WET SEAL INC
Form SC 13G/A
January 30, 2004

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

SCHEDULE 13G
Under the Securities Exchange Act of 1934
(Amendment No. 1)*

Wet Seal Inc
(Name of Issuer)

Class A Common
(Title of Class of Securities)

961840105
(CUSIP Number)

December 31, 2003
(Date of Event Which Requires Filing of this Statement)

Check the appropriate box to designate the rule pursuant to which this Schedule is filed:
[x] Rule 13d-1(b)
[ ] Rule 13d-1(c)
[ ] Rule 13d-1(d)
*The remainder of this cover page shall be filled out for a reporting person's initial filing on this form with respect to the subject class of securities, and for any subsequent amendment containing information which would alter the disclosures provided in a prior cover page.
The information required in the remainder of this cover page shall not be deemed to be "filed" for the purpose of Section 18 of the Securities Exchange Act of 1934 ("Act") or otherwise subject to the liabilities of that section of the Act but shall be subject to all other provisions of the Act (however, see the Notes).

13G
CUSIP No. 961840105

1.
Names of Reporting Persons.
U.S. Bancorp
800 Nicollet Mall
Minneapolis, MN 55402-7020

I.R.S. Identification Nos. of above persons (entities only).
41-0255900

2.
Check the Appropriate Box if a Member of a Group (See Instructions)
(a) [ ]
(b) [ ]

3.
SEC Use Only

4.
Citizenship or Place of Organization
Delaware, U.S.A.

Number of Shares Beneficially Owned by Each Reporting Person
With:
5. Sole Voting Power: 333,166
6. Shared Voting Power: 0
7. Sole Dispositive Power: 378,051
8. Shared Dispositive Power: 915

9.
Aggregate Amount Beneficially Owned by Each Reporting Person
380,466

10.
Check if the Aggregate Amount in Row (9) Excludes Certain Shares
(See Instructions)
[ ]

11.
Percent of Class Represented by Amount in Row (9)
1.49

12.
Type of Reporting Person (See Instructions)
H.C.

13G
CUSIP No. 961840105

1.
Names of Reporting Persons.
U.S. Bancorp Asset Management, Inc.

I.R.S. Identification Nos. of above persons (entities only).
41-2003732

2.
Check the Appropriate Box if a Member of a Group (See Instructions)
(a) []
(b) []

3.
SEC Use Only

4.
Citizenship or Place of Organization
Delaware

Number of Shares Beneficially Owned by Each Reporting Person

With:

5. Sole Voting Power: 331,666
6. Shared Voting Power: 0
7. Sole Dispositive Power: 378,051
8. Shared Dispositive Power: 915

9.Aggregate Amount Beneficially Owned by Each Reporting Person
378,966

10.
Check if the Aggregate Amount in Row (9) Excludes Certain Shares
(See Instructions)
[]

11.
Percent of Class Represented by Amount in Row (9)
1.48

12.
Type of Reporting Person (See Instructions)
IA

Item 1.
(a)
Name of Issuer
Wet Seal Inc

(b)
Address of Issuer's Principal Executive Offices
Wet Seal Inc
26972 Burbank
Foothill Ranch, CA 92610

Item 2.
(a)
Name of Person Filing
U.S. Bancorp

U.S. Bancorp Asset Management, Inc.

(b)
Address of Principal Business Office or, if none, Residence
U.S. Bancorp
800 Nicollet Mall
Minneapolis, MN 55402

U.S. Bancorp Asset Management
800 Nicollet Mall
Minneapolis, MN 55402

(c)

Citizenship
U.S. Bancorp: Delaware

U.S. Bancorp Asset Management, Inc.: Delaware

(d)
Title of Class of Securities
Class A Common

(e)
CUSIP Number
961840105

Item 3.
The person filing is a:
U.S. Bancorp: Parent Holding Company

U.S. Bancorp Asset Management, Inc. : Investment Advisor

Item 4.
Ownership.

Provide the following information regarding the aggregate number and percentage of the class of securities of the issuer identified in Item 1.
(a)
Amount beneficially owned: 380,466
(b)
Percent of class: 1.49

(c)
Number of shares as to which the person has:
(i) Sole power to vote or to direct the vote: 333,166
(ii) Shared power to vote or to direct vote: 0
(iii) Sole power to dispose or to direct the disposition of:
378,051
(iv) Shared power to dispose or to direct the disposition of:
915

Item 5.
Ownership of Five Percent or Less of a Class

If this statement is being filed to report the fact that as of the date hereof the reporting person has ceased to be the beneficial owner of more than five percent of the class of securities, check the following [X].

Item 6.
Ownership of More than Five Percent on Behalf of Another Person.

Accounts or persons have the right to receive or the power to direct the receipt of dividends from, or the proceeds from the sale of, shares reported in this filing. To our knowledge no such interest of any account or person relates to more than 5% of the class.

Item 7.
Identification and Classification of the Subsidiary Which Acquired the Security Being Reported on By the Parent Holding Company:
See Exhibit A

Item 8.

Identification and Classification of Members of the Group:
Not applicable

Item 9.
Notice of Dissolution of Group:
Not applicable

Item 10.
Certification

By signing below I certify that, to the best of my knowledge and belief, the securities referred to above were acquired and are held in the ordinary course of business and were not acquired and are not held for the purpose of or with the effect of changing or influencing the control of the issuer of the securities and were not acquired and are not held in connection with or as a participant in any transaction having that purpose or effect.

SIGNATURE
After reasonable inquiry and to the best of my knowledge and belief, I certify that the information set forth in this statement is true, complete and correct.

01/31/04
Date

____
Signature

Beverly Antonich, Vice President
Name/Title

nt:-10.0pt;">Acquisition costs

(3,480

)

Purchases of property and equipment

(71,472

)

(37,841

)

Purchases of technology licenses

(6,600

)

Net cash used in investing activities

(240,788

)

(140,340

)

Cash flows from financing activities:

Proceeds from the issuance of common stock

33,860

51,606

Principal payments on capital lease obligations

(9,057

)

(6,784

)

Excess tax benefits from stock-based compensation

860

Net cash provided by financing activities

25,663

44,822

Net increase in cash and cash equivalents

(116

)

85,516

Cash and cash equivalents at beginning of period

348,431

166,471

Cash and cash equivalents at end of period

$

348,315

$

251,987

Supplemental cash flows information:

Acquisition of property and equipment under capital lease obligations

$

10,211

$

19,797

Long-term leased assets under construction

$

7,000

$

14,750

Elimination of deferred stock-based compensation due to FAS 123R adoption

$

61,986

$

(1) See Note 1 Restatement of Consolidated Financial Statements

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. Restatement of Consolidated Financial Statements

Background

On about May 23, 2006, the Company s Chief Executive Officer initiated a review of the Company s past stock option granting practices. Then on May 25, 2006, the Board appointed a committee, chaired by and consisting solely of an independent and disinterested member of the Audit Committee who had no prior involvement in the stock option process, to conduct the internal review of the Company s historical stock option practices and related accounting matters. This committee retained outside legal counsel at the time to assist with this internal review. In June and July 2006, this committee identified various stock option grants as having been potentially selected with the benefit of hindsight. During this time the Company was also named as a nominal defendant, and a number of the Company s current and former directors and officers were named as defendants, in purported shareholder derivative actions.

During this time, the Company was informed that the Company s outside legal counsel at the time could not represent both the independent committee and the Company, particularly if that independent committee was going to evaluate and address matters raised by the derivative actions. Our Board met on July 19, 2006 and appointed a successor special committee, titled the Special Committee Regarding Derivative Litigation, to assume responsibility for the stock option review and to address matters raised by the derivative action (the Special Committee). The same independent director continued as the sole member of the Special Committee and, after consideration of a number of firms, selected new independent counsel to represent the Special Committee. The Special Committee subsequently retained a second independent law firm (collectively Independent Counsel). Independent Counsel retained forensic accounting experts to assist in the internal review.

The Special Committee reported its preliminary findings on quantitative issues to the Audit Committee and the Board on September 28, 2006. Based on the report of the Special Committee, and upon the recommendation of management and the Audit Committee, the Board concluded on October 2, 2006, that the Company would need to restate historical financial statements to record additional non-cash charges for stock-based compensation expense related to past option grants and that the historical financial statements and all earnings press releases and similar communications issued by the Company relating to periods beginning on or after its initial public offering in June 2000 should no longer be relied upon. The Company reported these conclusions in a current report on Form 8-K filed on the same day.

On February 7, 2007, the former General Counsel of the U.S. subsidiary, Marvell Semiconductor, Inc. (MSI), who was a subject of the internal review, raised allegations regarding the independence of the sole member of the Special Committee. The Audit Committee thereafter formed a subcommittee consisting of the Chairman of the Audit Committee to investigate the matter. The subcommittee appointed a former federal judge to serve as independent reviewer for the subcommittee who in turn retained independent counsel. Although the independent reviewer made no findings as to the truth of the allegations themselves and expressed substantial doubt regarding the credibility of the allegations, he nevertheless concluded that the independent director should step down from the Special Committee to ensure compliance with the stringent independence standards developed by courts reviewing the independence of special litigation committees formed to assess the merits of shareholder derivative litigation. The subcommittee also found that the General Counsel violated the Company s Code of Ethics and Business Conduct for not reporting the allegations timely. The subcommittee accepted the findings of the independent reviewer. The Company has since terminated the General Counsel for the violation. On March 30, 2007, the independent director resigned from the Special Committee and the Board appointed two independent non-director members to the Special Committee to continue the review of the Company s historical stock option practices and related accounting matters, which action is permitted under the Company s bye-laws. As a result, the Special Committee thereafter consisted of two non-directors.

On April 27, 2007, the Special Committee reported its findings to the Board of Directors and to the Implementation Committee, which consists of three independent members of the Board Douglas King, Paul Gray and Herbert Chang. The Implementation Committee was formed by the Board on April 26, 2007 to make such decisions and take such action as the committee determines to be appropriate in light of the Special Committee s findings and recommendations. On May 8, 2007, the Company disclosed on Form 8-K the completion of the independent review.

Findings of the Special Committee

From the Company s initial public offering through June 9, 2006 (the Relevant Period), option grants awarded to employees who were not then executive officers, as defined in Section 16 of the Securities Exchange Act of 1934, as amended (Section 16 Officers), were awarded either by the Board of Directors or the Stock Option Committee of the Board. The Stock Option Committee was formed by the Board of Directors in December 2000 and consisted of the Chief Executive Officer and the former Executive Vice President and Chief Operating Officer. Pursuant to authority delegated by the Board of Directors under Marvell s 1995 Stock Option Plan, the Stock Option Committee was empowered to act jointly. The Stock Option Committee awarded all grants to non-executives employees after its formation until June 9, 2006.

The Special Committee concluded that only one member of the Stock Option Committee was actively involved in the grant approval process. Of the 59 minutes of meetings of the Stock Option Committee, all of which were prepared by or under the direction of the former General Counsel of MSI, only the first set of minutes were separately prepared for each member s signature and signed by each of them; subsequently only one member signed those minutes. Additionally, the Special Committee determined that the Stock Option Committee conducted no meetings with respect to option grants and that minutes reflecting such meetings were false.

The Special Committee determined that in a substantial number of instances grant dates were chosen by management with the benefit of hindsight, so as to provide exercise prices lower than the fair market value on the actual measurement date.

In addition to the foregoing, the review determined that false employee-related paperwork was employed to reflect start dates that preceded the actual first day of employment, and to reflect secondary grant authorizations as if they occurred on dates prior to the original grant date, which facilitated giving the employees favorable prices.

From the Company s initial public offering in June 2000 through February 28, 2002, grants to the Company s former Chief Financial Officer were awarded only by the Stock Option Committee. The Stock Option Committee was not advised that it lacked the authority to make such awards. Furthermore, the first award made to the Company s former Chief Financial Officer by the Executive Compensation Committee dated October 16, 2002 was backdated and the Special Committee found that the former General Counsel misled the Executive Compensation Committee with respect to the facts and circumstances surrounding the grant, including the grant date.

During the Relevant Period, option grants to Section 16 Officers and members of the Board of Directors were approved by the Board of Directors or the Executive Compensation Committee or made pursuant to the Automatic Director Grant Program under the 1997 Director s Stock Option Plan. In the absence of a meeting, grant approvals by the Executive Compensation Committee were documented via written consents, which were dated as of a specified date but signed at a later time. The Executive Compensation Committee comprised three to four independent members of the Board over the Relevant Period. The Special Committee found that current board members who had served or are serving on the Executive Compensation Committee had not engaged in impropriety or intentional backdating with the benefit of hindsight.

The Special Committee found evidence of recommendations made by representatives of Human Resources and Finance and the Company s external auditors between 2000 and 2004 to grant options on fixed grant dates In August 2004, the Company implemented revisions to the Company s stock option grant processes and procedures for new hire and secondary grants that generally followed a fixed grant date schedule.

For the period from the Company s initial public offering in June 2000 through June 2006, the Special Committee found a systemic failure in controls over the stock option process, and that corporate documents, including the Company s SEC filings on Form 10-K and Form 10-Q, and proxy statements, were false in relation to the accounting and related disclosure covering stock option matters.

The Special Committee found that certain individuals had varying degrees of responsibility for the lack of controls and the inappropriate grant practices. As to the following individuals, the Special Committee concluded among other things:

Matthew Gloss, MSI s corporate counsel from April 2000 until February 2001 and thereafter its Vice President and subsequently, General Counsel until his termination in March 2007, failed to properly advise upper management, including Dr. Sutardja and Ms. Dai, about their responsibilities and duties regarding stock options and other financial filings. The minutes of the Stock Option Committee were prepared by or at the direction of Matthew Gloss. Mr. Gloss was also found to have misled the Executive Compensation Committee by creating false minutes and unanimous written consents including in one instance adding or directing the addition of a grant date to a unanimous written consent after that unanimous written consent was executed, or by creating minutes that were incomplete, inaccurate or misleading. He also failed to establish proper controls over the stock option process despite being on notice of various control problems.

George A. Hervey, MSI s Vice President and Chief Financial Officer throughout the Relevant Period until his resignation in May 2007, failed to properly advise upper management, including Dr. Sutardja and Ms. Dai, about their responsibilities and duties regarding stock options and other financial filings. Mr. Hervey also was found to have been aware of awarding options to two employees prior to their start date. He also failed to establish a system of proper controls despite being on notice of repeated concerns raised by others regarding the stock option process. He signed inaccurate external documents, including the Company s SEC filings and financial statements.

Weili Dai, the Company s former Board member, whoserved as Executive Vice President and General Manager of the Communications **Business Group from 1999 to April 2006** and thereafter also as Chief Operating Officer until she resigned from such positions in May 2007, played a central role in all Stock Option Committee grants. Ms. Dai participated in the selection of grant dates with the benefit of hindsight and signed false minutes and other employee related corporate documents. The Special Committee also found that she failed to establish proper internal controls and failed to exercise proper review and inquiry as an officer. Certain individuals involved in the process said that they did not feel able to provide her with frank advice. She signed inaccurate external documents, including 10-K s and proxy statements. She did not personally benefit from any of the grants she approved.

Dr. Sehat Sutardja, the Company s Chairman of the Board, President and Chief Executive Officer, was found to have had a very limited role in the stock option process and to have participated in a few instances in awards with incorrect measurement dates with respect to which he had received no or inadequate advice. He signed inaccurate external documents, including the Company s SEC filings, financial statements, and proxy statements. The Special Committee found that he failed to establish proper internal controls and that certain individuals involved in the process to some extent did not feel able to provide him with frank advice. He did not personally benefit from any of the grants he approved.

Remediation

With respect to the following employees, the Special Committee made recommendations, and Marvell s Implementation Committee has implemented or is in the process of implementing the following remedial steps:

The Company accepted the resignation of George A. Hervey on May 2, 2007. All unvested stock options previously awarded to him were cancelled.

The Implementation Committee of the Board of Directors determined, contrary to the recommendation of the Special Committee, that Ms. Dai has no continuing role with the Company, that retaining the services of Ms. Dai in a substantially reduced capacity as Director of Strategic Marketing and Business Development, an individual contributor in a non-managerial role, and under the auspices of the Implementation Committee better serves the interests of all shareholders. Ms. Dai will have no authority to undertake any decisions affecting internal controls or financial matters of the Company. The Implementation Committee will provide periodic compliance updates to the Board of Directors on Ms. Dai s activities. Additionally, all of Ms. Dai s outstanding options that were unvested as of May 6, 2007 have been cancelled and the exercisability of already vested options have been limited, notwithstanding her continued employment.

Dr. Sehat Sutardja will remain as President and Chief Executive Officer and as a member of the Board, but will step down as Chairman of the Board in favor of a non-executive Chairman. Dr. Sutardja agreed to reduce the number of shares received in his December 26, 2003 option grant by 500,000 pre-split shares (2,000,000 post-split shares), which is the amount of underlying shares mistakenly awarded by the Executive Compensation Committee in excess of that authorized under the applicable stock option plan.

In April 2007, the Stock Option Committee was formally dissolved; however, it ceased to function during June 2006 and has granted no options since that time. Currently, the Executive Compensation Committee, comprising two independent Board members, holds periodic meetings to approve equity award grants. The process requires that any proposed equity awards be reviewed in advance by the Human Resources, Legal, Finance and Internal Audit Departments, and requires communication of the details of proposed equity awards to committee members prior to each monthly meeting, as well as awarding recipients promptly after the meeting. Equity awards are priced and valued based upon the closing price of the Company s common stock on the date of the meeting. Decisions of the committee meeting are documented by minutes. Additionally, the Executive Compensation Committee adopted a policy regarding

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the granting of equity-based compensation awards. Following the Special Committee s recommendations, the Company is conducting a search for a new Chief Operating Officer, Chief Financial Officer, General Counsel and Vice President of Compliance. Additionally, the Board s Governance Committee is conducting a search for three new independent directors to fill existing vacancies. One of these independent directors will succeed Dr. Sutardja as Chairman of the Board.

Pre-tax Financial Impact of the Equity Award Review

Approximately 74% of shares granted during the Relevant Period were backdated or resulted in additional accounting charges. Of these re-measured grants, the stock prices on the original grant date were lower than the prices on the appropriate measurement dates for 97% of such shares. Substantially all options granted (99% of shares granted during the Relevant Period) have been evaluated for appropriate re-measurement dates under Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (APB 25).

The types of grant discrepancies uncovered by the internal review (by both the Special Committee and management) and the additional pre-tax stock-compensation expense arising from these adjustments, quantified under APB 25 for periods through fiscal 2006, are summarized as follows (in thousands):

	Cumulative through January 28, 2006	**Year Ended January 28, 2006**	**Year Ended January 29, 2005**	**Year Ended January 31, 2004**	**Year Ended February 1, 2003**	**Year Ended February 2, 2002**	**Year Ended January 27, 2001 and prior**
Board of Director Grants (a)	$ 1	$ 1	$	$	$	$	$
Officer Grants (b)	19,577	6,317	12,023	836	270	127	4
Re-priced Officer Grants (c)	39,658	24,827	9,888	4,943			
New Hire Grants - effective hire dates (d)	19,879	249	1,530	2,729	4,754	7,278	3,339
Other New Hire (e)	49,876	5,313	13,235	13,437	10,322	7,061	508
Secondary Grants (e)	18,165	2,360	3,713	3,016	4,432	3,975	669
Re-priced New Hire Grants (f)	100,575	49,798	23,727	25,254	(1,885)	3,681	
Evergreen Grants (g)	60,838	9,870	11,082	12,634	17,911	9,312	29
Non-employee Grants * (h)	8,800	121	486	1,166	(264)	1,884	5,407
Termination related charges (i)	10,006						10,006
	$ 327,375	$ 98,856	$ 75,684	$ 64,015	$ 35,540	$ 33,318	$ 19,962

*The restated financial statements include charges for non-employee grants of $1,062,000 for fiscal 2000, $139,000 for fiscal 1999, $41,000 for fiscal 1998, $12,000 for fiscal 1997 and $1,000 for fiscal 1996.

(a) Board of Director Grants: Non-employee directors receive initial and annual grants in their capacity as directors. A grant of 24,000 shares to a non-employee director, issued on an annual general meeting date in accordance with the terms of his appointment letter, was outside the 1997 Directors Stock Option Plan and therefore, required approval from the Board. The Board approval was obtained at a later date. For accounting purposes, the grant was re-measured based on the Company s stock price at the date of the Board s ratification.

In December 2006, the terms of this option were reformed to reflect the revised stock option exercise price.

(b) Officer Grants: During the Relevant Period, the Company granted options on 13 different dates (including the Re-priced Officer Grants) to the then-Section 16 Officers Dr. Sehat Sutardja, Weili Dai, Dr. Pantas Sutardja and George Hervey. The Company recorded additional compensation costs for

one grant on December 26, 2003 (which represented 75% of options granted) for three of the officers who were also founders of the Company (Founder Officers) and six grants (which represented 96% of options granted) for George Hervey. For accounting purposes, the grant of 12,640,000 shares to the Founder Officers was re-measured based on the stock price at the date the Executive Compensation Committee meeting occurred to approve the grants. Grants to George Hervey totaling 1,279,892 shares of options originally priced at the as of dates of the written consents have been re-measured to the last documented date of approval received from members of the Executive Compensation Committee.

In December 2006, the terms of the options deemed to have been issued at a discount were reformed to reflect the revised stock option exercise prices for all affected Section 16 Officer grants. Of these 5.4 million reformed options, the Company received from the Officers the incremental exercise prices for the portion of these options which had previously been exercised totaling $9.6 million. The reformation of these options did not result in incremental compensation cost in the fourth quarter of fiscal 2007.

The amounts above do not include $7.5 million in unrecognized stock-based compensation that will be recorded in the second quarter of fiscal 2008 in connection with the cancellation of certain officer grants to Dr. Sehat Sutardja and Weili Dai.

(c) Re-priced Officer Grants: The minutes of the May 22, 2002 Executive Compensation Committee meeting reflect the Committee s approval of a grant to the Founder Officers totaling 1.6 million shares, to be effective on the execution of a unanimous written consent. In June 2002, the Executive Compensation meeting members executed a unanimous written consent dated June 6, 2002 and effective as of May 22, 2002. The Special Committee found that on September 10, 2002 after the former General Counsel had a discussion with two of the Founder Officers who indicated that in the setting of the price as of May 22, 2002 was inaccurate, the grant was re-priced to the fair market value on June 6, 2002. The Special Committee found that the former General Counsel had misled the Executive Compensation Committee as to the reasons for the change. The Special Committee further found that the amendment was falsely characterized as a documentation error rather than a grant modification. While the affected options were not considered to be issued at a discount on the date of the modification, these shares were subject to variable accounting until the Company s adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R) at the beginning of fiscal 2007.

(d) New Hire Grants effective hire dates: The internal review identified 4,669,200 options to 30 new hire recipients which required revision to reflect a later date of effective employment. In all cases, the stock price on the original grant date was lower than the price on the appropriate measurement date. For accounting purposes, the new hire start dates had to be reconstructed through payroll records and evaluated to determine appropriate re-measurement dates.

(e) Other New Hire and Secondary Grants: In addition to grants issued to new hires at the commencement of their employment, the Company occasionally issues secondary grants to employees for outstanding performance, retention or other discretionary reasons outside of the annual performance review cycle. During the Relevant Period, the Company granted new hire and secondary options on 86 different dates, excluding assumption of acquisition-related options. These dates included grants made from August 2004 onwards when a fixed grant date schedule was set on the first Friday of each month. As a result of the internal review, the Company recorded additional compensation costs for grants relating to 37 different grant dates, impacting approximately two-thirds of the new hire and secondary grants (totaling 48,708,478 options). The original grant date with respect to such grants preceded the appropriate measurement date and in substantially all instances, the stock price on the former date was lower than the price on the appropriate measurement date. Generally, the terms of new hire grants, except for their exercise prices, are stated in employee offer letters which are acknowledged by employees. For new hire grants, re-measurement dates were determined based on the first instance when the Stock Option Committee grant date was picked. For secondary grants, as there was no other reliable documentation available to support the measurement date, the Company applied the date the grant was submitted to stock administration for processing, which typically indicated the conclusion of the grant process. The last date of submission was used unless the submitted change was proven to be purely administrative in nature and unrelated to the terms of the grant. Absent such submission documentation, the Company used the date the grant entry was created in the option database, as this was the most objectively verifiable date when the terms of the grant were known, in accordance with the SEC Chief Accountant s letter issued on September 19, 2006, outlining the SEC staff s interpretation of specific accounting guidance for registrants under APB 25.

(f) Re-priced New Hire Grants: Of the New Hire grants in the Relevant Period, grant prices were re-set for a segment of grants on three grant dates. Consequently, affected awards totaling 6,224,200 options were subject to variable accounting until the Company s adoption of SFAS 123R. The re-pricing resulted from the Stock Option Committee s originally designated grant date being modified to a later grant date.

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(g) Evergreen Grants: During the Relevant Period, there were eight Evergreen grant dates. Substantially all employess are entitled to these grants for retention purposes. There were two Evergreen grant dates in both fiscal 2003 and 2004. There was evidence of amendments to the recipients and/or the number of options subsquent to the grant date. In all cases, the definitive lists of award recipients could not be reasonably determined until after the original grant date, impacting 54,702,828 options. Consequently, all Evergreen grants were re-measured on subsequent dates when the granting process was considered to be finalized. For purposes of the restatement, the Company used the date the grant was submitted to stock administration for processing, which typically indicated the conclusion of the grant process. The last date of submission was used unless the submitted change was proven to be purely administrative in nature and unrelated to the terms of the grant. Absent this supporting documentation, the date the grant entry was created in the option database was used. In substantially all instances, the stock price on the former date was lower than the price on the appropriate measurement date. The last Evergreen grant (totaling 7,215,056 options) occurred during fiscal 2007 and the effects on the restatement were included in the restated fair value of the affected grants under SFAS 123R, increasing the grant date fair value of affected options by $0.31 per share.

(h) Non-employee Grants: Since the inception of the Company, 3,819,000 options were granted to 13 recipients who were not employees or directors of the Company. These grants were erroneously accounted for under APB 25 as if they had been made to employees. Of these, four recipients that were granted a total of 1,483,000 options subsequently became employees or directors of the Company. As a result, the affected awards were accounted for as non-employee grants under EITF 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services, which resulted in the application of variable accounting on these options until exercised or cancelled. Options held by consultants who became employees or directors of the Company have been accounted for under FASB Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation, which addresses a change in grantee status.

(i) Termination-related charges: With respect to option grants to an employee, the post-service exercise period for 605,332 vested stock options was effectively extended by an unpaid leave of absence arrangement which appears to have lacked substance. The Company applied APB 25 as if the leave of absence arrangement was a constructive modification extending the exercise period of vested awards. The Company recorded $10.0 million in additional deferred compensation charges in fiscal 2001.

Notwithstanding the foregoing, the lack of conclusive evidence in the case of certain grants required management to apply significant judgment in establishing revised measurement dates. The Company determined that the total cumulative, pre-tax, non-cash, stock-based compensation expense resulting from revised measurement dates under APB 25 was $327.4 million for periods through fiscal 2006. There was no impact on revenue. The Company adopted SFAS 123R at the beginning of fiscal 2007.

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Tax Impact of the Equity Award Review and Other

The majority of the additional $327.4 million stock option compensation is expensed on the financial statements of the entities located in tax jurisdictions having a lower tax rate than that of the U.S. The tax benefits associated with all but $12.0 million of the $327.4 million total expense is recorded in Bermuda at zero percent tax rate. The $12.0 million of compensation expense and associated tax benefits have resulted in a cumulative deferred tax asset of $2.5 million as of January 28, 2006 and a deferred provision benefit of $4.8 million. The tax impact of the adjustments arising from the equity award review is summarized as follows (in thousands):

	Cumulative through January 28, 2006	Year Ended January 28, 2006	Year Ended January 29, 2005	Year Ended January 31, 2004	Year Ended February 1, 2003	Year Ended February 2, 2002	Year Ended January 27, 2001
Operating costs and expenses Payroll tax* (a)	$ 7,628	$ 4,384	$ 2,306	$ 921	$ 17	$	$
Provision for income tax Deferred Income Tax Benefit (b)	(4,806)	(1,822)	(1,150)	(1,170)	(405)	(259)	
Provision for income tax Section 162(m) and utilization of deferred tax assets**(c)	27,206	27,206					
Tax impact of the equity award review	$ 30,028	$ 29,768	$ 1,156	$ (249)	$ (388)	$ (259)	$
Reduction to deferred tax asset for exemption benefit (d)	$ 5,275	$ 3,249	$ 2,026				

* $3.0 million of additional employer and employee withholding taxes relating to exercises of affected options, including penalty and interest, and $24.2 million of Section 409A expenses of employees, including penalties and interest was also recorded in fiscal 2007.

** $4.9 million of penalty and interest associated with Section 162(m) liability was also recorded in fiscal 2007.

(a) Payroll Tax - The federal and state revised measurement dates for certain stock options as discussed in this filing may result in adverse tax consequences to holders of those options under IRC Section 409A which was enacted in 2004 to impose certain restrictions on deferred compensation arrangements. The adverse tax consequences are that Section 409A may subject the option holder of the re-measured retroactively priced stock options to a penalty tax and interest on the exercise of the options vesting after December 31, 2004. In addition to similar penalty taxes and interest under California and other state income tax laws upon the exercise of the option grant will apply.

- *Exercised options*. The option grants had been issued as incentive stock options. Due to the re-measurement caused by the re-pricing, they have originally become non-statutory stock options. The Company has accrued employment taxes for the exercise in each of the years due to the conversion of the options from incentive to non-statutory. Included in the restated results through fiscal 2006 are additional employer and employee withholding taxes relating to exercises of affected options totaling $7.6 million, including penalties and interest. The amounts represent additional compensation expense and have been classified in their respective functional categories. On a calendar year basis the amounts total: calendar 2003 of $0.8 million, calendar 2004 of $1.9 million, calendar 2005 of $3.7 million, and calendar 2006 of $4.2 million. The above table reflects the amounts on a fiscal year basis. The full amount of compensation, taxes, interest and penalties has been accrued as reflected above as well as in fiscal 2007. The total amount accrued through fiscal 2007 is $10.6 million.

- *Section 409A*

The Company has informed employees who exercised options in 2006 that any additional tax costs accruing to such employees from Section 409A, ISO disqualification, and employment taxes will be reimbursed by the Company and grossed up. For the Section 409A affected options exercised during calendar year 2006, the IRS issued guidelines that would allow employers to enter into a global settlement of Section 409A issues on behalf of their employees. California and other states have offered a similar program. This liability does not appear in the above table, but has been accrued in fiscal year 2007 as explained in the remainder of this section.

Because all holders of re-measured stock options generally were not involved in or aware of the retroactive pricing, the Board of Directors approved the Company s plan to deal with the adverse tax consequences that may be incurred by the holders of the re-measured options in the fourth quarter of fiscal 2007. Therefore, the Company recorded in the last quarter of fiscal

2007 Section 409A expenses for the adverse tax consequences of the re-measured options exercised during calendar year 2006 of approximately $24.2 million, including estimated penalties and interest. The amount represents additional compensation expense and has been classified in the respective functional categories. The Company has sent timely notices to the IRS and the California Franchise Tax Board that it elected to participate in these programs.

- *Unexercised options*. The IRS has provided taxpayers with the following two ways of correcting unexercised discounted stock options: 1) setting a fixed exercise date; or 2) increasing the exercise price of the option up to the fair market price on the date of grant. The Company is actively evaluating these options. The discount associated with unexercised stock options outstanding as of January 27, 2007 amounted to $51.7 million. The Company has not determined the tax consequences associated with these potential future remedies.

(b) Deferred Tax Asset for Stock Based Compensation: The Company recorded adjustments for the creation of additional deferred tax asset for stock based compensation that is deductible at later periods for U.S. income tax purposes on its balance sheets for year end dates of each of fiscal 2002 through fiscal 2006. As a result, additional benefits for income tax arising from stock based compensation was recognized in fiscal 2006 of $1.8 million, fiscal 2005 of $1.1 million, fiscal 2004 of $1.2 million, fiscal 2003 of $0.4 million and fiscal 2002 of $0.3 million. The total gross stock-based compensation cost that results in a deferred tax benefit is $12.0 million of the total expense of $327.4 million.

In addition, the Company evaluated the impact of the restatement on its global tax provision. The Company and its subsidiaries file tax returns in multiple tax jurisdictions around the world. In the U.S. jurisdiction one of the company s subsidiaries claims a tax deduction relative to stock options with regard to the U.S. distributor business. In accordance with FAS 123R for this jurisdiction where the deduction is claimed during fiscal 2007, the Company has recorded a deferred tax asset totaling $3.5 million at January 27, 2007, to reflect future tax deductions to the extent the company believes such asset is recoverable.

(c) Income Tax - Section 162(m) and utilization of deferred tax assets: The Company has accrued for the current and deferred tax impact of $104.5 million of non-deductible officer compensation related to Internal Revenue Code Section 162(m) (Section 162(m)) in fiscal 2006. Section 162(m) limits the deductibility of compensation in excess of one million dollars, but exempts stock option compensation where the option was issued at fair market value on the date of grant. The Company has determined that $104.5 million of executive compensation in fiscal 2006 does not meet the exclusion criteria under Section 162(m), under existing IRS interpretations, and have therefore accrued $21.8 million of current tax expense and $5.4 million of deferred tax expense associated with the utilization of net operating losses. The Company has accrued the penalty and interest totaling $4.9 million associated with this liability in fiscal 2007.

(d) Other: The Company recorded adjustments to correct an overstatement of deferred tax asset related to the Singapore entity. The original deferred tax asset had not reflected the benefit of the Pioneer status of this entity.

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Accumulated Deficit Impact of Equity Award Review and Other Tax Adjustments

The table below reflects the breakdown by year of the cumulative adjustment to retained earnings. The consolidated financial statements for periods through fiscal 2006 included in previously filed periodic reports with the SEC for such periods have not been amended. The consolidated financial statements, included in this Form 10-Q, have been restated as follows (in thousands):

		Stock-based compensation expense	**Estimated additional payroll tax expense**	**Additional deferred income tax benefit**	**Additional deferred income tax provision**	**Section 162(m) and utilization of deferred tax assets**	**Cummulative effect of change in accounting principle, net of tax effect**	**Total Adjustments, net of taxes**	
Fiscal 2000 and prior *		$ 1,255	$	$	$	$	$	$ 1,255	
Fiscal 2001		18,707						18,707	
Fiscal 2002		33,318		(259				33,059	
Fiscal 2003		35,540	17	(405				35,152	
Fiscal 2004		64,015	921	(1,170				63,766	
Cumulative effect at January 31, 2004		152,835	938	(1,834				151,939	
	Net income as reported								**Net income as restated**
Fiscal 2005	$ 141,661	75,684	2,306	(1,150	) 2,026			78,866	$ 62,795
Fiscal 2006:									
Three months ended April 30, 2005		8,719	866					9,585	
Three months ended July 30, 2005		29,120	1,083					30,203	
Three months ended October 29, 2005		9,102	589					9,691	
Three months ended January 28, 2006		51,915	1,846	(1,822	) 3,249	27,206		82,394	
Total for Fiscal 2006	331,363	98,856	4,384	(1,822	) 3,249	27,206		131,873	199,490

Cumulative effect at January 28, 2006		327,375	7,628	(4,806)	5,275	27,206		362,678	
Three months ended April 29, 2006	75,297	4,225	2,170	(3,325)		3,510	(8,846)	(2,266)	77,563
Cumulative effect at April 29, 2006		$ 331,600	$ 9,798	$ (8,131)	$ 5,275	$ 30,716	$ (8,846)	$ 360,412	

* Comprised $1,062,000 for fiscal 2000, $139,000 for fiscal 1999, $41,000 for fiscal 1998, $12,000 for fiscal 1997 and $1,000 for fiscal 1996.

The restatement adjustments reduced previously reported basic net income per share by $0.24 and $0.14 for fiscal 2006 and 2005, respectively and diluted net income per share by $0.20 and $0.13 for fiscal 2006 and fiscal 2005, respectively.

Cashflows Impact of Equity Award Review

The additional payable for payroll taxes associated with these stock option grants of approximately $10.6 million, additional Section 409A expenses for the adverse tax consequences of the re-measured options exercised during calendar year 2006 of approximately $24.2 million, and Section 162(m) liabilities of $26.5 million for cumulative period from fiscal 2001 through 2007, represents future cash outflow totaling $61.3 million.

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The following tables present the impact of the financial statement adjustments on the previously reported Consolidated Statement of Operations for the three and six months ended July 30, 2005:

	Three Months Ended July 30, 2005				**Six Months Ended July 30, 2005**			
	As Previously Reported	**Adjustments**		**As Restated**	**As Previously Reported**	**Adjustments**		**As Restated**
	(In thousands, except per share amounts)							
Net revenue	$ 390,454	$		$ 390,454	$ 755,224	$		$ 755,224
Operating costs and expenses:								
Cost of goods sold	183,646	1,805	(A)	185,451	358,890	2,346	(A)	361,236
Research and development	73,164	14,941	(A)	88,105	145,062	20,993	(A)	166,055
Selling and marketing	21,275	4,864	(A)	26,139	42,264	5,897	(A)	48,161
General and administrative	8,340	9,110	(A)	17,450	15,078	11,940	(A)	27,018
Amortization of stock-based compensation	517	(517	)(A)		1,388	(1,388	)(A)	
Amortization and write-off of goodwill and acquired intangible assets and other	19,753			19,753	39,512			39,512
Total operating costs and expenses	306,695	30,203		336,898	602,194	39,788		641,982
Operating income (loss)	83,759	(30,203	)	53,556	153,030	(39,788	)	113,242
Interest and other income, net	4,384			4,384	7,996			7,996
Income (loss) before income taxes	88,143	(30,203	)	57,940	161,026	(39,788	)	121,238
Provision for income taxes	10,841			10,841	20,192			20,192
Net income (loss)	$ 77,302	$ (30,203	)	$ 47,099	$ 140,834	$ (39,788	)	$ 101,046
Basic net income (loss) per share	$ 0.14	$ (0.06	)	$ 0.08	$ 0.25	$ (0.07	)	$ 0.18
Diluted net income (loss) per share	$ 0.12	$ (0.04	)	$ 0.08	$ 0.23	$ (0.07	)	$ 0.16
Weighted average shares basic	561,832			561,832	559,709			559,709
Weighted average shares diluted	626,205			626,205	623,798			623,798

(A.) Adjustments for additional stock-based compensation expense pursuant to APB 25 and reclassification of previously reported stock-based compensation expenses to the respective functional cost and expense line items.

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The following tables present the impact of the financial statement adjustments on the previously reported Consolidated Balance Sheets as of January 28, 2006:

	January 28, 2006 As Previously Reported	Adjustments		As Restated
	(In thousands, except per share amounts)			
ASSETS				
Current assets:				
Cash and cash equivalents	$ 348,431	$		$ 348,431
Short-term investments	572,591			572,591
Accounts receivable, net of allowance of $3,028	245,164			245,164
Inventories	211,374			211,374
Prepaid expenses and other current assets	104,307			104,307
Deferred income taxes	18,007	(14,062)	(B)	3,945
Total current assets	1,499,874	(14,062)		1,485,812
Property and equipment, net	260,921			260,921
Goodwill	1,558,209			1,558,209
Acquired intangible assets, net	111,973			111,973
Other non-current assets	82,312	5,279	(B)	87,591
Total assets	$ 3,513,289	$ (8,783)		$ 3,504,506
LIABILITIES AND SHAREHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$ 196,606	$		$ 196,606
Accrued liabilities	34,905			34,905
Accrued employee compensation	51,549	7,628	(C)	59,177
Income taxes payable	3,352	21,042	(B)	24,394
Deferred income	29,773			29,773
Current portion of capital lease obligations	16,563			16,563
Total current liabilities	332,748	28,670		361,418
Capital lease obligations, net of current portion	24,447			24,447
Non-current income taxes payable	85,126	1,419	(B)	86,545
Other long-term liabilities	24,871			24,871
Total liabilities	467,192	30,089		497,281
Shareholders equity:				
Preferred stock, $0.002 par value; 8,000 shares authorized; no shares issued and outstanding				
Common stock, $0.002 par value; 992,000 shares authorized; 582,776 shares issued and outstanding	1,165			1,165
Additional paid-in capital	3,249,587	384,652	(A)	3,634,239
Deferred stock-based compensation	(1,141)	(60,846)	(A)	(61,987)
Accumulated other comprehensive loss	(1,759)			(1,759)
Accumulated deficit	(201,755)	(362,678)		(564,433)
Total shareholders equity	3,046,097	(38,872)		3,007,225
Total liabilities and shareholders equity	$ 3,513,289	$ (8,783)		$ 3,504,506

(A.) Adjustments for additional stock-based compensation expense pursuant to APB 25, net of tax benefit from employee stock transactions.

(B.) Adjustments to deferred tax assets arising from the stock-based compensation charge.

(C.) Adjustments for additional payroll taxes.

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The following tables present the impact of the financial statement adjustments on the previously reported Statements of Cash Flows for the three and six months ended July 29, 2005:

	Six Months Ended July 29, 2005 As Previously Reported (In thousands)	Adjustments		As Restated
Cash flows from operating activities:				
Net income	$ 140,834	$ (39,788)		$ 101,046
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	27,589			27,589
Stock-based compensation	1,388	37,839	(A)	39,227
Amortization of acquired intangible assets	39,512			39,512
Changes in assets and liabilities, net of acquisition:				
Accounts receivable	(9,255)			(9,255)
Inventories	14,702			14,702
Prepaid expenses and other assets	(65,308)			(65,308)
Accounts payable	9,946			9,946
Accrued liabilities and other	1,048			1,048
Accrued employee compensation	708	1,949	(B)	2,657
Income taxes payable	18,148			18,148
Deferred income	1,722			1,722
Net cash provided by operating activities	181,034			181,034
Cash flows from investing activities:				
Purchases of short-term investments	(253,023)			(253,023)
Sales and maturities of short-term investments	150,524			150,524
Purchases of property and equipment	(37,841)			(37,841)
Net cash provided by (used in) investing activities	(140,340)			(140,340)
Cash flows from financing activities:				
Proceeds from the issuance of common stock	51,606			51,606
Principal payments on capital lease obligations	(6,784)			(6,784)
Net cash provided by financing activities	44,822			44,822
Net increase (decrease) in cash and cash equivalents	85,516			85,516
Cash and cash equivalents at beginning of period	166,471			166,471
Cash and cash equivalents at end of period	$ 251,987	$		$ 251,987

(A.) Adjustments for additional stock-based compensation expense pursuant to APB 25.

(B.) Adjustments for additional payroll tax.

Note 2. The Company and its Significant Accounting Policies

The Company

Marvell Technology Group Ltd. (the Company), a Bermuda company, was incorporated on January 11, 1995. The Company is a leading global semiconductor provider of high-performance analog, mixed-signal, digital signal processing and embedded microprocessor integrated circuits. The Company s diverse product portfolio includes switching, transceivers, wireless, PC connectivity, gateways, communications controllers, storage and power management solutions that serve diverse applications used in business enterprises, consumer electronics and emerging markets.

Basis of presentation

The Company s fiscal year is the 52- or 53-week period ending on the Saturday closest to January 31. In a 52-week year, each fiscal quarter consists of 13 weeks. The additional week in a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks. Fiscal years 2007 and 2006 comprised 52-weeks.

On February 21, 2006, the Board of Directors approved a 2 for 1 stock split of the Company s common stock, to be effected pursuant to the issuance of additional shares as a stock dividend. The stock split was subject to shareholder approval of an increase in the Company s authorized share capital at the Company s 2006 Annual General Meeting. On June 9, 2006, shareholders at the Company s 2006 Annual General Meeting approved an increase in the authorized share capital by 500 million shares of common stock. Stock certificates representing one additional share for each share held were delivered on July 24, 2006 (payment date) to all shareholders of record at the close of business on July 10, 2006 (record date). All share and per share amounts in these condensed consolidated financial statements and related notes have been retroactively adjusted to reflect the stock split for all periods presented.

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments except for the effect of the restatement as discussed in Note 1, necessary to fairly state the Company s financial position as of July 29, 2006, the results of its operations for the three and six months ended July 29, 2006 and July 30, 2005, respectively and its cash flows for the six months ended July 29, 2006 and July 30, 2005, respectively. 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 year ended January 27, 2007, filed concurrently with this Form 10-Q. The results of operations for the three and six months ended July 29, 2006 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 unaudited interim condensed consolidated financial statements in conformity with generally accepted accounting principles 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. On an on-going basis, the Company evaluates its estimates, including those related to uncollectible receivables, the useful lives of long-lived assets including property and equipment, investment fair values, goodwill and other intangible assets, income taxes, and contingencies. In addition, the Company uses assumptions when employing the Black-Scholes option valuation model to calculate the fair value of stock-based awards granted. The Company bases its estimates of the carrying value of certain assets and liabilities on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, when these carrying values are not readily available from other sources. Actual results may differ from these estimates.

Principles of consolidation

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

Revenue recognition

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

Product revenue is generally recognized upon shipment of product to customers, net of accruals for estimated sales returns and allowances. However, some of the Company s sales are made through distributors under agreements allowing for price protection and rights of return on product unsold by the distributors. Product revenue on sales made through distributors with rights of return and price protection is deferred until the distributors sell the product to end customers. The Company s sales to direct customers are made primarily pursuant to standard purchase orders for delivery of products. The Company generally allows customers to cancel or change purchase orders with limited notice prior to the scheduled shipment dates and from time to time it also may request a customer to accept a shipment of product before the original requested delivery date, in which case revenue is not recognized until there is written

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confirmation from the customer accepting early shipment, delivery has occurred, the fee is fixed or determinable, and collection is reasonably assured. Additionally, collection is not deemed to be reasonably assured if customers receive extended payment terms. As a result, revenue on sales to customers with payment terms substantially greater than the Company s normal payment terms is deferred and is recognized as revenue as the payments become due. Deferred revenue less the related cost of the inventories is reported as deferred income.

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

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

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

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

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

Research and development and other

Research and development and other costs consist primarily of $149.9 million and $85.9 million of research and development costs for the three month periods ended July 29, 2006 and July 30, 2005, respectively, excluding costs related to patent investigation and filings for the three month periods ended July 29, 2006 and July 30, 2005 which were $2.7 million and $2.2 million, respectively.

Research and development and other costs consist primarily of $276.8 million and $162.8 million of research and development costs for the six month periods ended July 29, 2006 and July 30, 2005, respectively, excluding costs related to patent investigation and filings for the six month periods ended July 29, 2006 and July 30, 2005 which were $5.1 million and $3.3 million, respectively.

Inventories

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

Warranty accrual

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

Stock-based compensation

Effective from January 29, 2006, the Company adopted FASB Statement of Financial Accounting Standards No. 123 (revised 2004), Share Based Payment (SFAS 123R). SFAS 123R requires the measurement and recognition of compensation expense for all share-based awards to employees and directors, including employee stock options, restricted stock units and employee stock purchase rights based on estimated fair values. SFAS 123R supersedes previous accounting guidance under Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (APB 25) and related interpretations and amends SFAS No. 95, Statement of Cash Flows. Under SFAS 123R, the benefits of tax deductions in excess of recognized compensation cost has to be reported as a financing cash flow, rather than as an operating cash flow. This may reduce future net cash flows from operations and increase future net financing cash flows. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107), which provides guidance regarding the interaction of SFAS 123R and certain SEC rules and regulations. The Company has applied the provisions of SAB 107 in its adoption of SFAS 123R.

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Prior to January 29, 2006, the Company accounted for its stock based compensation plans using the intrinsic value method under the provisions of APB 25 and related guidance, under the accelerated method of amortization.

The Company adopted SFAS 123R using the modified prospective method. Under the modified prospective method, results of operations include compensation costs of unvested options granted prior to January 29, 2006, and options granted subsequent to that date. For grants prior to January 29, 2006, the Company amortizes stock-based compensation expense under the accelerated method. For grants from January 29, 2006, the Company amortizes stock-based compensation expense ratably over the expected term.

Cumulative Effect of Change in Accounting Principle

The adoption of SFAS 123R resulted in a cumulative benefit from change in auditing principle of $8.8 million net of tax as of the year ended January 27, 2007, as restated, reflecting the net cumulative impact of estimated forfeitures that were previously not included in the determination of historic stock based compensation expense in periods prior to January 28, 2006.

As a result of the adoption of SFAS 123R, stock-based compensation increased from $29.7 million and $39.4 million in the three and six months ended July 30, 2005, respectively to $55.6 million and $104.4 million in the three and six months ended July 29, 2006. Stock-based compensation of $0.7 million was capitalized in inventory as of July 29, 2006. There was no stock-based compensation cost included in inventory as of January 28, 2006. In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123R. Prior to the adoption of SFAS 123R, the Company presented deferred compensation as a separate component of shareholders equity. In accordance with the provisions of SFAS 123R, on January 29, 2006, unamortized deferred compensation totaling $62.0 million on that date was eliminated with a corresponding reduction in additional paid-in capital.

In November 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 123(R)-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards (FSP 123R-3). We have elected to adopt the alternative transition method provided in the FSP 123R-3 for calculating the tax effects of stock-based compensation pursuant to SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the APIC pool related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123R.

Note 3. Supplemental Financial Information

Available-for-sale investments (in thousands)

	July 29, 2006							
	Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Estimated Fair Value	
Corporate debt securities	$	25,719	$		$			