300)	(5,000)
Unrealized losses included in accumulated other comprehensive income	(170)	(112)
Ending balance	\$ 16,299	\$ 18,103

Note 7. Goodwill and Acquired Intangible Assets, Net**Goodwill**

The following table summarizes the activity related to the carrying value of goodwill (in thousands):

Balance at February 2, 2013	\$ 2,032,138
Additions due to business combinations	400

Balance at August 3, 2013

\$ 2,032,538

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The carrying amount of acquired intangible assets are as follows (in thousands):

	Range of Useful Lives	August 3, 2013			February 2, 2013		
		Gross Carrying Amounts	Accumulated Amortization and Write-Offs	Net Carrying Amount	Gross Carrying Amounts	Accumulated Amortization and Write-Offs	Net Carrying Amount
Purchased technology	4 - 7 years	\$ 54,690	\$ (23,071)	\$ 31,619	\$ 54,690	\$ (18,552)	\$ 36,138
Core technology	5 - 8 years	138,650	(132,960)	5,690	138,650	(123,298)	15,352
Trade names	5 years	1,300	(438)	862	1,300	(308)	992
Customer intangibles	5 - 7 years	89,400	(68,940)	20,460	89,400	(61,927)	27,473
IPR&D	*	13,086		13,086	9,700		9,700
Total intangible assets, net		\$ 297,126	\$ (225,409)	\$ 71,717	\$ 293,740	\$ (204,085)	\$ 89,655

* Upon completion of the projects, the related in-process research and development (IPR&D) assets will be amortized over its estimated useful life. If any of the projects are abandoned or the forecast of the project indicates that the fair value is less than the carrying amount, the Company will be required to write down the related IPR&D asset.

Based on the identified intangible assets recorded at August 3, 2013, the future amortization expense excluding IPR&D for the next five fiscal years is as follows (in thousands):

Fiscal year	
Remainder of fiscal 2014	\$ 14,454
2015	14,942
2016	12,203
2017	11,018
2018	5,590
Thereafter	424
	\$ 58,631

Note 8. Income Tax

The income tax benefit for the three months ended August 3, 2013 included the current income tax liability of \$5.2 million, which was offset by a net reduction in unrecognized tax benefits of \$6.8 million in the three months ended August 3, 2013. The net reduction in unrecognized tax benefits arose from the expiration of the statute of limitations, less an increase in current unrecognized tax benefit estimates. The income tax benefit for the six months ended August 3, 2013 included the current income tax liability of \$7.0 million plus \$0.7 million in settlements of audits in non-U.S. jurisdictions, which were offset by a net reduction in unrecognized tax benefits of \$16.5 million. The net reduction in unrecognized tax benefits primarily arose from the expiration of statute of limitations in non-U.S. jurisdictions and from the settlement of two audits in non-U.S. jurisdictions (one for \$3.5 million and the other for \$4.1 million), less an increase in current unrecognized tax estimates.

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The income tax provision for the three and six months ended July 28, 2012 included the current income tax liability of \$5.9 million and \$8.6 million, respectively, which were partially offset by a net reduction in unrecognized tax benefits of \$3.4 million in the three months ended July 28, 2012 and \$6.0 million in the six months ended July 28, 2012. These net reductions in unrecognized tax benefits arose primarily from the expiration of the statute of limitations in non-U.S. jurisdictions less an increase in current unrecognized tax benefit estimates.

It is reasonably possible that the amount of unrecognized tax benefits could increase or decrease significantly due to changes in tax law in various jurisdictions, new tax audits, and changes in U.S. dollar as compared to foreign currencies within the next 12 months. Excluding these factors, uncertain tax positions may decrease by as much as \$30 million from the lapse of the statutes of limitation in various jurisdictions during the next 12 months.

The Company operates under tax holidays in certain countries, which are extended if certain additional requirements are satisfied. The tax holidays are conditional upon meeting certain employment and investment thresholds. The impact of these tax holidays decreased foreign taxes by \$9.2 million for the six months ended August 3, 2013. The benefit of the tax holidays on net income per share was less than \$0.01 per share for the six months ended August 3, 2013.

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MARVELL TECHNOLOGY GROUP LTD.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 9. Commitments and Contingencies

Purchase Commitments

Under the Company's manufacturing relationships with its foundry partners, cancellation of all outstanding purchase orders are allowed but require payment of all costs and expenses incurred through the date of cancellation. As of August 3, 2013, these foundries had incurred approximately \$302.9 million of manufacturing costs and expenses relating to the Company's outstanding purchase orders.

Intellectual Property Indemnification

The Company has agreed to indemnify certain customers for claims made against the Company's products, where such claims allege infringement of third party intellectual property rights, including, but not limited to, patents, registered trademarks, and/or copyrights. Under the aforementioned indemnification clauses, the Company may be obligated to defend the customer and pay for the damages awarded against the customer under an infringement claim as well as the attorneys' fees and costs. The Company's indemnification obligations generally do not expire after termination or expiration of the agreement containing the indemnification obligation. Generally, there are limits on and exceptions to the Company's potential liability for indemnification. The Company cannot estimate the amount of potential future payments, if any, that it might be required to make as a result of these agreements. The maximum potential amount of any future payments that the Company could be required to make under these indemnification obligations could be significant.

Contingencies

The Company and certain of its subsidiaries are currently a party to various legal proceedings, including those noted in this section. The legal proceedings and claims described below could result in substantial costs and could divert the attention and resources of the Company's management. Litigation is subject to inherent uncertainties and unfavorable rulings could occur. An unfavorable ruling in litigation could require the Company to pay damages, one-time license fees or ongoing royalty payments, and could prevent the Company from manufacturing or selling some of its products or limit or restrict the type of work that employees involved in such litigation may perform for the Company, any of which could adversely affect financial results in future periods. The Company believes that its products do not infringe valid and enforceable claims and it will continue to conduct a vigorous defense in these proceedings. However, there can be no assurance that these matters will be resolved in a manner that is not adverse to the Company's business, financial condition, results of operations or cash flows.

As of August 3, 2014, the Company has recorded a total charge of \$10.4 million related to certain legal proceedings described below in this section. The amount recorded does not relate to the litigation with Carnegie Mellon University (CMU). Other than these matters for which the Company has recognized in the consolidated financial statements, it has not recorded any amounts for contingent losses associated with these matters based on its belief that losses, while reasonably possible, are not probable. Unless otherwise stated, the Company is currently unable to predict the final outcome of these lawsuits and therefore cannot determine the likelihood of loss nor estimate a range of possible loss.

Carnegie Mellon Litigation. On March 6, 2009, CMU filed a complaint in the U.S. District Court for the Western District of Pennsylvania naming Marvell Semiconductor, Inc. (MSI) and the Company as defendants and alleging patent infringement. CMU has asserted U.S. Patent Nos. 6,201,839 and 6,438,180 (collectively, the CMU patents in suit), which relate to read-channel integrated circuit devices and the HDD products incorporating such devices. A jury trial began on November 26, 2012. On December 26, 2012, a jury delivered a verdict that found the CMU patents in suit were literally and willfully infringed and valid, and awarded past damages in the amount of \$1.17 billion. Due to the finding of willfulness during post trial proceedings, the judge could enhance the damages by an amount up to triple the damages awarded by the jury at trial. In addition, CMU has disclosed in its post trial motions that it is seeking pre-judgment interest up to \$322 million, post-judgment interest, attorneys' fees, and an injunction or ongoing royalties. Post-trial motions were heard on May 1 and 2, 2013. On June 26, 2013, the District Court denied CMU's post-trial motion for attorney fees. On August 23, 2013, the District Court denied the motion for mistrial. The Company expects the District Court to issue its final judgment sometime in the next few months.

The Company and MSI believe that the evidence and the law do not support the jury's findings of infringement, validity and the award of damages and do not believe a material loss is probable. The Company believes that there are strong grounds for appeal and the Company and MSI will seek to overturn the verdict in post trial motions before the District Court and, if necessary, to appeal to the U.S. Court of Appeals for

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the Federal Circuit in Washington, D.C. The Company and MSI intend to vigorously challenge the judgment through all appropriate post trial motions and appeal processes. In addition, the District Court in Pittsburgh has yet to rule on certain of the Company's defenses and motions, including laches. The Company believes the low end of the possible range of loss is zero, but it cannot reasonably estimate the upper range of the possible loss, as a number of factors (including finalization of the post-trial motions at the District Court) could significantly change the assessment of damages.

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Jasmine Networks Litigation. On September 12, 2001, Jasmine Networks, Inc. (Jasmine) filed a lawsuit in the Santa Clara County Superior Court alleging claims against MSI and three of its officers for allegedly improperly obtaining and using information and technologies during the course of the negotiations with its personnel regarding the potential acquisition of certain Jasmine assets by MSI.

The case proceeded to trial on September 20, 2010. On November 24, 2010, a Santa Clara County jury returned a verdict in favor of MSI on all claims. On January 7, 2011, the court entered judgment in MSI s favor. Pursuant to California Civil Procedure provisions, Jasmine filed motions for a new trial and for a judgment notwithstanding the verdict. These motions were heard by the court on February 25, 2011 and denied in written orders. Jasmine has appealed and MSI is contesting the appeal vigorously. Oral arguments on the appeal were heard on June 18, 2013. On July 17, 2013, the Court of Appeals unanimously affirmed judgment in favor of MSI. It is unknown whether Jasmine will appeal to the California Supreme Court.

USEI Litigation. On October 9, 2009, U.S. Ethernet Innovations, LLC (USEI) filed a complaint in the U.S. District Court for the Eastern District of Texas, in which USEI has accused a number of system manufacturers, including the Company s customers, of patent infringement (the USEI litigation). Specifically, USEI has asserted that these customers infringe U.S. Patent Nos. 5,307,459, 5,434,872, 5,732,094 and 5,299,313 (collectively, the USEI patents in suit), which relate to Ethernet technologies. The complaint seeks unspecified damages and an injunction.

On May 4, 2010, MSI filed a motion to intervene in the USEI litigation, which was granted on May 19, 2010. On July 13, 2010, the District Court issued an order granting the defendants motion to transfer the action to the U.S. District Court for the Northern District of California; the case was formally transferred on August 23, 2010. On September 14, 2011, USEI withdrew its allegations against MSI for the 459 patent. On October 21, 2011, the court conducted a claim construction hearing, and issued a ruling on January 31, 2012. A supplemental claim construction hearing was held on May 3, 2012, and a ruling was issued on August 29, 2012. On August 16, 2013, the District Court granted defendants summary judgment motion to preclude the plaintiff from recovering certain pre-suit damages. Trial is scheduled for January 5, 2015.

Lake Cherokee Patent Litigation. On June 30, 2010, Lake Cherokee Hard Drive Technologies, L.L.C. filed a complaint in the U.S. District Court for the Eastern District of Texas. The complaint alleges infringement of U.S. Patent Nos. 5,844,738 and 5,978,162 (collectively, the Lake Cherokee patents in suit). The Lake Cherokee patents in suit relate to read-channel integrated circuit devices, and to certain HDD products incorporating such devices. MSI filed its answer and counterclaims to the complaint on September 13, 2010. Defendants filed a motion to transfer on April 1, 2011, which was denied on February 13, 2012. Lake Cherokee filed an amended complaint on April 21, 2011. MSI filed its answer and counterclaims to the amended complaint on May 9, 2011. A claim construction hearing was held on May 14, 2012, and the claim construction ruling was issued on August 6, 2012. Lake Cherokee s damages claim, which excluded non-U.S. related sales as a result of the District Court s summary judgment ruling, was approximately \$193 million at the start of trial. MSI strongly disputed its liability and the damages claimed by Lake Cherokee. The case proceeded to trial on August 12, 2013. On August 16, 2013, an Eastern District of Texas jury returned a verdict and unanimously found that MSI did not infringe the Lake Cherokee patents in suit. On the same day, the Court entered judgment in MSI s favor. It is unknown whether Lake Cherokee will appeal the jury s verdict.

APT Patent Litigations. On January 18, 2011, Advanced Processor Technologies, LLC (APT), a subsidiary of Acacia Research Corp., filed a complaint in the U.S. District Court for the Eastern District of Texas. The complaint names MSI and eight other defendants and alleged infringement of U.S. Patent Nos. 6,047,354 and 5,796,978. In April 2013, the parties reached an agreement to dismiss all claims and counterclaims. On June 25, 2013, MSI was dismissed from the cases. The resolution did not have a significant impact on the Company s financial statements.

MOSAID Litigation. On March 16, 2011, MOSAID Technologies Inc. filed suit in the U.S. District Court for the Eastern District of Texas against MSI and 16 other companies. The complaint alleges that defendants products, which operate in compliance with various IEEE 802.11 standards, infringe the six asserted patents (U.S. Patent Nos. 5,131,006; 5,151,920; 5,422,887; 5,706,428; 6,563,768; 6,992,972). MSI filed its answer and counterclaims on June 9, 2011. On March 28, 2012, MSI and other defendants filed a motion to transfer, which was denied. A claim construction hearing was held on April 16, 2013 and a claim construction ruling was issued by the magistrate judge on April 22, 2013. On June 3, 2013, the District Court issued an order denying plaintiff s motion for reconsideration and adopted the magistrate s claim construction ruling. On August 20, 2013, MSI and MOSAID reached a tentative settlement related to the litigation between the parties. The tentative settlement did not have a significant impact on the Company s financial statements.

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Azure Networks Litigation. On March 22, 2011, Azure Networks, LLC and Tri-County Excelsior Foundation filed suit in the U.S. District Court for the Eastern District of Texas against MSI and eight other companies. The Complaint asserts U.S. Patent No. 7,756,129 against MSI's Bluetooth products. MSI filed its answer and counterclaims on July 20, 2011. On November 2, 2012, defendants filed a

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motion for summary judgment of invalidity, which was denied. A claim construction hearing was held on December 20, 2012. On January 15, 2013, the magistrate judge issued a claim construction ruling. On May 20, 2013, the District Court issued an order denying plaintiff's motion for reconsideration and adopted the magistrate judge's claim construction ruling. On May 30, 2013, the District Court entered a judgment of non-infringement. On June 24, 2013, Azure appealed.

Power Management Systems Litigation. On August 22, 2011, Power Management Systems LLC (PMS), a subsidiary of Acacia Research Corp., filed a complaint against the Company's subsidiary Marvell Semiconductor, Ltd. (MSL) and other defendants, in the U.S. District Court for the District of Delaware. The complaint asserts U.S. Patent No. 5,504,909, which relates to a power management apparatus, against various products. The complaint seeks unspecified damages. On October 17, 2011, PMS amended its complaint by substituting MSL with MSI. MSI filed its answer and counterclaims on November 4, 2011. A claim construction hearing was held on January 18, 2013, and a ruling was issued on May 30, 2013. On June 14, 2013, the District Court entered a judgment of non-infringement. On June 17, 2013, PMS appealed.

HSM/TPL Litigation. On September 1, 2011, HSM Portfolio, LLC and Technology Properties Limited, LLC filed a complaint against the Company and MSL in the U.S. District Court for the District of Delaware. The complaint also named numerous other defendants. On June 25, 2013, MSI was dismissed from the case.

France Telecom Litigation. On June 26, 2012, France Telecom S.A. (France Telecom) filed a complaint against MSI in the U.S. District Court for the Southern District of New York. The complaint asserts U.S. Patent No. 5,446,747 (the '747 patent) against MSI's communications processors and thin modems. The complaint seeks unspecified damages as well as injunctive relief. MSI answered the complaint on July 18, 2012 and August 1, 2012. On July 30, 2012, MSI filed a motion to transfer the lawsuit to the U.S. District Court for the Northern District of California. On September 17, 2012, the Court granted MSI's motion and transferred the case to the Northern District of California. Trial is scheduled for May 12, 2014.

Freescale Litigation. On July 6, 2012, Freescale Semiconductor, Inc. (Freescale) filed a complaint against MSI in the U.S. District Court for the Western District of Texas. The complaint asserts U.S. Patent Nos. 6,920,316, 5,825,640, 5,943,274, 5,467,455 and 7,927,927 (collectively, the Freescale patents in suit) against certain of the Company's integrated circuits and/or chipsets. The complaint seeks unspecified damages and a permanent injunction. Freescale filed an amended complaint on January 14, 2013, and withdrew its assertion of U.S. Patent No. 5,825,640; MSI filed its answer to the amended complaint on February 4, 2013. This case has been consolidated for pre-trial purposes with nine other pending cases. A claim construction hearing is scheduled for October 24, 2013. No trial date has been set.

On January 4, 2013, three of the Company's subsidiaries, MSI, Marvell International Ltd. and Marvell World Trade Ltd., filed a complaint against Freescale in the U.S. District Court for the Western District of Texas, and filed an amended complaint on January 14, 2013. The amended complaint alleges that Freescale infringes U.S. Patents Nos. 6,903,448 and 7,379,718. A claim construction hearing is scheduled for December 13, 2013. No trial date has been set.

Indemnities, Commitments and Guarantees

During its normal course of business, the Company has made certain indemnities, commitments and guarantees under which it may be required to make payments in relation to certain transactions. These indemnities may include intellectual property indemnities to the Company's customers in connection with the sales of its products, indemnities for liabilities associated with the infringement of other parties' technology based upon the Company's products, indemnities for general commercial obligations, indemnities to various lessors in connection with facility leases for certain claims arising from such facility or lease, and indemnities to directors and officers of the Company to the maximum extent permitted under the laws of Bermuda. In addition, the Company has contractual commitments to various customers, which could require the Company to incur costs to repair an epidemic defect with respect to its products outside of the normal warranty period if such defect were to occur. The duration of these indemnities, commitments and guarantees varies, and in certain cases, is indefinite. Some of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential future payments that the Company could be obligated to make. In general, the Company does not record any liability for these indemnities, commitments and guarantees in the accompanying consolidated balance sheets as the amounts cannot be reasonably estimated and are not considered probable. The Company does, however, accrue for losses for any known contingent liability, including those that may arise from indemnification provisions, when future payment is probable.

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Activity under the Company's stock option plans for the six months ended August 3, 2013 is summarized below (in thousands, except per share amounts):

	Time-Based Options		Market-Based Options		Total	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Balance at February 2, 2013	49,637	\$ 13.28	2,759	\$ 15.43	52,396	\$ 13.39
Granted	18,381	\$ 10.76		\$	18,381	\$ 10.76
Exercised	(4,873)	\$ 7.53		\$	(4,873)	\$ 7.53
Canceled/Forfeited	(1,675)	\$ 15.56	(42)	\$ 15.43	(1,717)	\$ 15.56
Balance at August 3, 2013	61,470	\$ 12.92	2,717	\$ 15.43	64,187	\$ 13.03
Vested or expected to vest at August 3, 2013	57,294	\$ 13.03				
Exercisable at August 3, 2013	36,550	\$ 13.65				

For time-based stock options vested and expected to vest at August 3, 2013, the aggregate intrinsic value was \$110.6 million and the weighted average remaining contractual term was 5.6 years. For time-based stock options exercisable at August 3, 2013, the aggregate intrinsic value was \$73.0 million and the weighted average remaining contractual term was 3.5 years. The aggregate intrinsic value of stock options exercised during the three months ended August 3, 2013 and July 28, 2012 was \$5.0 million and \$5.4 million, respectively. The aggregate intrinsic value of stock options exercised during the six months ended August 3, 2013 and July 28, 2012 was \$16.1 million and \$23.7 million, respectively. There was no aggregate intrinsic value for market-based stock options at August 3, 2013 and the weighted average remaining contractual term of market-based stock options vested and expected to reach the end of the vesting period at August 3, 2013 was 7.7 years. The Company's closing stock price of \$13.12 as reported on the NASDAQ Global Select Market for all in-the-money options as of August 2, 2013 was used to calculate the aggregate intrinsic value.

As of August 3, 2013, the unamortized compensation expense for time-based stock options was \$78.0 million and market-based stock options was \$2.0 million. The unamortized compensation expense for time-based and market-based stock options will be amortized on a straight-line basis and is expected to be recognized over a weighted-average period of 3.3 years and 0.4 years, respectively.

Included in the following table is activity related to the non-vested portion of the restricted stock units as follows (in thousands, except for share prices):

	Restricted Stock Units Outstanding	Weighted Average Grant Date Fair Value
Balance at February 2, 2013	12,739	\$ 15.78
Granted	3,075	\$ 10.43
Vested	(3,544)	\$ 16.51

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Canceled/Forfeited	(632)	\$	14.53
Balance at August 3, 2013	11,638	\$	14.21

The aggregate intrinsic value of restricted stock units expected to vest as of August 3, 2013 was \$137.6 million. The number of restricted stock units that are expected to vest is 10.5 million shares.

As of August 3, 2013, unamortized compensation expense related to restricted stock units was \$123.7 million. The unamortized compensation expense for restricted stock units will be amortized on a straight-line basis and is expected to be recognized over a weighted-average period of 2.1 years.

Employee Stock Purchase Plan

During the three and six months ended August 3, 2013, a total of 5.0 million shares were issued at a weighted-average price of \$7.34 per share under the 2000 Employee Stock Purchase Plan, as amended and restated (the "ESPP"). During the three and six months ended July 28, 2012, a total of 3.3 million shares were issued at a weighted-average price of \$10.40 per share under the ESPP. As of August 3, 2013, there was \$40.9 million of unrecognized compensation cost related to the ESPP.

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MARVELL TECHNOLOGY GROUP LTD.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Share Repurchase Program

The Company repurchased 7.2 million of its common shares for \$82.6 million in cash during the three months ended August 3, 2013 and 19.8 million of its common shares for \$250.3 million in cash during the three months ended July 28, 2012. The Company repurchased 27.1 million common shares for \$282.8 million in cash during the six months ended August 3, 2013 and 34.4 million common shares for \$473.5 million in cash during the six months ended July 28, 2012. The repurchased shares were retired immediately after the repurchases were completed. The Company records all repurchases, as well as investment purchases and sales, based on trade date. Approximately \$0.1 million of repurchases during the three months ended August 3, 2013 was made within the final three days of the fiscal quarter and is included in accrued liabilities in the condensed consolidated balance sheet due to the standard three-day settlement period. As of August 3, 2013, a total of 210.8 million cumulative shares have been repurchased under the Company's share repurchase program for a total \$2.7 billion in cash and there was \$329.8 million remaining available for future share repurchases.

Subsequent to the end of the quarter through August 29, 2013, the Company repurchased an additional 1.8 million of its common shares for \$21.6 million at an average price per share of \$11.85.

Dividend Program

Cash dividends of \$0.06 per share were paid for a total of \$29.7 million in the three months ended August 3, 2013 and cash dividends of \$0.12 per share were paid for a total of \$60.0 million in the six months ended August 3, 2013. Cash dividends of \$0.06 per share were paid for a total of \$33.5 million in the three and six months ended July 28, 2012. Future payment of a regular quarterly cash dividend on the Company's common shares will be subject to, among other things, the best interests of its shareholders, the Company's results of operations, cash balances and future cash requirements, financial condition, statutory requirements of Bermuda law and other factors that the Company's board of directors may deem relevant.

On August 22, 2013, the Company announced that its board of directors declared a cash dividend of \$0.06 per share to be paid on October 3, 2013 to shareholders of record as of September 12, 2013.

Table of Contents**MARVELL TECHNOLOGY GROUP LTD.****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 11. Share-Based Compensation**

The following table presents details of share-based compensation expenses by functional line item (in thousands):

	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Cost of goods sold	\$ 1,868	\$ 1,775	\$ 3,735	\$ 3,898
Research and development	28,982	22,413	52,261	39,587
Selling and marketing	3,648	3,458	7,040	6,494
General and administrative	6,593	5,582	11,568	10,441
	\$ 41,091	\$ 33,228	\$ 74,604	\$ 60,420

Share-based compensation capitalized in inventory was \$2.1 million at August 3, 2013 and \$1.5 million at February 2, 2013.

Valuation Assumptions

The following weighted average assumptions were used for each respective period to calculate the fair value of each time-based stock option award on the date of grant using the Black-Scholes valuation model:

	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Time-based Stock Options:				
Weighted average fair value	\$ 3.63	\$ 3.73	\$ 3.41	\$ 5.59
Expected volatility	44%	46%	45%	44%
Expected term (in years)	5.0	4.8	5.0	4.8
Risk-free interest rate	1.2%	0.7%	0.8%	0.9%
Expected dividend yield	2.1%	2.0%	2.4%	0-2.0%

	Three and Six Months Ended	
	August 3, 2013	July 28, 2012
Employee Stock Purchase Plan:		
Estimated fair value	\$ 3.45	\$ 3.77
Volatility	40%	39%
Expected term (in years)	1.3	1.3
Risk-free interest rate	0.2%	0.2%
Dividend yield	2.2%	2.0%

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act), which are subject to the safe harbor created by those sections. These statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results to differ materially from those implied by the forward-looking statements. Words such as anticipates, expects, intends, plans, believes, seeks, estimates, can, and similar expressions identify such forward-looking statements. We make a number of forward-looking statements that relate to future periods and include statements relating to our anticipation that the rate of new orders and shipments may vary significantly from quarter to quarter; our expectations regarding market acceptance of 3G and LTE solutions; our expectations regarding industry trends; our expectations regarding our inventory levels; our expectations regarding the amount of our future sales in Asia; our expectations regarding competition; our expectations relating to the protection of our intellectual property; our expectations regarding the amount of customer concentration in the future; our plans and expectations regarding our auction rate securities; our expectations regarding acquisitions, investments, strategic alliances and joint ventures; our expectations regarding net revenue, cost of goods sold as a percentage of revenue and operating expenses for the third quarter ending November 2, 2013 compared with the second quarter ended August 3, 2013; our expectations regarding the growth of solid state drive revenue; our expectations regarding the impact of legal proceedings and claims; our ability to meet our capital needs for at least the next 12 months; our ability to attract and retain highly skilled personnel; our expectations regarding future growth opportunities; our plan regarding forward exchange contracts and the effect of foreign exchange rates; our expectations regarding unrecognized tax benefits; the effect of recent accounting pronouncements and changes in taxation rules; our expectation regarding the effectiveness of our hedges of foreign currency exposures; our expectations that quarterly operating results will fluctuate from quarter to quarter; our expectations regarding the current economic environment; our expectations regarding arrangements with suppliers; our expectations regarding our ability to develop and introduce new products and achieve market acceptance of our products; our expectations regarding pricing; our expectations regarding demand for our products and the impact of seasonality on demand; our expectations regarding defects; our expectations regarding the implementation and improvement of operational and financial systems, as well as the implementation of additional procedures and other internal management systems; our expectations regarding gross margin and the events that may cause gross margin to fluctuate; our expectations to transition our semiconductor products to increasingly smaller line width geometries; our expectations regarding the portion of our operations and sales outside of the United States; our expectations regarding the adequacy of our internal control over financial reporting; our expectations regarding future impairment review of our goodwill and intangible assets; and the anticipated features and benefits of our technology solutions. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements. Factors that could cause actual results to differ materially from those predicted, include but are not limited to, our dependence upon the hard disk drive and mobile and wireless markets, which are highly cyclical and intensely competitive; our ability and the ability of our customers to successfully compete in the markets in which we serve; our dependence on a small number of customers; the outcome of pending or future litigation and legal proceedings; the impact of international conflict and continued economic volatility in either domestic or foreign markets; our ability to scale our operations in response to changes in demand for existing or new products and services; our maintenance of an effective system of internal controls; our ability and our customers' ability to develop new and enhanced products and the adoption of those products in the market; our success in integrating businesses we acquire and the impact such acquisitions may have on our operating results; our ability to estimate customer demand and future sales accurately; the success of our strategic relationships; our reliance on independent foundries and subcontractors for the manufacture, assembly and testing of our products; our ability to manage future growth; the development and evolution of markets for our integrated circuits; our ability to protect our intellectual property; the impact of any change in our application of the United States federal income tax laws and the loss of any beneficial tax treatment that we currently enjoy; the impact of changes in international financial and regulatory conditions; and the impact of lengthy and expensive product sales cycles. Additional factors which could cause actual results to differ materially include those set forth in the following discussion, as well as the risks discussed in Part II, Item 1A, Risk Factors, and other sections of this Quarterly Report on Form 10-Q. These forward-looking statements speak only as of the date hereof. Unless required by law, we undertake no obligation to update any forward-looking statements.

Overview

We are a leading global semiconductor provider of high-performance application-specific standard products. Our core strength of expertise is the development of complex SoC devices, leveraging our extensive technology portfolio of intellectual property in the areas of analog, mixed-signal, digital signal processing, and embedded ARM-based microprocessor integrated circuits. We also develop platforms that we define as integrated hardware along with software that incorporates digital computing technologies designed and configured to provide an optimized computing solution compared to individual components. Our broad product portfolio includes devices for data storage, enterprise-class Ethernet data switching, Ethernet physical-layer transceivers, mobile handsets and other consumer electronics, Ethernet-based wireless networking, personal area networking, Ethernet-based PC connectivity, control plane communications controllers, video-image processing and power management solutions. Our products serve diverse applications used in carrier, metropolitan, enterprise and PC-client data communications and storage systems. Additionally, we serve the consumer electronics market for the convergence of voice, video and data applications. We are a fabless integrated circuit company, which means that we rely on independent, third party contractors to perform manufacturing, assembly and test functions. This approach allows us to focus on designing, developing and marketing our products and significantly reduces the amount of

capital we need to invest in manufacturing products.

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A significant number of our products are being incorporated into consumer electronics products, including gaming devices and personal computers, which are subject to significant seasonality and fluctuations in demand. Holiday and back to school buying trends may at times negatively impact our results in the first and fourth quarter and positively impact our results in the second and third quarter of our fiscal years.

A relatively large portion of our sales have historically been made on the basis of purchase orders rather than long-term agreements. In addition, the sales cycle for our products is long, which may cause us to experience a delay between the time we incur expenses and the time revenue is generated from these expenditures. We anticipate that the rate of new orders may vary significantly from quarter to quarter. Consequently, if anticipated sales and shipments in any quarter do not occur when expected, expenses and inventory levels could be disproportionately high, and our operating results for that quarter and future quarters may be adversely affected.

In this Quarterly Report on Form 10-Q, we refer to the fiscal year ended February 2, 2008 as fiscal 2008, the fiscal year ended January 31, 2009 as fiscal 2009, the fiscal year ended January 30, 2010 as fiscal 2010, the fiscal year ended January 29, 2011 as fiscal 2011, the fiscal year ended January 28, 2012 as fiscal 2012, the fiscal year ended February 2, 2013 as fiscal 2013, the fiscal year ending February 1, 2014 as fiscal 2014 and the fiscal year ending January 31, 2015 as fiscal 2015.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates, judgments and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Actual results could differ from these estimates, and such differences could affect the results of operations reported in future periods. For a description of our critical accounting policies and estimates, please refer to the Critical Accounting Policies and Estimates section of our Management s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended February 2, 2013.

Results of Operations

Net revenue for the three months ended August 3, 2013 of \$807 million was lower by 1% compared to the three months ended July 28, 2012, mostly driven by the decline in revenue in the mobile and wireless end markets compared year over year. On a sequential basis net revenue grew approximately 10% during the second quarter of fiscal 2014 compared to the first quarter of fiscal 2014 as we continued to see traction with our products based on our 3G unified platform and we continued to benefit from share gains in storage. We are seeing many of our customers introducing new devices using our innovative solutions, which we believe will drive success across all of our end markets. Our future growth is expected to be driven by areas such as mobile handsets, tablets, connectivity, smart home devices and solid state drives (SSDs).

In the mobile market, our 3G unified platform is in mass production at multiple top tier OEMs. For example, Samsung has successfully launched their 7-inch Galaxy Tab 3 globally based on our dual-core platform and China Mobile recently selected our dual-core platform to launch its first branded smartphone. In addition to our dual-core devices, our quad-core platform is now in production with leading OEM customers who have introduced multiple quad-core smartphone models targeting both the high-end and mass-market segments for both WCDMA and TD-SCDMA. We continue to make steady progress with our LTE solution, which passed qualifications in China, and is expected to achieve full certification in North America by the end of this year.

In wireless connectivity market, an example of our recent success is the Armada 1500 platform that powers the Chromecast, an innovative new product that allows consumers to seamlessly connect and stream video content from a small screen mobile device to any large screen. We also continue to see increased traction for our 2x2 combo solution for 802.11n and 802.11ac, where we have won multiple designs in tablets, ultrabooks, gaming and video platforms. In the gaming market, we expect to benefit from multiple new consoles that are scheduled to launch over the next few months. In addition, in the smart phone market, we have on-going 100% attach rates on our new mobile platforms for our connectivity solutions. We also continue to see significant traction for our 4x4 solutions as global enterprise carriers are realizing this design is the necessary architecture for HD video distribution. Looking forward, we anticipate seasonal increases in wireless connectivity during our third quarter as our OEM customers ramp-up production activity for the holiday season.

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In the storage market, we continue to execute well despite a tepid end-market. We have gained market share within the hard disk drive (HDD) market as we have seen strong growth for our 500 gigabyte per platter products. In addition, we are seeing increased demand on enterprise drives at a top North America based HDD customer. Within the SSD market, our revenue has continued to grow and our strategy of partnering with top tier OEMs has resulted in excellent traction for our advanced SSD solutions where we believe we have a lead in PCIe based SSD solutions for the client market. We are also leveraging our technology leadership in HDD and SSD to help our customer migrate to hybrid storage devices. Here we are developing a single-chip solution that we believe will drive lower price points and allow the market to grow significantly.

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In the networking market, our enterprise networking products have continued to perform relatively well, but we experienced unexpected weakness within the second quarter of fiscal 2014 from certain PON customers. In addition, we continued to gain traction with our network processor product line, where we announced our first 28nm packet processor family, the Presteria® DX, targeting the software-defined network and mobile infrastructure markets. The combination of our high-performance networking solutions and advanced software capabilities is well suited for emerging software-defined networks of the future.

Our gross margin for the three months ended August 3, 2013 decreased compared to both the three months ended May 4, 2013 and July 28, 2012. As we expand our presence and grow revenues in the consumer space, we expect our gross margin to continue to face downward pressure, as these end markets generally have lower average gross margins than the rest of our business. However, we expect growth in the consumer space will result in improvement to total gross margin dollars and operating profit.

Our financial position is strong and we remain committed to deliver shareholder value through our share repurchase and dividend programs.

Our cash, cash equivalents and short-term investments were \$1.7 billion at August 3, 2013 and we generated cash flow from operations of \$170.4 million through the second quarter of fiscal 2014.

We paid a cash dividend of \$0.06 per share for a total of \$29.7 million in the second quarter of fiscal 2014 and we recently announced a dividend of \$0.06 per share to be paid during the third quarter of fiscal 2014.

We repurchased a total of 7.2 million of our common shares for \$82.6 million in cash during the second quarter of fiscal 2014. We are currently involved in a patent litigation action with Carnegie Mellon University (CMU) (See Risk Factors under Part II, Item 1A of this Quarterly Report on Form 10-Q and Note 9 Commitments and Contingencies in the Notes to Unaudited Condensed Consolidated Financial Statements for a further discussion of the risks associated with this matter and other patent litigation matters). We strongly believe that we do not infringe on the methods described in the CMU patents and that our products use our own internally developed patented read channel technology. As a result, we have filed multiple post trial motions to overturn the jury verdict and if necessary, we will go through the appeal process.

The following table sets forth information derived from our unaudited condensed consolidated statements of operations expressed as a percentage of net revenue:

	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
Net revenue	100.0%	100.0%	100.0%	100.0%
Operating costs and expenses:				
Cost of goods sold	47.8	46.8	46.8	46.4
Research and development	36.3	32.4	37.1	32.3
Selling and marketing	4.8	5.0	5.1	5.0
General and administrative	3.4	3.1	3.4	3.2
Amortization and write-off of acquired intangible assets	1.3	1.6	1.4	1.7
Total operating costs and expenses	93.6	88.9	93.8	88.6
Operating income	6.4	11.1	6.2	11.4
Interest and other income (expense), net	1.1	0.7	0.7	0.4
Income before income taxes	7.5	11.8	6.9	11.8
Provision (benefit) for income taxes	(0.2)	0.4	(0.6)	0.2
Net income	7.7%	11.4%	7.5%	11.6%

Table of Contents**Three and Six Months Ended August 3, 2013 and July 28, 2012***Net Revenue*

	Three Months Ended			Six Months Ended		
	August 3, 2013	July 28, 2012	% Change	August 3, 2013	July 28, 2012	% Change
	(in thousands, except percentage)					

Net revenue	\$ 807,056	\$ 816,104	(1.1)%	\$ 1,541,425	\$ 1,612,455	(4.4)%
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Net revenue for the three and six months ended August 3, 2013 declined \$9.0 million or 1.1% and \$71.0 million or 4.4%, respectively, compared to the three and six months ended July 28, 2012 primarily due to the decline in revenue for our products in the mobile and wireless end market, which was partially offset by an increase in revenue from our storage end market. In the mobile market, declining revenue from our leading North American handset customer due to their competitive challenges and lower demand for our products for the TD handset market in China as we transition to our multi-core processors led to the decline in revenues year over year. In our storage market, we saw higher HDD revenue, which was mostly driven by strong growth for our 500 gigabyte per platter products and increased demand on enterprise drives at a top North America based HDD customer as a result of continued share gains.

We currently expect overall net revenue for the three months ending November 2, 2013 to be in the range of \$850 million to \$890 million due to seasonal increases in sales of wireless connectivity products and the continued ramp-up of new mobile programs.

Historically, a relatively small number of customers have accounted for a significant portion of our net revenue. We had two end customers who each represented greater than 10% of our total net revenue for the three and six months ended August 3, 2013. Combined revenue from these two customers was 37% and 38% of total net revenue for the three and six months ended August 3, 2013, respectively. No distributors accounted for more than 10% of our net revenue for the three and six months ended August 3, 2013. We had two end customers who each represented greater than 10% of our total net revenue for the three and six months ended July 28, 2012. Combined revenue from these two customers was 37% and 34% of total net revenue for the three and six months ended July 28, 2012. In addition, we had one distributor who accounted for more than 10% of our net revenue for the three and six months ended July 28, 2012. We expect to continue to experience similar customer concentration in future periods.

Most of our sales are expected to continue to be made to customers located outside of the United States, primarily in Asia. Sales to customers located in Asia represented 95% and 94% of our net revenue for the three and six months ended August 3, 2013, respectively, compared to 91% and 89% of our net revenue for the three and six months ended July 28, 2012, respectively. Because many manufacturers and manufacturing subcontractors of our customers are located in Asia, we expect that most of our net revenue will continue to be represented by sales to our customers in that region.

Cost of Goods Sold

	Three Months Ended			Six Months Ended		
	August 3, 2013	July 28, 2012	% Change	August 3, 2013	July 28, 2012	% Change
	(in thousands, except percentage)					

Cost of goods sold	\$ 386,059	\$ 381,839	1.1%	\$ 721,497	\$ 748,161	(3.6)%
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% of net revenue	47.8%	46.8%		46.8%	46.4%	
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Cost of goods sold as a percentage of net revenue was higher for the three and six months ended August 3, 2013 compared to the three months ended July 28, 2012. Although we continued to benefit from lower commodity costs driven by our ongoing effort to replace the use of gold in our products with copper, manufacturing costs were higher in the three and six months ended August 3, 2013 due to higher inventory write downs, increased royalty expense and the ramp up of new product designs. Our cost of goods sold as a percentage of net revenue may fluctuate in future periods due to, among other things, changes in the mix of products sold; the timing of production ramps of new products; increased pricing pressures from our customers and competitors, particularly in the consumer product markets that we are targeting; charges for obsolete or potentially excess inventory; changes in the costs charged by our foundry; assembly and test subcontractors; product warranty costs; changes in commodity prices such as gold; and the margin profiles of our new product introductions.

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We currently expect cost of goods sold as a percentage of net revenue for the three months ending November 2, 2013 to be higher compared to the three months ended August 3, 2013.

Table of Contents*Share-Based Compensation Expense*

	Three Months Ended		Six Months Ended	
	August 3, 2013	July 28, 2012	August 3, 2013	July 28, 2012
	(in thousands)			
Cost of goods sold	\$ 1,868	\$ 1,775	\$ 3,735	\$ 3,898
Research and development	28,982	22,413	52,261	39,587
Selling and marketing	3,648	3,458	7,040	6,494
General and administrative	6,593	5,582	11,568	10,441
	\$ 41,091	\$ 33,228	\$ 74,604	\$ 60,420

Share-based compensation expense increased for the three and six months ended August 3, 2013 by \$7.9 million and \$14.2 million, respectively, compared to the three and six months ended July 28, 2012. The increases were primarily due to increased headcount in fiscal 2014, combined with higher expense related to the employee stock purchase plan. The offering price of the employee stock purchase plan was reset in June 2012 and also in December 2012 due to the decline in our stock price. In addition, equity awards granted in fiscal 2014 contained shorter vesting periods, which accelerated the share-based compensation expense.

Research and Development

	Three Months Ended			Six Months Ended		
	August 3, 2013	July 28, 2012	% Change	August 3, 2013	July 28, 2012	% Change
	(in thousands, except percentage)					
Research and development	\$ 292,642	\$ 264,175	10.8%	\$ 571,694	\$ 520,145	9.9%
% of net revenue	36.3%	32.4%		37.1%	32.3%	

Research and development expense increased for the three months ended August 3, 2013 by \$28.5 million compared to the three months ended July 28, 2012. The increase was primarily attributable to higher personnel-related costs as a result of increased headcount and higher average employee compensation, as well as higher computer-aided design tools and depreciation costs.

Research and development expense increased for the six months ended August 3, 2013 by \$51.5 million compared to the six months ended July 28, 2012. The increase was primarily attributable to increased headcount to support new designs and higher average employee compensation, as well as higher computer-aided design tools and depreciation costs as we continue to invest in the development of advanced solutions.

Selling and Marketing

	Three Months Ended			Six Months Ended		
	August 3, 2013	July 28, 2012	% Change	August 3, 2013	July 28, 2012	% Change
	(in thousands, except percentage)					
Selling and marketing	\$ 38,548	\$ 41,034	(6.1)%	\$ 78,537	\$ 81,100	(3.2)%
% of net revenue	4.8%	5.0%		5.1%	5.0%	

Selling and marketing expense for the three and six months ended August 3, 2013 decreased by \$2.5 million and \$2.6 million, respectively, compared to the three and six months ended July 28, 2012. These decreases were attributable to lower expenses for marketing communication activities as a result of our efforts to control discretionary spending.

General and Administrative

	Three Months Ended			Six Months Ended		
	August 3, 2013	July 28, 2012	% Change	August 3, 2013	July 28, 2012	% Change
	(in thousands, except percentage)					
General and administrative	\$ 27,192	\$ 25,718	5.7%	\$ 53,515	\$ 51,423	4.1%
% of net revenue	3.4%	3.1%		3.4%	3.2%	

General and administrative expense for the three and six months ended August 3, 2013 increased by \$1.5 million and \$2.1 million, respectively, compared to the three and six months ended July 28, 2012. These increases were due primarily to higher legal expenses for ongoing litigation matters and higher share-based compensation, which were partially offset by lower discretionary expenses as a result of our efforts to control costs.

Table of Contents*Amortization and Write-Off of Acquired Intangible Assets*

	Three Months Ended			Six Months Ended		
	August 3, 2013	July 28, 2012	% Change	August 3, 2013	July 28, 2012	% Change
	(in thousands, except percentage)					
Amortization and write-off of acquired intangible assets	\$ 10,638	\$ 13,023	(18.3)%	\$ 21,324	\$ 27,378	(22.1)%
% of net revenue	1.3%	1.6%		1.4%	1.7%	

Amortization and write-off of acquired intangible assets for the three and six months ended August 3, 2013 decreased by \$2.4 million and \$6.1 million, respectively, compared to the three and six months ended July 28, 2012. These decreases were primarily due to certain intangible assets that became fully amortized. In addition, the six months ended July 28, 2012 included a \$0.8 million write-off of in-process research and development related to an abandoned project.

Interest and Other Income, Net

	Three Months Ended			Six Months Ended		
	August 3, 2013	July 28, 2012	% Change	August 3, 2013	July 28, 2012	% Change
	(in thousands, except percentage)					
Interest and other income, net	\$ 8,253	\$ 5,864	40.7%	\$ 11,413	\$ 6,921	64.9%
% of net revenue	1.1%	0.7%		0.7%	0.4%	

Interest and other income, net, increased for the three and six months ended August 3, 2013 compared to the three and six months ended July 28, 2012 primarily due to the impact of the strengthening of the U.S. dollar on our foreign currency denominated tax liabilities. This was partially offset by lower interest income from lower average cash and investment balances and higher imputed interest expense related to technology license obligations in the three months and six months ended August 3, 2013. In addition, we also had a \$1.0 million write down of an equity investment in the six months ended August 3, 2013.

Provision (benefit) for Income Taxes

	Three Months Ended			Six Months Ended		
	August 3, 2013	July 28, 2012	% Change	August 3, 2013	July 28, 2012	% Change
	(in thousands, except percentage)					
Provision (benefit) for income taxes	\$ (1,596)	\$ 3,105	(151.4)%	\$ (8,764)	\$ 3,552	(346.7)%
% of net revenue	(0.2)%	0.4%		(0.6)%	0.2%	

We had an income tax benefit in the three and six months ended August 3, 2013 and our effective tax benefit rate was 2.6% and 8.2%, respectively. For the three months ended August 3, 2013, the income tax benefit included the current income tax liability of \$5.2 million, which was offset by net reductions in unrecognized tax benefits of \$6.8 million in the three months ended August 3, 2013. The net reduction in unrecognized tax benefits arose from the expiration of the statute of limitations, less an increase in current unrecognized tax benefit estimates. For the six months ended August 3, 2013, the income tax benefit included the current income tax liability of \$7.0 million plus \$0.7 million in settlements of audits in non-U.S. jurisdictions, which were offset by a net reduction in unrecognized tax benefits of \$16.5 million. The net reduction in unrecognized tax benefits primarily arose from the expiration of statute of limitations in non-U.S. jurisdictions and from the settlement of two audits in non-U.S. jurisdictions (one for \$3.5 million and the other for \$4.1 million), less an increase for current unrecognized tax benefit estimates.

For the three and six months ended July 28, 2012, our effective tax rate was 3.2% and 1.9%, respectively. The income tax provision for the three and six months ended July 28, 2012 included the current income tax liability of \$5.9 million and \$8.6 million, respectively, which were primarily offset by net reductions in unrecognized tax benefits of \$3.4 million in the three months ended July 28, 2012 and \$6.0 million in the six months ended July 28, 2012. These net reductions in unrecognized tax benefits primarily arose from the expiration of statute of limitations and from the settlement of audits in non-U.S. jurisdictions less increases in current unrecognized tax benefit estimates.

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It is reasonably possible that the amount of unrecognized tax benefits could increase or decrease significantly due to changes in tax law in various jurisdictions, new tax audits, and changes in U.S. dollar as compared to foreign currencies within the next 12 months. Excluding these factors, uncertain tax positions may decrease by as much as \$30 million from the lapse of the statutes of limitation in various jurisdictions during the next 12 months.

We operate under tax holidays in certain countries, which are extended if certain additional requirements are satisfied. The tax holidays are conditional upon meeting certain employment and investment thresholds. The impact of these tax holidays decreased foreign taxes by \$9.2 million for the six months ended August 3, 2013. The benefit of the tax holidays on net income per share was less than \$0.01 per share for the six months ended August 3, 2013. A new corporate tax rate for Israel was officially published on August 5, 2013. The new rate of 26.5% is applicable beginning January 1, 2014 and includes corporations that are eligible for a beneficial tax regime.

Table of Contents**Liquidity and Capital Resources**

Our principal source of liquidity as of August 3, 2013 consisted of approximately \$1.7 billion of cash, cash equivalents and short-term investments. We believe that our existing cash, cash equivalents and short-term investments, together with cash generated from operations, exercise of employee stock options and purchases under our employee stock purchase plan will be sufficient to cover our working capital needs, capital expenditures, investment requirements and commitments for at least the next 12 months. Our capital requirements will depend on many factors, including our rate of sales growth, market acceptance of our products, costs of securing access to adequate manufacturing capacity, the timing and extent of research and development projects and increases in operating expenses, which are all subject to uncertainty. In addition, we are named as defendants to several litigation actions and an unfavorable outcome in any current litigation could have a material adverse effect on our liquidity, cash flows and results of operations. Specifically, with respect to the CMU litigation, a jury has awarded past damages of \$1.17 billion and CMU has sought pre-judgment damages of up to \$322 million. If the District Court upholds the jury verdict and awards pre-judgment damages, we intend to appeal and we would seek to stay any award of damages pending the appeal.

To the extent that our existing cash, cash equivalents and short-term investments and cash generated by operations are insufficient to fund our future activities, we may need to raise additional funds through public or private debt or equity financing. We may enter into additional acquisitions of businesses, purchase assets or enter into other strategic arrangements in the future, which could also require us to seek debt or equity financing. Additional equity financing or convertible debt financing may be dilutive to our current shareholders. If we elect to raise additional funds, we may not be able to obtain such funds on a timely basis or on acceptable terms, if at all. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing shareholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to our common shares.

Net Cash Provided by Operating Activities

Net cash provided by operating activities was \$170.4 million for the six months ended August 3, 2013. The cash inflows from operations for the six months ended August 3, 2013 were due to \$266.0 million of net income adjusted for non-cash items, partially offset by a negative effect from changes in working capital of \$95.6 million. The cash outflow from working capital for the six months ended August 3, 2013 was primarily driven by an increase in accounts receivable from higher shipments toward the end of the quarter, and higher inventories due to seasonally higher demand in the subsequent period and anticipated ramp-up of new products. This negative impact on working capital was partially offset by an increase in accounts payable primarily the result of increased manufacturing spending in advance of higher expected revenue in the third quarter of fiscal 2014.

Net cash provided by operating activities was \$387.9 million for the six months ended July 28, 2012. The cash inflows from operations in the six months ended July 28, 2012 were primarily due to \$323.0 million of net income adjusted for non-cash items and a positive effect from changes in working capital of \$64.9 million.

Net Cash (Used in) Provided by Investing Activities

Net cash used in investing activities was \$22.8 million for the six months ended August 3, 2013 compared to net cash provided by investing activities of \$192.5 million for the six months ended July 28, 2012. For the six months ended August 3, 2013, net cash used in investing activities was primarily due to the payment of \$39.1 million for the purchase of property and equipment and \$7.6 million for the purchase of technology licenses. These were offset by the cash inflows from the sales and maturities of available-for-sale securities of \$498.7 million less purchases of available-for-sale securities of \$471.5 million.

Net cash provided by investing activities for the six months ended July 28, 2012 was generated from the sales and maturities of available-for-sale securities of \$881.3 million less purchases of available-for-sale securities of \$646.9 million. In addition, we paid \$29.7 million for the purchase of property and equipment, \$6.5 million for the purchase of technology licenses and \$5.8 million for a new investment in a privately-held company.

Net Cash Used in Financing Activities

Net cash used in financing activities was \$307.9 million for the six months ended August 3, 2013 compared to net cash used in financing activities of \$459.1 million for the six months ended July 28, 2012. For the six months ended August 3, 2013, net cash used in financing activities was primarily attributable to repurchases under our share repurchase program. Adjusted for repurchases made within the final three days of the quarter that are accrued but not yet paid due to the standard three-day settlement period, we paid \$304.8 million to repurchase shares during the six months ended August 3, 2013. We also made payments of our quarterly dividends of \$60.0 million. The cash outflow was partially offset by net proceeds of \$63.2 million from the issuance of our common shares under our share-based plans less the minimum tax

withholding on behalf of employees for net share settlements.

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Net cash used in financing activities for the six months ended July 28, 2012 was primarily attributable to repurchases under our share repurchase program of 34.4 million of our common shares in the open market for \$473.5 million. The cash outflow was partially offset by net proceeds of \$47.9 million from the issuance of our common shares under our share-based plans less the minimum tax withholding paid on behalf of employees for net share settlements.

Subsequent to the end of the quarter through August 29, 2013, we repurchased an additional 1.8 million of our common shares for \$21.6 million at an average price per share of \$11.85.

Off-Balance Sheet Arrangements

As of August 3, 2013, we did not have any material off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

Contractual Obligations

We presented our contractual obligations at February 2, 2013 in our Annual Report on Form 10-K for the fiscal year then ended. There has been no material changes outside the ordinary course of business in those obligations during three months ended August 3, 2013.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk. Our interest rate risk relates primarily to our fixed income short-term investment portfolio as we did not have any outstanding debt as of August 3, 2013. We maintain an investment policy that requires minimum credit ratings, diversification of credit risk and limits the long-term interest rate risk by requiring maturities of generally less than five years. We invest our excess cash primarily in highly liquid debt instruments of the U.S. government and its agencies, time deposits, money market mutual funds, and corporate debt securities. These investments are classified as available-for-sale and, consequently, are recorded on our balance sheets at fair market value with their related unrealized gain or loss reflected as a component of accumulated other comprehensive (loss) income in shareholders' equity. Investments in both fixed rate and floating rate interest earning securities carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than predicted if interest rates fall.

To provide an assessment of the interest rate risk associated with our investment portfolio, we performed a sensitivity analysis to determine the impact that an adverse change in interest rates would have on the value of the investment portfolio. Based on investment positions as of August 3, 2013, a hypothetical 100 basis point increase in interest rates across all maturities would result in a \$15.3 million decline in the fair market value of the portfolio. Due to our positive cash flow from operations, the relatively short-term nature of our investment portfolio and our ability to hold investments to maturity, such change in fair market value would likely not have resulted in any cash flow impact.

As of August 3, 2013, our investment portfolio included \$19.2 million in par value of auction rate securities. Beginning in February 2008, liquidity issues in the global credit markets resulted in a failure of auction rate securities, as the amount of securities submitted for sale in those auctions exceeded the amount of bids. Since this time, many of the issuers have refinanced their debt and paid down the auction rate securities which have resulted in a smaller pool of outstanding securities. Although these securities have continued to pay interest and show an improvement in the underlying collateralization, there is currently limited trading volume. To estimate the fair value of the auction rate securities, we use a discounted cash flow model based on estimated timing and amount of future interest and principal payments. In developing the cash flow model, we consider the credit quality and liquidity of the underlying securities and related issuer, the collateralization of underlying security investments and other considerations. As of August 3, 2013, the fair value of auction rate securities in our investment portfolio was \$2.9 million less than par value and the fair value was recorded in long-term investments.

Based on our balance of approximately \$1.7 billion in cash, cash equivalents and short-term investments, and the fact that we continue to generate positive cash flow on a quarterly basis, we do not anticipate having to sell these securities below par value and do not have the intent to sell these auction rate securities until recovery. Since we consider the impairment to be temporary, we recorded the unrealized loss to accumulated other comprehensive (loss) income, a component of shareholders' equity.

Investment Risk. We invest in equity instruments of privately held companies for strategic purposes. We account for these investments under the cost method when we do not have the ability to exercise significant influence or control over the operations of these companies and under the equity method when we have the ability to exercise significant influence, but do not have control. Carrying value of these equity investments was \$13.9 million at August 3, 2013, and was included in other non-current assets in our balance sheets. We monitor these investments for impairment and make appropriate reductions in carrying value when an impairment is deemed to be other-than-temporary.

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Foreign Currency Exchange Risk. Substantially all of our sales and the majority of our expenses are denominated in U.S. dollars. Since we operate in many countries, we pay certain payroll and other operating expenses in local currencies and these expenses may be higher or lower in U.S. dollar terms. Furthermore, our operation in Israel represents a large portion of our total foreign currency exposure. We may also hold certain assets and liabilities, including potential tax liabilities in local currency on our balance sheet. These tax liabilities would be settled in local currency. Therefore, foreign exchange gains and losses from remeasuring the tax liabilities are recorded to interest and other income, net. The related effects of foreign exchange fluctuations on local currency expenses are recorded to operating expenses. Significant fluctuations in exchange rates in countries where we incur expenses or record assets or liabilities in local currency could affect our business and operating results in the future. There is also a risk that our customers may be negatively impacted in their ability to purchase our products priced in U.S. dollars when there has been significant volatility in foreign currency exchange rates.

We engage in hedging transactions to help mitigate some of the volatility to forecasted cash flows due to changes in foreign exchange rates, and in particular hedge a portion of the forecasted Israeli shekel expenses. We enter into certain short-term forward exchange contracts, typically less than 12 months in duration, to hedge exposures for expenses and purchases denominated in foreign currencies when the currency exposure is significant and there is a high certainty of the underlying cash flow. We do not enter into derivative financial instruments for trading or speculative purposes. We may choose not to hedge certain foreign exchange exposures due to immateriality, offsetting exposures, prohibitive economic cost of hedging a particular currency, and limited availability of appropriate hedging instruments. To the extent our foreign currency hedges are effective, the results of the hedge activities offset the underlying expense within the operating expense. De-designated hedges or hedges deemed ineffective are recorded in interest and other income, net. We do not hedge our tax liabilities denominated in local currency on our balance sheet as the timing of these tax liabilities becoming cash flows is not deemed to be certain.

To provide an assessment of the foreign currency exchange risk associated with our foreign currency exposures within operating expense, we performed a sensitivity analysis to determine the impact that an adverse change in exchange rates would have on our financial statements. If the U.S. dollar weakened by 10%, our operating expense could increase by 3.82%. We expect our hedges of foreign currency exposures to be highly effective and offset a significant portion of the short-term impact of changes in exchange rates.

Item 4. Controls and Procedures

Management's Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Interim Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act). Our disclosure controls and procedures are designed to ensure that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (SEC) and that such information is accumulated and communicated to management, including the Chief Executive Officer and Interim Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Interim Chief Financial Officer concluded that, as of August 3, 2013, our disclosure controls and procedures were effective to provide reasonable assurance.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended August 3, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitation on Effectiveness of Controls

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. The design of any control system is based, in part, upon the benefits of the control system relative to its costs. Control systems can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. In addition, over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies and procedures may deteriorate. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information under the caption "Contingencies" as set forth in "Note 9 - Commitments and Contingencies" of our Notes to Unaudited Condensed Consolidated Financial Statements, included in Part I, Item 1, is incorporated herein by reference. For additional discussion of certain risks associated with legal proceedings, see Part II, Item 1A, "Risk Factors," immediately below.

Item 1A. Risk Factors

Before deciding to purchase, hold or sell our common shares, you should carefully consider the risks described below in addition to the other cautionary statements and risks described elsewhere and the other information contained in this Quarterly Report on Form 10-Q and in our other filings with the SEC, including our Annual Report on Form 10-K for the year ended February 2, 2013 and subsequent reports on Forms 10-Q and 8-K. Many of these risks and uncertainties are beyond our control, including business cycles and seasonal trends of the computing, semiconductor and related industries.

Our financial condition and results of operations may vary from quarter to quarter, which may cause the price of our common shares to decline.

Our quarterly results of operations have fluctuated in the past and could do so in the future. Because our results of operations are difficult to predict, you should not rely on quarterly comparisons of our results of operations as an indication of our future performance.

Fluctuations in our results of operations may be due to a number of factors, including, but not limited to, those listed below and those identified throughout this "Risk Factors" section:

changes in general economic and political conditions and specific conditions in the end markets we address, including the continuing volatility in the technology sector and semiconductor industry;

the highly competitive nature of the end markets we serve, particularly within the semiconductor industry;

any current and future litigation that could result in substantial costs and a diversion of management's attention and resources that are needed to successfully maintain and grow our business;

our dependence on a few customers for a significant portion of our revenue;

our ability to maintain a competitive cost structure for our manufacturing and assembly and test processes and our reliance on third parties to produce our products;

cancellations, rescheduling or deferrals of significant customer orders or shipments, as well as the ability of our customers to manage inventory;

gain or loss of a design win or key customer;

failure to qualify our products or our suppliers' manufacturing lines;

our ability to develop and introduce new and enhanced products in a timely and effective manner, as well as our ability to anticipate and adapt to changes in technology;

seasonality in sales of consumer devices in which our products are incorporated;

failure to protect our intellectual property;

impact of a significant natural disaster, including earthquakes, floods and tsunamis; and

our ability to attract and retain highly skilled managerial, engineering, sales and marketing personnel.

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Due to fluctuations in our quarterly results of operations and other factors, the price at which our common shares will trade is likely to continue to be highly volatile. From January 30, 2011 through August 3, 2013, our common shares have traded as low as \$6.98 and as high as \$20.42 per share. Accordingly, you may not be able to resell your common shares at or above the price you paid. In future periods, our stock price could decline if, amongst other factors, our revenues or operating results are below our estimates or the estimates or expectations of securities analysts and investors. As a result of stock price volatility, we may be subject to securities class action litigation. Any litigation could result in substantial costs and a diversion of management's attention and resources that are needed to successfully maintain and grow our business.

We operate in the intensely competitive markets, and our failure to compete effectively would harm our results of operations.

The semiconductor industry and specifically the mobile and wireless communications markets are extremely competitive, and we expect competition to intensify as current competitors expand their product offerings and new competitors enter the market. This has especially intensified as semiconductor companies have begun to offer more integrated platforms. We currently compete with a number of large domestic and international companies in the business of designing integrated circuits and related applications, some of which have greater financial, technical and management resources than us. We expect competition to continue to increase as industry standards continue to evolve and become better known, and others realize the market potential of this trend to platform integration. As competition in the markets in which we operate continues to increase, our revenues and gross margins may decline. For example, competitors with greater financial resources may be able to offer lower prices than us, or they may offer additional products, services or other incentives that we may not be able to match. In addition, many of our competitors operate and maintain their own fabrication facilities and have longer operating histories, greater name recognition, larger customer bases, and greater sales, marketing and distribution resources than we do. Furthermore, our current and potential competitors in the mobile and wireless markets have established or may establish financial and strategic relationships among themselves or with existing or potential customers or other third parties to increase the ability of their products to address the needs of customers. Accordingly, new competitors or alliances among these competitors may acquire significant market share, which would harm our business. While we continue to pursue similar strategic relationships, and currently have significant financial and technical resources, we cannot assure you that we will be able to continue to compete successfully against existing or new competitors, which would harm our results of operations.

In addition, the semiconductor providers competing in the mobile and wireless communication markets have recently experienced consolidation. For example, Broadcom Corporation acquired NetLogic Microsystems in February 2011 and Texas Instruments Incorporated acquired National Semiconductor in September 2011. Consolidation among our competitors could lead to a changing competitive landscape, capabilities and market share, which could harm our results of operations.

A significant portion of our business is dependent on the HDD industry, which is highly cyclical, experiences rapid technological change, is subject to industry consolidation and is facing increased competition from alternative technologies.

The HDD industry is intensely competitive, and the technology changes rapidly. This industry has historically been cyclical, with periods of increased demand and rapid growth followed by periods of oversupply and subsequent contraction. These cycles may affect us because some of our largest customers are participants in this industry.

HDD manufacturers tend to order more components than they may need during growth periods, and sharply reduce orders for components during periods of contraction. Rapid technological changes in the HDD industry often result in shifts in market share among the industry's participants. If the HDD manufacturers using our products do not retain or increase their market share, our sales may decrease.

In addition, the HDD industry has experienced consolidation over the past several years. For example, during fiscal 2010, Toshiba acquired the HDD operations of Fujitsu. In December 2011, Seagate completed the acquisition of Samsung's HDD unit. In March 2012, Western Digital completed the acquisition of Hitachi's HDD unit. Consolidation among our customers could lead to changing demand for our products, replacement of our products by the merged entity with those of our competitors and cancellation of orders, each of which could harm our results of operations. On the other hand, this could lead to increased opportunities for our products within the combined company if we can leverage our technology and customer relationships.

Furthermore, future changes in the nature of information storage products could reduce demand for traditional HDDs. For example, products using alternative technologies, such as solid-state flash drives and other storage technologies could become a source of competition to manufacturers of HDDs. Although we offer SSD controllers, leveraging our technology in hard drives, we cannot ensure we will be able to maintain significant market share if demand for traditional HDDs decreases.

We are currently involved in a patent litigation action involving Carnegie Mellon University, and, if we do not prevail on our post trial motions or our appeal of the CMU verdict, we could be liable for substantial damages.

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On March 6, 2009, Carnegie Mellon University (CMU) filed a complaint in the U.S. District Court for the Western District of Pennsylvania naming MSI and us as defendants and alleging patent infringement. CMU has asserted U.S. Patent Nos. 6,201,839 and 6,438,180 (collectively, the CMU patents in suit), which relate to read-channel integrated circuit devices and the HDD products

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incorporating such devices. A jury trial began on November 26, 2012. On December 26, 2012, a jury delivered a verdict that found the CMU patents in suit were literally and willfully infringed and valid, and awarded past damages in the amount of \$1.17 billion. Due to the finding of willfulness, during post trial proceedings the judge could enhance the damages by an amount up to triple the damages awarded by the jury at trial. In addition, CMU has disclosed in its post trial motions that it is seeking pre-judgment interest up to \$322 million, post-judgment interest, attorneys' fees, and an injunction or ongoing royalties. Post trial motions were heard on May 1 and 2, 2013. On August 23, 2013, the District Court denied the motion for mistrial. While we believe that there are strong grounds for appeal and will seek to overturn the verdict in post trial motions before the District Court and, if necessary, to appeal to the U.S. Court of Appeals for the Federal Circuit in Washington, D.C., there is no guarantee that we will be successful. We intend to vigorously challenge the judgment through all appropriate post trial motions and appeal processes. Please see Note 9 Commitments and Contingencies of our Notes to Unaudited Condensed Consolidated Financial Statements set forth in Part I, Item 1 of this Quarterly Report on Form 10-Q for a more detailed description of a number of litigation matters we are currently engaged in. Should the judge in the CMU case grant an injunction or if we are required to pay most or all of the damages awarded by the jury after all appeals have been exhausted, this could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We may become involved with costly and lengthy litigation involving our patents and other intellectual property, which could subject us to liability, require us to indemnify our customers, require us to obtain or renew licenses, stop selling our products or force us to redesign our products.

Litigation involving patents and other intellectual property is widespread in the high-technology industry and is particularly prevalent in the semiconductor industry, where a number of companies and other entities aggressively bring numerous infringement claims to assert their patent portfolios. The amount of damages alleged in intellectual property infringement claims can often be very significant. For example, a jury has awarded past damages in the amount of \$1.17 billion in our litigation with CMU. If we receive a significant adverse judgment in any litigation matter that is ultimately upheld after all appeals, our results of operations, financial position and cash flows will be adversely affected.

From time to time our subsidiaries and customers receive, and may continue to receive in the future, notices that allege claims of infringement, misappropriation or misuse of the intellectual property rights of third parties. In addition to standards-based infringement claims, infringement claims have also been directed against us and our subsidiaries' proprietary technologies, particularly those related to storage technology, microprocessors and other circuit components. We have also had certain patent licenses with third parties that have not been renewed, and if we cannot successfully renew these licenses, our subsidiaries and customers could face claims of infringement. These claims could result in litigation and/or claims for indemnification, which, in turn, could subject us to significant liability for damages, attorneys' fees and costs. Any potential intellectual property litigation also could force us to do one or more of the following:

stop selling, offering for sale, making, having made or exporting products or using technology that contains the allegedly infringing intellectual property;

limit or restrict the type of work that employees involved in such litigation may perform for us;

pay substantial damages and/or license fees and/or royalties to the party claiming infringement that could adversely impact our liquidity or operating results;

attempt to obtain or renew licenses to the relevant intellectual property, which licenses may not be available on reasonable terms or at all; and

attempt to redesign those products that contain the allegedly infringing intellectual property.

We may also be required to indemnify some customers under our contracts if a third party alleges, or a court finds, that our products have infringed upon the proprietary rights of other parties. From time to time, we have agreed to indemnify select customers for claims made against our products, where such claims allege infringement of third party intellectual property rights, including, but not limited to, patents, registered trademarks and/or copyrights. If we are required to make a significant payment under any of our indemnification obligations, our result of operations may be harmed.

Our sales are concentrated in a few customers, and if we lose or experience a significant reduction in sales to any of these key customers, or if any of these key customers experience a significant decline in market share, our revenues may decrease substantially.

We receive a significant amount of our revenues from a limited number of customers. Net revenue from our two largest customers represented 38% and 34% of our net revenue for the six months ended August 3, 2013 and July 28, 2012, respectively. Sales to our largest customers have fluctuated significantly from period to period and year to year primarily due to the timing and number of design wins with each customer, natural disasters that may divert a customer's operations, as well as the continued diversification of our customer base as we expand into new markets, and will likely continue to fluctuate in the future. The loss of any of our large customers or a significant reduction

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in sales we make to them would likely harm our financial condition and results of operations. Our operating results in the foreseeable future will continue to depend on sales to a relatively small number of customers, as well as the ability of these customers to sell products that incorporate our products. In the future, these customers may decide not to purchase our products at all, purchase fewer products than they did in the past, or alter their purchasing patterns in some other way, particularly because:

a significant portion of our sales are made on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with relatively short notice to us;

our customers may purchase integrated circuits from our competitors;

our customers may discontinue sales or lose market share in the markets for which they purchase our products;

our customers may develop their own solutions; or

our customers may be subject to severe business disruptions.

We rely on independent foundries and subcontractors for the manufacture, assembly and testing of our integrated circuit products, and the failure of any of these third party vendors to deliver products or otherwise perform as requested could damage our relationships with our customers, decrease our sales and limit our ability to grow our business.

We do not have our own manufacturing or assembly facilities and have very limited in-house testing facilities. Therefore, we currently rely on several third party foundries to produce our integrated circuit products. We also currently rely on several third party assembly and test subcontractors to assemble, package and test our products. This exposes us to a variety of risks, including the following:

Regional Concentration:

Substantially all of our products are manufactured by third party foundries located in Taiwan. Our other sources for manufacturing are located in China and Singapore. In addition, substantially all of our third party assembly and testing facilities are located in Singapore, Taiwan, Malaysia and the Philippines. Because of the geographic concentration of these third party foundries, as well as our assembly and test subcontractors, we are exposed to the risk that their operations may be disrupted by regional disasters or by political changes. For example, the risk of an earthquake in Taiwan and elsewhere in the Pacific Rim region is significant due to the proximity of major earthquake fault lines to the facilities of our foundries and assembly and test subcontractors. Taiwan has experienced significant earthquakes in the past and may be subject to additional earthquakes that could disrupt manufacturing operations. In the event of a significant natural disaster or a quarantine or closure that affects our manufacturers in the Pacific Rim, our revenues, cost of goods sold and results of operations would be negatively impacted. In addition, if we were unable to quickly identify alternate manufacturing facilities, we could experience significant delays in product shipments, which could harm our results of operations.

No Guarantee of Capacity or Supply:

The ability of each foundry to provide us with semiconductor devices is limited by its available capacity and existing obligations. When demand is strong, availability of foundry capacity may be constrained or not available, and with limited exceptions, our vendors are not obligated to perform services or supply products to us for any specific period, in any specific quantities, or at any specific price, except as may be provided in a particular purchase order. We place our orders on the basis of our customers' purchase orders or our forecast of customer demand, and the foundries can allocate capacity to the production of other companies' products and reduce deliveries to us on short notice. It is possible that foundry customers that are larger and better financed than we are or that have long-term agreements with our main foundries may induce our foundries to reallocate capacity to those customers. This reallocation could impair our ability to secure the supply of components that we need. Moreover, if any of our third party foundry suppliers are unable to secure necessary raw materials from their suppliers, lose benefits under material agreements, experience power outages, lack sufficient capacity to manufacture our products, encounter financial difficulties or suffer any other disruption or reduction in efficiency, we may encounter supply delays or disruptions, which could harm our business or results of operations.

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Despite our strategy to move to a dual source, most of our products are not manufactured at more than one foundry at any given time, and our products typically are designed to be manufactured in a specific process at only one of these foundries. Accordingly, if one of our foundries is unable to provide us with components as needed, it may be difficult for us to transition the manufacture of our products to other foundries, and we could experience significant delays in securing sufficient supplies of those components. This could result in a material decline in revenues, net income and cash flow.

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In order to secure sufficient foundry capacity when demand is high and mitigate the risks described in the foregoing paragraph, we may enter into various arrangements with suppliers that could be costly and harm our results of operations, such as non-refundable deposits with or loans to foundries in exchange for capacity commitments, and contracts that commit us to purchase specified quantities of integrated circuits over extended periods. We may not be able to make any such arrangement in a timely fashion or at all, and any arrangements may be costly, reduce our financial flexibility, and not be on terms favorable to us. Moreover, if we are able to secure foundry capacity, we may be obligated to use all of that capacity or incur penalties. These penalties may be expensive and could harm our financial results.

We are also subject to risk from fluctuating market prices of certain commodity raw materials, particularly gold, that are incorporated into our end products or used by our suppliers to manufacture our end products. Supplies for such commodities may from time to time become restricted, or general market factors and conditions may affect pricing of such commodities. Over the past few years, the price of gold increased significantly and certain of our supply chain partners assessed surcharges to compensate for the resultant increase in manufacturing costs. As a result, our gross margins have been adversely affected by increases in the price of gold. We are currently restructuring certain manufacturing processes to use copper instead of gold in our products. In transitioning from gold to copper, because the capacity of either wafer producers or assemblers can be limited from time to time, we may be unable to satisfy the demand of our customers, or may have to accept price increases or other compensation arrangements that increase our operating expenses and erode our gross margins. Our results may also be materially affected adversely if we fail to execute successfully or if we experience resistance from our customer base in the transition from gold to copper.

Uncertain Yields and Quality:

The fabrication of integrated circuits is a complex and technically demanding process. Our foundries have from time to time experienced manufacturing defects and reduced manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials by our foundries could result in lower than anticipated manufacturing yields or unacceptable performance. Many of these problems are difficult to detect at an early stage of the manufacturing process and may be time consuming and expensive to correct. Poor yields from our foundries, or defects, integration issues or other performance problems in our products could cause us significant customer relations and business reputation problems, harm our financial results and result in financial or other damages to our customers. Our customers could also seek damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend. In addition, defects in our existing or new products could result in significant warranty, support and repair costs, and divert the attention of our engineering personnel from our product development efforts.

To the extent that we rely on outside suppliers to manufacture or assemble and test our products, we may have a reduced ability to control directly product delivery schedules and quality assurance. This lack of control may result in product shortages or quality assurance problems that could delay shipments of products or increase manufacturing, assembly, testing or other costs.

If we are unable to develop and introduce new and enhanced products that achieve market acceptance in a timely and cost-effective manner, our results of operations and competitive position will be harmed.

Our future success will depend on our ability, in a timely and cost-effective manner, to develop and introduce new products and enhancements to our existing products. We sell products in markets that are characterized by rapid technological change, evolving industry standards, frequent new product introductions, short product life cycles and increasing demand for higher levels of integration and smaller process geometries. In addition, the development of new silicon devices is highly complex, and due to supply chain cross-dependencies and other issues, we may experience delays in completing the development, production and introduction of our new products. Our past sales and profitability have resulted, to a large extent, from our ability to anticipate changes in technology and industry standards and to develop and introduce new and enhanced products incorporating the new standards and technologies. Our ability to adapt to these changes and to anticipate future standards, and the rate of adoption and acceptance of those standards, will be a significant factor in maintaining or improving our competitive position and prospects for growth. If new industry standards emerge that we do not properly anticipate, our products or our customers' products could become unmarketable or obsolete, and we could lose market share. We may also have to incur substantial unanticipated costs to comply with these new standards. In addition, our target markets continue to undergo rapid growth and consolidation. A significant slowdown in any of these markets could materially and adversely affect our business, financial condition and results of operations. Our success will also depend on the ability of our customers to develop new products and enhance existing products for the markets they serve and to introduce and promote those products successfully in a timely manner. Even if new and enhanced products are introduced to the market, we and our customers may not be able to achieve market acceptance of them.

In addition, our long-standing relationships with some of our larger customers may also deter other potential customers who compete with these customers from buying our products. To attract new customers or retain existing customers, we may offer certain customers certain price concessions, which could cause our average selling prices and gross margins to decline.

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Our gross margin and results of operations may be adversely affected in the future by a number of factors, including decreases in average selling prices of products over time and shifts in our product mix.

The products