PIXELWORKS, INC
Form 10-Q
August 06, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009.

or

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

For the transition period from __________ to __________.

Commission File Number: 000-30269

PIXELWORKS, INC.

(Exact name of registrant as specified in its charter)

OREGON	**91-1761992**
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification No.)

16760 SW Upper Boones Ferry Road, Suite 101
Portland, OR 97224
(503) 601-4545

(Address of principal executive offices, including zip code,
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 last 90 days.

Yes þ No o

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 o No o

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.

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company þ

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

Number of shares of Common Stock outstanding as of July 31, 2009: 13,396,859

PIXELWORKS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2009
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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

PIXELWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

	June 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 18,795	$ 53,149
Short-term marketable securities	6,848	8,058
Accounts receivable, net	5,146	6,149
Inventories, net	3,720	4,981
Prepaid expenses and other current assets	3,230	3,381
Total current assets	37,739	75,718
Long-term marketable securities	2,550	2,110
Property and equipment, net	5,070	5,187
Other assets, net	5,030	5,331
Acquired intangible assets, net	2,196	3,386
Total assets	$ 52,585	$ 91,732
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,489	$ 4,215
Accrued liabilities and current portion of long-term liabilities	7,458	9,419
Current portion of income taxes payable	216	137
Total current liabilities	12,163	13,771
Long-term liabilities, net of current portion	1,993	2,035
Income taxes payable, net of current portion	9,040	10,581
Long-term debt	15,779	60,634
Total liabilities	38,975	87,021
Commitments and contingencies (Note 11)		
Shareholders equity:		
Common stock	334,404	333,974
Accumulated other comprehensive income	408	55
Accumulated deficit	(321,202)	(329,318)

Total shareholders equity		13,610		4,711
Total liabilities and shareholders equity	$	52,585	$	91,732

See accompanying notes to condensed consolidated financial statements.

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PIXELWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Revenue, net	$ 14,213	$ 20,793	$ 24,993	$ 44,769
Cost of revenue (1)	7,440	10,295	14,064	22,600
Gross profit	6,773	10,498	10,929	22,169
Operating expenses:				
Research and development (2)	4,532	7,193	9,308	13,915
Selling, general and administrative (3)	3,340	4,491	7,213	9,177
Restructuring	64	(158)	101	850
Amortization of acquired intangible assets		74		164
Total operating expenses	7,936	11,600	16,622	24,106
Loss from operations	(1,163)	(1,102)	(5,693)	(1,937)
Gain on repurchase of long-term debt, net	3,836		12,860	11,557
Interest expense	(145)	(419)	(396)	(992)
Interest income	75	553	173	1,536
Amortization of debt issuance costs	(26)	(125)	(87)	(271)
Other income		218		218
Other-than-temporary impairment of a marketable security				(6,490)
Interest and other income, net	3,740	227	12,550	5,558
Income (loss) before income taxes	2,577	(875)	6,857	3,621
Provision (benefit) for income taxes	358	375	(1,259)	(1,262)
Net income (loss)	$ 2,219	$ (1,250)	$ 8,116	$ 4,883
Net income (loss) per share basic	$ 0.17	$ (0.09)	$ 0.61	$ 0.33
Net income (loss) per share diluted	$ 0.16	$ (0.09)	$ 0.61	$ 0.33
Weighted average shares outstanding:				
Basic	13,291	14,577	13,321	14,753

Diluted	13,475	14,577	13,344	14,766
(1) Includes:				
Amortization of acquired developed technology	$ 573	$ 705	$ 1,190	$ 1,410
Additional amortization of non-cancelable prepaid royalty	50		118	
Restructuring	(4)		43	
Stock-based compensation	3	20	10	38
(2) Includes stock-based compensation	108	449	226	898
(3) Includes stock-based compensation	105	313	357	738

See accompanying notes to condensed consolidated financial statements.

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PIXELWORKS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30,	
	2009	**2008**
Cash flows from operating activities:		
Net income	$ 8,116	$ 4,883
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Gain on repurchase of long-term debt, net	(12,860)	(11,557)
Other-than-temporary impairment of a marketable security		6,490
Depreciation and amortization	2,299	3,375
Amortization of acquired intangible assets	1,190	1,574
Stock-based compensation	593	1,674
Deferred income tax benefit	(207)	(473)
Amortization of debt issuance costs	87	271
Amortization (accretion) on short- and long-term marketable securities	16	(295)
Loss on asset disposals	6	80
Other	24	27
Changes in operating assets and liabilities:		
Accounts receivable, net	1,003	(515)
Inventories, net	1,261	4,994
Prepaid expenses and other current and long-term assets, net	207	(535)
Accounts payable	274	(334)
Accrued current and long-term liabilities	(3,147)	(1,667)
Income taxes payable	(1,462)	(62)
Net cash provided by (used in) operating activities	(2,600)	7,930
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	4,100	36,814
Purchases of marketable securities	(2,993)	(16,659)
Purchases of property and equipment	(412)	(1,245)
Purchases of other assets	(27)	
Proceeds from sales of property and equipment		20
Net cash provided by investing activities	668	18,930
Cash flows from financing activities:		
Repurchase of long-term debt	(31,532)	(37,939)
Payments on asset financings	(727)	(2,764)
Repurchase of common stock	(167)	(1,371)
Proceeds from issuances of common stock	4	36

Net cash used in financing activities	(32,422)	(42,038)
Net change in cash and cash equivalents	(34,354)	(15,178)
Cash and cash equivalents, beginning of period	53,149	74,572
Cash and cash equivalents, end of period	$ 18,795	$ 59,394

See accompanying notes to condensed consolidated financial statements.

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PIXELWORKS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share and per share data)
(Unaudited)

NOTE 1: BASIS OF PRESENTATION

Nature of Business

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications. Our solutions enable manufacturers of digital display and projection devices, such as large-screen liquid crystal displays and digital front projectors, to differentiate their products with a consistently high level of video quality, regardless of the content s source or format. We were founded in 1997 and are incorporated under the laws of the state of Oregon.

Condensed Consolidated Financial Statements

These condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (GAAP) have been condensed or omitted pursuant to such regulations, although we believe that the disclosures provided are adequate to prevent the information presented from being misleading.

The financial information included herein for the three and six month periods ended June 30, 2009 and 2008 is unaudited; however, such information reflects all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows of the Company for these interim periods. The financial information as of December 31, 2008 is derived from our audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2008, included in Item 8 of our Annual Report on Form 10-K, filed with the SEC on March 16, 2009, and should be read in conjunction with such consolidated financial statements.

We have evaluated subsequent events through August 6, 2009, the date of issuance of the condensed consolidated financial statements.

The results of operations for the three and six month periods ended June 30, 2009 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2009.

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.* This pronouncement provides additional guidance for estimating fair value in accordance with SFAS 157, *Fair Value Measurement* (SFAS 157) when the volume and level of activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. We do not currently have any financial assets in non-active markets. The adoption of this FSP during the current quarter did not have a material impact on our consolidated financial position or results of operations.

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In April 2009, the FASB issued FSP FAS 107-1, APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments.* This pronouncement amends SFAS 107, *Disclosures about Fair Value of Financial Instruments*, (SFAS 107) to require disclosures about fair value of financial instruments not measured on the balance sheet at fair value in interim financial statements as well as in annual financial statements. Prior to this FSP, fair values for these assets and liabilities were only disclosed annually. This FSP applies to all financial instruments within the scope of SFAS 107 and requires disclosure of the methods and significant assumptions used to estimate the fair value of financial instruments. The adoption of this FSP during the current quarter did not have a material impact on our consolidated financial position or results of operations.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. This FSP requires the recognition of an other-than-temporary impairment if we intend to sell an impaired debt security and it is more likely than not that the security will be sold before it recovers its cost basis. This FSP also requires increased disclosure about the credit and noncredit components of impaired debt securities that are not expected to be sold and also requires increased and more frequent disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. The adoption of this FSP during the current quarter did not have a material impact on our consolidated financial position or results of operations.

In June 2009, the FASB issued SFAS 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162* (SFAS 168), which establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with US GAAP. SFAS 168 explicitly recognizes rules and interpretive releases of the SEC under federal securities laws as authoritative GAAP for SEC registrants. SFAS 168 will become effective for interim and annual periods ending after September 15, 2009 and is not expected to have a material impact on our consolidated financial position or results of operations.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and judgments that affect amounts reported in the financial statements and accompanying notes. Our significant estimates and judgments include those related to product returns, warranty obligations, bad debts, inventories, property and equipment, intangible assets, impairment of long-lived assets, valuation of short- and long-term marketable securities, amortization of prepaid royalties, valuation of share-based payments, income taxes, litigation and other contingencies. The actual results experienced could differ materially from our estimates.

As of June 30, 2009, we elected to use the simplified method to estimate the expected term used in the valuation of stock options granted after the May 19, 2009 amendment of the 2006 Incentive Stock Plan, which shortened the contractual life of newly issued stock options from ten to six years. The simplified method was used in accordance with Staff Accounting Bulletin (SAB) 107, *Share Based Payment* and SAB 110, *Certain Assumptions Used in Valuation Methods Expected Term,* as we do not have sufficient historical share option exercise experience for options granted with a six year contractual life. We will continue to use the simplified method until we have sufficient historical share option exercise experience to develop a more refined estimate of expected term.

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Reclassifications

Certain reclassifications have been made to the 2008 condensed consolidated financial statements to conform with the 2009 presentation, including the reclassification of payments on asset financing to financing activities in the consolidated statements of cash flow. Similar amounts will be reclassified in future filings for prior periods.

NOTE 2: BALANCE SHEET COMPONENTS

Marketable Securities See Note 3

Accounts Receivable, Net

Accounts receivable are recorded at invoiced amount and do not bear interest when recorded or accrue interest when past due. We do not have any off balance sheet exposure risk related to customers. Accounts receivable are stated net of an allowance for doubtful accounts, which is maintained for estimated losses that may result from the inability of our customers to make required payments. Accounts receivable, net consists of the following:

	June 30, 2009	December 31, 2008
Accounts receivable, gross	$ 5,688	$ 6,691
Less: allowance for doubtful accounts	(542)	(542)
Accounts receivable, net	$ 5,146	$ 6,149

Our allowance for doubtful accounts had no provisions, recoveries or other activity during the first half of 2009 and 2008.

Inventories, Net

Inventories consist of finished goods and work-in-process, and are stated at the lower of standard cost (which approximates actual cost on a first-in, first-out basis) or market (net realizable value), net of a reserve for slow-moving and obsolete items.

Inventories, net consist of the following:

	June 30, 2009	December 31, 2008
Finished goods	$ 3,325	$ 4,617
Work-in-process	3,845	5,358
	7,170	9,975
Less: reserve for slow-moving and obsolete items	(3,450)	(4,994)
Inventory, net	$ 3,720	$ 4,981

The following is the change in our reserve for slow-moving and obsolete items:

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	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Balance at beginning of period	$ 4,994	$ 5,950
New provision	223	1,315
Sales of previously reserved inventory	(510)	(655)
Net provision (benefit) for obsolete inventory	(287)	660
Final scrap of previously reserved inventory	(1,257)	(1,084)
Balance at end of period	$ 3,450	$ 5,526

Based upon our forecast and backlog, we do not currently expect to be able to sell or otherwise use the reserved inventory we have on hand at June 30, 2009. However, it is possible that a customer will decide in the future to purchase a portion of the reserved inventory. It is not possible for us to predict if or when this may happen, or how much we may sell. If such sales occur, we do not expect that they will have a material effect on gross profit margin.

Property and Equipment, Net

Property and equipment consists of the following:

	June 30, 2009	December 31, 2008
Gross carrying amount	$ 16,815	$ 20,227
Less: accumulated depreciation and amortization	(11,745)	(15,040)
Property and equipment, net	$ 5,070	$ 5,187

Acquired Intangible Assets, Net

Acquired intangible assets consist of the following developed technology:

	June 30, 2009	December 31, 2008
Gross carrying amount	$ 19,170	$ 19,170
Less: accumulated amortization	(16,974)	(15,784)
Acquired intangible assets, net	$ 2,196	$ 3,386

Estimated future amortization of acquired intangible assets is $1,146 for the six months ending December 31, 2009 and $1,050 for the year ending December 31, 2010.

Accrued Liabilities and Current Portion of Long-Term Liabilities

Accrued liabilities and current portion of long-term liabilities consist of the following:

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	June 30, 2009	December 31, 2008
Current portion of accrued liabilities for asset financings	$ 2,155	$ 1,116
Accrued payroll and related liabilities	2,010	3,749
Accrued commissions and royalties	661	728
Reserve for warranty returns	468	593
Accrued interest payable	194	236
Accrued costs related to restructuring	167	940
Reserve for sales returns and allowances	100	100
Other	1,703	1,957
	$ 7,458	$ 9,419

The following is the change in our reserves for warranty returns and sales returns and allowances:

	Six Months Ended June 30,	
	2009	2008
Reserve for warranty returns:		
Balance at beginning of period	$ 593	$ 932
Provision (benefit)	271	(54)
Charge offs	(396)	(152)
Balance at end of period	$ 468	$ 726
Reserve for sales returns and allowances:		
Balance at beginning of period	$ 100	$ 175
Provision	44	14
Charge offs	(44)	(14)
Balance at end of period	$ 100	$ 175

Long-Term Liabilities, Net of Current Portion

Long-term liabilities, net of current portion, consist of the following:

	June 30, 2009	December 31, 2008
Accrued liabilities for asset financings	$ 1,011	$ 699
Deferred rent	556	617
Accrued costs related to restructuring	181	262
Payroll and related liabilities	179	182
Other	66	275
	$ 1,993	$ 2,035

Long-Term Debt

In 2004, we issued $150,000 of 1.75% convertible subordinated debentures (the debentures) due 2024. In February 2006, we repurchased and retired $10,000 of the debentures. In February 2008, we repurchased and retired $50,248 of the debentures for $37,939 in cash. We recognized a net gain of $11,557 on the repurchase, which included a $13,064 discount, offset by legal and professional fees of $755 and a write-off of debt issuance costs of $752. In August 2008, we repurchased and retired $29,118 of the debentures for $20,615 in cash. We recognized a net gain of $8,113 on the repurchase, which included an $8,503 discount, offset by a write-off of debt issuance costs of $390. In February 2009, we repurchased and retired $27,090 of the debentures for $17,778 in cash. We recognized a net gain on the repurchase of $9,024, which included a $9,346 discount, offset by a write-off of debt issuance costs of $288 and other fees of $34. In May 2009, we repurchased and retired $17,765 of the debentures for $13,754 in cash. We recognized a net gain of $3,836 on the repurchase, which included a $4,011 discount, offset by a write-off of debt issuance costs of $175. Gains on the repurchase of our long-term debt are included in other income in our statement of operations. As of June 30, 2009, $15,779 of the debentures are outstanding.

The remaining debentures are convertible, under certain circumstances, into our common stock at a conversion rate of 13.6876 shares of common stock per $1 principal amount of debentures for a total of 215,977 shares. This is equivalent to a conversion price of approximately $73.06 per share. The debentures are convertible if (a) our stock trades above 130% of the conversion price for 20 out of 30 consecutive trading days during any calendar quarter, (b) the debentures trade at an amount less than or equal to 98% of the if-converted value of the debentures for five consecutive trading days, (c) a call for redemption occurs, or (d) in the event of certain other specified corporate transactions. If our debentures are converted into common stock, they can not be settled in cash or other assets.

We may redeem some or all of the debentures for cash on or after May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest. The holders of the debentures have the right to require us to purchase all or a portion of the $15,779 debentures outstanding at each of the following dates: May 15, 2011, May 15, 2014, and May 15, 2019, at a purchase price equal to 100% of the principal amount plus accrued and unpaid interest. The debentures are unsecured obligations and are subordinated in right of payment to all of our existing and future senior debt.

Shareholders Equity

The Board of Directors has authorized the repurchase of up to $10,000 of the Company s common stock under a share repurchase program that extends through September 2009. The program does not obligate the Company to acquire any particular amount of common stock and may be modified or suspended at any time at the Company s discretion. Share repurchases under the program may be made through open

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market and privately negotiated transactions at the Company s discretion, subject to market conditions and other factors. We repurchased 228,600 shares for $167 in the first quarter of 2009 and no shares during the second quarter of 2009. As of June 30, 2009, $2,937 remained available for repurchase under the plan.

NOTE 3: MARKETABLE SECURITIES AND FAIR VALUE MEASUREMENTS

At June 30, 2009 and December 31, 2008, all of our marketable securities are classified as available-for-sale in accordance with SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities* and consist of the following:

	Cost	Unrealized Gain	Fair Value
Short-term marketable securities:			
As of June 30, 2009:			
US government agencies debt securities	$ 3,460	$ 34	$ 3,494
Commercial paper	2,398		2,398
Corporate debt securities	952	4	956
	$ 6,810	$ 38	$ 6,848
As of December 31, 2008:			
US government agencies debt securities	$ 3,487	$ 105	$ 3,592
Commercial paper	3,486	2	3,488
Corporate debt securities	960	18	978
	$ 7,933	$ 125	$ 8,058

	Cost	Unrealized Gain	Fair Value
Long-term marketable securities:			
As of June 30, 2009:			
Equity security	$2,110	$ 440	$2,550
As of December 31, 2008:			
Equity security	$2,110	$	$2,110

Unrealized holding gains and losses are recorded in accumulated other comprehensive income, a component of shareholders equity, in the condensed consolidated balance sheets.

On March 31, 2008 we analyzed our long-term equity security for other-than-temporary impairment in accordance with FSP 115-1/124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. After reviewing the investment s rapid decline in value from December 31, 2007 to March 31, 2008, the extended duration of time which the fair value of the investment had been below our cost, as well as decreased target price estimates, analyst downgrades and macroeconomic factors, we determined that we would not recover the cost basis of the investment. Accordingly, we recognized an other-than-temporary impairment loss of $6,490 in the first quarter of 2008, which decreased our cost basis from $10,000 to $3,510. As of December 31, 2008 the value of this

investment had decreased to $2,110. Based on the same factors considered in our March 31, 2008 analysis, we determined that we would not recover the $3,510 cost basis of the investment and recorded a second other-than-temporary impairment loss of $1,400 in the fourth quarter of 2008. Both other-than-temporary impairments were recorded in our statement of operations.

Fair Value Measurements

SFAS 157 defines fair value and describes three levels of inputs that may be used to measure fair value:

Level 1: Valuations based on quoted prices in active markets for identical assets and liabilities.

Level 2: Valuations based on observable inputs other than quoted prices in active markets for identical assets and liabilities.

Level 3: Valuations based on unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions.

The table below presents information about the financial assets that we measure at fair value in our consolidated balance sheet at June 30, 2009:

	Level 1	Level 2	Level 3	Total
Cash equivalents	$ 17,862	$	$	$ 17,862
Short-term marketable securities		6,848		6,848
Long-term marketable securities	2,550			2,550
Total	$ 20,412	$ 6,848	$	$ 27,260

Level 1 financial assets include money market funds and a long-term equity security. Level two financial assets include commercial paper, corporate debt securities and U.S. government agencies debt securities.

As of June 30, 2009, the fair value of our long-term debt is $12,327, based on the most recent sale of our debt in May 2009. The carrying value of our long-term debt at June 30, 2009 is $15,779.

NOTE 4: RESTRUCTURING PLANS

In December 2008, we initiated a restructuring plan to reduce our operating expenses in response to decreases in current and forecasted revenue which resulted primarily from the global economic crisis. This plan reduced operations, research and development and administrative headcount in our San Jose, Taiwan and China offices and was completed during the current quarter.

In November 2006, we initiated a restructuring plan to reduce operating expenses. This plan included consolidation of our operations in order to reduce compensation and rent expense. As part of this plan we closed our offices in Toronto, Beijing and Shenzhen. Additionally, we eliminated all operations and research and development activities at our Oregon location and transferred them to our offices in San Jose, Shanghai and Hsin Chu. The consolidation and closure of these offices and reduction in headcount resulted in charges for non-cancelable leases and termination and retention benefits for effected employees. In connection with this restructuring we also narrowed and redefined our product development strategy which resulted in the write-off of intellectual property assets, tooling, software development tools and charges for related non-cancelable contracts. This plan was completed in the fourth quarter of 2008.

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Total restructuring expenses related to these plans were as follows:

	Six Months Ended June 30, 2009	Cumulative Amount Incurred To June 30, 2009
Cost of revenue restructuring:		
Termination and retention benefits	$ 43	$ 353
Net write-off of assets and reversal of related liabilities		2,072
	43	2,425
Operating expenses restructuring:		
Termination and retention benefits	75	7,780
Consolidation of leased space	26	2,058
Net write-off of assets and reversal of related liabilities		13,224
Contract termination fee		1,693
Payments, non-cancelable contract		827
Other		88
	101	25,670
Total restructuring expense	$ 144	$ 28,095

Accrued expenses related to the restructuring plans are included in current and non-current accrued liabilities in the consolidated balance sheets. The following is a summary of the change in accrued liabilities related to our restructuring plans:

	December 31, 2008	Expensed	Payments	June 30, 2009
Termination and retention benefits	$ 737	$ 118	$ (827)	$ 28
Lease termination costs	465	26	(171)	320
Total	$ 1,202	$ 144	$ (998)	$ 348

The remaining liability for lease termination costs was accrued under the November 2006 plan and will be paid in cash over the remaining lease terms. Lease termination costs recorded in the first half of 2009 were due to adjustments of accruals previously made under the November 2006 Plan.

NOTE 5: INCOME TAXES

The provision for income taxes recorded for the second quarter of 2009 and 2008 included current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. The benefit for income taxes recorded for the first half of 2009 was primarily due to a benefit of $1,815 recorded in the first quarter of 2009 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. The benefit for income taxes recorded for the first half of 2008 was primarily due to

benefits recorded in the first quarter of 2008 of $1,000 for refundable research and experimentation credits, $559 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, and a deferred tax benefit of $446 which resulted from an increase in the tax rate of a single foreign jurisdiction. These benefits were partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions.

As of June 30, 2009, we continued to provide a full valuation allowance against essentially all of our U.S. and Canadian net deferred tax assets as we do not believe that it is more likely than not that we will realize a benefit from those assets. We have not recorded a valuation allowance against our other foreign net deferred tax assets as we believe that it is more likely than not that we will realize a benefit from those assets.

As of June 30, 2009 and December 31, 2008, the amount of our uncertain tax positions was a liability of $9,040 and $10,581, respectively. A number of years may elapse before an uncertain tax position is resolved by settlement or statute of limitations. Settlement of any particular position could require the use of cash. If the uncertain tax positions we have accrued for are sustained by the taxing authorities in our favor, the reduction of the liability will reduce our effective tax rate. We reasonably expect reductions in the liability for uncertain tax positions of approximately $5,283 within the next twelve months due to the expiration of statutes of limitations in foreign jurisdictions. We recognize interest and penalties related to uncertain tax positions in income tax expense in our consolidated statement of operations.

NOTE 6: COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	**2008**	**2009**	**2008**
Net income (loss)	$ 2,219	$ (1,250)	$ 8,116	$ 4,883
Reclassification adjustment from accumulated other comprehensive income for other-than-temporary loss on marketable security included in net income				4,810
Unrealized gain (loss) on available-for-sale investments	591	(729)	353	(547)
Total comprehensive income (loss)	$ 2,810	$ (1,979)	$ 8,469	$ 9,146

NOTE 7: EARNINGS PER SHARE

We calculate earnings per share in accordance with SFAS 128, *Earnings per Share*. Basic earnings per share amounts are computed based on the weighted average number of common shares outstanding and reflect our June 4, 2008 one-for three reverse stock split in all periods presented.

Diluted weighted average shares outstanding includes the increased number of common shares that would be outstanding assuming the exercise of certain outstanding stock options, when such exercise would have the effect of reducing earnings per share, and the conversion of our debentures, using the if-converted method, when such conversion would be dilutive.

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The following schedule reconciles the computation of basic net income per share and diluted net income per share (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Net income (loss)	$ 2,219	$ (1,250)	$ 8,116	$ 4,883
Basic weighted average shares outstanding	13,291	14,577	13,321	14,753
Dilutive effect of stock options and awards	184		23	13
Diluted weighted average shares outstanding	13,475	14,577	13,344	14,766
Net income (loss) per common share basic	$ 0.17	$ (0.09)	$ 0.61	$ 0.33
Net income (loss) per common share diluted	$ 0.16	$ (0.09)	$ 0.61	$ 0.33

The following weighted average shares were excluded from the calculation of diluted weighted average shares outstanding as their effect on net income would have been anti-dilutive (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Stock options	1,541	1,816	2,179	1,716
Conversion of debentures	331	1,228	499	1,467

NOTE 8: SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental disclosure of cash flow information is as follows:

	Six Months Ended June 30,	
	2009	2008
Cash paid during the period for:		
Interest	$ 438	$1,121
Income taxes	191	238
Non-cash investing and financing activities:		
Acquisitions of property and equipment and other assets under extended payment terms	$2,078	$1,056

NOTE 9: SEGMENT INFORMATION

In accordance with SFAS 131, *Disclosures about Segments of an Enterprise and Related Information*, we have identified a single operating segment: the design and development of integrated circuits for use in electronic display devices. A majority of our assets are located in the U.S.

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Geographic Information

Revenue by geographic region, attributed to countries based on the domicile of the customer, was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Japan	$ 8,107	$ 12,241	$ 12,654	$ 26,246
Taiwan	3,517	2,171	5,563	4,064
Korea	675	2,006	1,764	3,609
China	572	390	876	1,110
Europe	535	1,965	1,635	4,342
U.S.	359	887	1,004	1,855
Other	448	1,133	1,497	3,543
	$ 14,213	$ 20,793	$ 24,993	$ 44,769

Significant Customers

The percentage of revenue attributable to our distributors, top five end customers, and individual distributors or end customers that represented more than 10% of revenue in at least one of the periods presented, is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Distributors:				
All distributors	51%	47%	50%	50%
Distributor A	38%	29%	34%	29%
End Customers: (1)				
Top five end customers	62%	54%	53%	55%
End customer A	19%	26%	16%	27%
End customer B	12%	0%	12%	0%
End customer C	12%	9%	11%	9%
End customer D	11%	6%	8%	7%

(1) End customers include customers who purchase directly from us, as well as customers who purchase our products indirectly through distributors and manufacturers representatives.

The following accounts represented 10% or more of gross accounts receivable in at least one of the periods presented:

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	June 30, 2009	December 31, 2008
Account A	28%	32%
Account B	23%	20%
Account C	16%	0%
Account D	0%	15%

NOTE 10: RISKS AND UNCERTAINTIES

Concentration of Suppliers

We do not own or operate a semiconductor fabrication facility and do not have the resources to manufacture our products internally. We rely on three third-party foundries to produce all of our wafers and three assembly and test vendors for completion of finished products. We do not have any long-term agreements with any of these suppliers. In light of these dependencies, it is reasonably possible that failure to perform by one of these suppliers could have a severe impact on our results of operations.

Risk of Technological Change

The markets in which we compete, or seek to compete, are subject to rapid technological change, frequent new product introductions, changing customer requirements for new products and features and evolving industry standards. The introduction of new technologies and the emergence of new industry standards could render our products less desirable or obsolete, which could harm our business.

Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist of cash equivalents, short- and long-term marketable securities and accounts receivable. We limit our exposure to credit risk associated with cash equivalent and marketable security balances by placing our funds in various high-quality securities and limiting concentrations of issuers and maturity dates. We limit our exposure to credit risk associated with accounts receivable by carefully evaluating creditworthiness before offering terms to customers.

NOTE 11: COMMITMENTS AND CONTINGENCIES

Indemnifications

Certain of our agreements include limited indemnification provisions for claims from third-parties relating to our intellectual property. Such indemnification provisions are accounted for in accordance with FASB Summary of Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others-an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No.34*. The indemnification is limited to the amount paid by the customer. As of June 30, 2009, we have not incurred any material liabilities arising from these indemnification obligations. However, in the future such obligations could immediately impact our results of operations but are not expected to materially affect our business.

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Legal Proceedings

We are subject to legal matters that arise from time to time in the ordinary course of our business. Although we currently believe that resolving such matters, individually or in the aggregate, will not have a material adverse effect on our financial position, our results of operations, or our cash flows, these matters are subject to inherent uncertainties and our view of these matters may change in the future.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Forward-looking Statements

This Management s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that are based on current expectations, estimates, beliefs, assumptions and projections about our business. Words such as expects, anticipates, intends, plans, believes, seeks, estimates and varia words and similar expressions are intended to identify such forward-looking statements. Such forward-looking statements include the disclosure contained under the caption Results of Operations Business Outlook below. These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict and which may cause actual outcomes and results to differ materially from what is expressed or forecasted in such forward-looking statements. A detailed discussion of risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in Part II, Item 1A of this Quarterly Report on Form 10-Q. These forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q. If we do update or correct one or more forward-looking statements, you should not conclude that we will make additional updates or corrections with respect thereto or with respect to other forward-looking statements. Except where the context otherwise requires, in this Quarterly Report on Form 10-Q, the Company, Pixelworks, we, us and our refer to Pixelworks, Inc., an Oregon corporation, and, where appropriate, subsidiaries.

Overview

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications. Our solutions enable manufacturers of digital display and projection devices, such as large-screen liquid crystal displays and digital front projectors, to differentiate their products with a consistently high level of video quality, regardless of the content s source or format. Our core technology leverages unique proprietary techniques for intelligently processing video signals from a variety of sources to ensure that all resulting images are optimized. Additionally, our products help our customers reduce costs and differentiate their display and projection devices, an important factor in industries that experience rapid innovation. Pixelworks flexible design architecture enables our technology to produce outstanding image quality in our customers display and projection products with a range of integrated circuit and software solutions. We were founded in 1997 and are incorporated under the laws of the state of Oregon.

Factors Affecting Results of Operations and Financial Condition

General Market Conditions

Economic conditions in the United States and in foreign markets in which we operate substantially affect our sales and profitability. Economic activity in the United States and throughout much of the world has undergone a sudden, sharp downturn. Global credit and capital markets have experienced unprecedented volatility and disruption and business credit and liquidity have tightened in much of the world. Some of

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our suppliers and customers may face credit issues and could experience cash flow problems and other financial hardships. Consumer confidence and spending are down significantly and we expect weaker demand from our customers to persist throughout 2009. Although we have taken steps to reduce our costs in response to these changes, including the restructuring efforts described below and temporary salary reductions for all employees, these economic conditions have, and are expected to continue to, adversely impact our business, results of operations and financial position and we are unable to forecast when or if these conditions will improve.

Results of Operations

Revenue, net

Revenue, net was as follows (dollars in thousands):

	Three months ended June 30,			Six months ended June 30,		
	2009	**2008**	**% change**	**2009**	**2008**	**% change**
Revenue, net	$14,213	$20,793	(32)%	$24,993	$44,769	(44)%

Net revenue decreased $6.6 million, or 32%, from the second quarter of 2008 to the second quarter of 2009. The decrease was attributable to a 37% decrease in units sold, partially offset by a 9% increase in average selling price. Net revenue decreased $19.8 million, or 44%, from the first half of 2008 to the first half of 2009. The decrease was attributable to a 48% decrease in units sold, partially offset by a 12% increase in average selling price.

The decrease in revenue during the 2009 periods resulted primarily from weakened demand for our products which we believe to be the result of the worldwide economic recession, which our customers responded to by significantly decreasing their inventory levels as end customer demand dropped sharply. Although we experienced some recovery in revenue levels in the second quarter of 2009 as compared to the first quarter of 2009, primarily due to increased sales of our projector image processors to our Japanese customers, current economic and market volatility impedes our ability to determine if, and to what extent, the current trends will continue throughout 2009 and beyond.

Decreased revenue in the 2009 periods also resulted from:

- Lower sales of our integrated circuits (ICs) into the advanced television market, as we continue to move away from the commoditized system-on-chip (SoC) segment of the market with our Motion Estimation Motion Compensation (MEMC) co-processor ICs, which improve the performance and viewing experience of large advanced LCD panels by reducing motion blur and judder; and
- Lower sales of legacy products that we acquired in conjunction with the Equator acquisition.

These decreases were partially offset by an increase in sales of our MEMC co-processor ICs and sales of our next generation projector image processors, which together comprised 20% and 21% of total revenue in the second quarter and first half of 2009, respectively, up from zero percent in the second quarter and first half of 2008.

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Cost of revenue and gross profit

Cost of revenue and gross profit were as follows (dollars in thousands):

	Three months ended June 30,			
	2009	% of revenue	2008	% of revenue
Direct product costs and related overhead [1]	$ 6,945	49%	$ 9,590	46%
Amortization of acquired intangible assets	573	4	705	3
Net benefit for obsolete inventory	(127)	(1)	(20)	(0)
Other cost of revenue [2]	49	0	20	0
Total cost of revenue	$ 7,440	52%	$ 10,295	50%
Gross profit	$ 6,773	48%	$ 10,498	50%

	Six months ended June 30,			
	2009	% of revenue	2008	% of revenue
Direct product costs and related overhead [1]	$ 12,990	52%	$ 20,492	46%
Amortization of acquired intangible assets	1,190	5	1,410	3
Net provision (benefit) for obsolete inventory	(287)	(1)	660	1
Other cost of revenue [2]	171	1	38	0
Total cost of revenue	$ 14,064	56%	$ 22,600	50%
Gross profit	$ 10,929	44%	$ 22,169	50%

[1] Includes purchased materials, assembly, test, labor, employee benefits, warranty expense and royalties.

[2] Includes stock based compensation, restructuring and additional amortization of non-cancelable prepaid royalty.

Cost of revenue increased to 52% of total revenue in the second quarter of 2009, up from 50% of total revenue in the second quarter of 2008. Cost of revenue increased to 56% of total revenue in the first half of 2009, up from 50% of total revenue in the first half of 2008. The increase in the 2009 periods resulted primarily from both an increase in direct product costs due to changes in the mix of products sold and the impact from lower overhead cost absorption due to decreased revenue without corresponding reductions in our fixed costs. We expect that any future increases in sales of our MEMC products and next generation projector processors may decrease our gross margin as a percentage of sales, however these decreases may be partially offset by production efficiencies as we improve our manufacturing processes. The net benefit for obsolete inventory in the second quarter and first half of 2009 is due to sales of previously reserved inventory in excess of new provisions for obsolete inventory, and is attributable to our increased focus on inventory management.

Research and development

Research and development expense includes compensation and related costs for personnel, development-related expenses including non-recurring engineering and fees for outside services, depreciation and amortization, expensed equipment, facilities and information technology expense allocations and travel and related expenses.

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Research and development expense for the three month periods ended June 30, 2009 and 2008, was as follows (dollars in thousands):

	Three months ended June 30,		2009 v 2008	
	2009	2008	$ change	% change
Research and development	$ 4,532	$ 7,193	$ (2,661)	(37)%

Research and development expense decreased $2.7 million, or 37%, from the second quarter of 2008 to the second quarter of 2009. This decrease is directly attributable to the restructuring efforts that we initiated in November of 2006 and continued to implement throughout 2007 and 2008. These efforts were primarily responsible for the following reductions in research and development expenses:

Depreciation and amortization expense and software maintenance expense decreased $950,000. This decrease resulted from reduced levels of engineering software tools due to reductions in research and development personnel and changes in product development strategy.

Compensation expense decreased $674,000. At June 30, 2009, we had 129 research and development employees compared to 137 at June 30, 2008.

Stock-based compensation expense decreased $341,000 due to personnel reductions and reduced valuation of our stock options.

Research and development expense for the six month periods ended June 30, 2009 and 2008, was as follows (dollars in thousands):

	Six months ended June 30,		2009 v 2008	
	2009	2008	$ change	% change
Research and development	$ 9,308	$ 13,915	$ (4,607)	(33)%

Research and development expense decreased $4.6 million, or 33%, from the first half of 2008 to the first half of 2009. This decrease is directly attributable to the restructuring efforts that we initiated in November of 2006 and continued to implement throughout 2007 and 2008. These efforts were primarily responsible for the following reductions in research and development expenses:

Depreciation and amortization expense, software maintenance expense and expensed equipment and software decreased $1.8 million. This decrease resulted from reduced levels of engineering software tools due to reductions in research and development personnel and changes in product development strategy.

Compensation expense decreased $1.1 million. At June 30, 2009, we had 129 research and development employees compared to 137 at June 30, 2008.

Stock-based compensation expense decreased $672,000 due to personnel reductions and reduced valuation of our stock options.

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Selling, general and administrative

Selling, general and administrative expense includes compensation and related costs for personnel, sales commissions, allocations for facilities and information technology expenses, travel, outside services and other general expenses incurred in our sales, marketing, customer support, management, legal and other professional and administrative support functions.

Selling, general and administrative expense for the three month periods ended June 30, 2009 and 2008 was as follows (dollars in thousands):

	Three months ended June 30,		2009 v 2008	
	2009	2008	$ change	% change
Selling, general and administrative	$ 3,340	$ 4,491	$(1,151)	(26)%

Selling, general and administrative expense decreased $1.2 million or 26%, from the second quarter of 2008 to the second quarter of 2009. This decrease is directly attributable to the restructuring efforts that we initiated in November of 2006 and implemented throughout 2007 and 2008. These efforts were primarily responsible for the following reductions in selling, general and administrative expenses:

- Compensation expense decreased $506,000. As of June 30, 2009, we had 62 employees in selling, general and administrative functions, compared to 70 as of June 30, 2008.
- Stock-based compensation expense decreased $208,000 due to personnel reductions and reduced valuation of our stock options.
- Sales commissions decreased $155,000 primarily due to lower sales volume and a decrease in the use of third party sales representatives.

Selling, general and administrative expense for the six month periods ended June 30, 2009 and 2008 was as follows (dollars in thousands):

	Six months ended June 30,		2009 v 2008	
	2009	2008	$ change	% change
Selling, general and administrative	$ 7,213	$ 9,177	$(1,964)	(21)%

Selling, general and administrative expense decreased $2.0 million, or 21%, from the first half of 2008 to the first half of 2009. This decrease is directly attributable to the restructuring efforts that we initiated in November of 2006 and implemented throughout 2007 and 2008. These efforts were primarily responsible for the following reductions in selling, general and administrative expenses:

- Compensation expense decreased $697,000. As of June 30, 2009, we had 62 employees in selling, general and administrative functions, compared to 70 as of June 30, 2008.
- Stock-based compensation expense decreased $381,000 due to personnel reductions and reduced valuation of our stock options.

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Sales commissions decreased $329,000 primarily due to lower sales volume and a decrease in the use of third party sales representatives.

Professional fees, including accounting and legal decreased $194,000.

Restructuring

We recorded restructuring expense in cost of revenue and operating expenses. Restructuring expense was comprised of the following amounts (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2009	2008	2009	2008
Termination and retention benefits [1]	$ 41	$ (111)	$ 118	$ 356
Consolidation of leased space [2]	19	(47)	26	494
Total restructuring expenses	$ 60	$ (158)	$ 144	$ 850
Included in cost of revenue	$ (4)	$	$ 43	$
Included in operating expenses	64	(158)	101	850

[1] Termination and retention benefits related to our restructuring plans included severance and retention payments for terminated employees and retention payments for certain continuing employees.

[2] Expenses related to the consolidation of leased space included future non-cancelable rent payments due for vacated space (net of estimated sublease income) and moving expenses.

In December 2008, we initiated a restructuring plan to reduce our operating expenses in response to decreases in current and forecasted revenue which resulted primarily from the global economic crisis. This plan reduced operations, research and development and administrative headcount in our San Jose, Taiwan and China offices. This plan was completed in the second quarter of 2009.

In November 2006, we initiated a restructuring plan to reduce operating expenses. This plan included consolidation of our operations in order to reduce compensation and rent expense. As part of this plan we closed our offices in Toronto, Beijing and Shenzhen. Additionally, we eliminated all operations and research and development activities at our Oregon location and transferred them to our offices in San Jose, Shanghai and Hsin Chu. The consolidation and closure of these offices and reduction in headcount resulted in charges for non-cancelable leases and termination and retention benefits for effected employees. In connection with this restructuring we also narrowed and redefined our product development strategy which resulted in the write-off of IP assets, tooling, software development tools and charges for related non-cancelable contracts. This plan was completed in the fourth quarter of 2008.

All restructuring expenses recorded in the first half of 2008 were attributable to the November 2006 plan. All expenses for consolidation of leased space recorded in the first half of 2009 were related to the adjustment of accruals previously made under the November 2006 plan and all termination and retention expenses recorded in the first half of 2009 were attributable to the December 2008 plan.

The expected benefits from these restructuring plans are fully reflected in our business outlook for the third quarter of 2009, which is presented below.

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Interest and other income, net

Interest and other income, net consisted of the following (in thousands):

	Three months ended June 30,			Six months ended June 30,		
	2009	2008	$ change	2009	2008	$ change
Gain on repurchase of long-term debt, net [1]	$ 3,836	$	$ 3,836	$ 12,860	$ 11,557	$ 1,303
Interest expense [2]	(145)	(419)	274	(396)	(992)	596
Interest income [3]	75	553	(478)	173	1,536	(1,363)
Amortization of debt issuance costs [4]	(26)	(125)	99	(87)	(271)	184
Other-than-temporary impairment of a marketable security, net [5]					(6,490)	6,490
Other income [6]		218	(218)		218	(218)
Total interest and other income, net	$ 3,740	$ 227	$ 3,513	$ 12,550	$ 5,558	$ 6,992

[1] In February 2008, we repurchased and retired $50.2 million of our 1.75% convertible subordinated debentures for $37.9 million in cash, including legal and other professional fees of $755,000. We recognized a gain on this repurchase of $11.6 million, net of a write-off of debt issuance costs of $752,000. In February 2009, we repurchased and retired $27.1 million of our outstanding debt for $17.8 million in cash. We recognized a net gain on the repurchase of $9.0 million, which includes a $9.3 million discount, offset by a write-off

of debt issuance costs of $288,000 and other fees of $34,000. In May 2009, we repurchased and retired $17.8 million of the debentures for $13.8 million in cash. We recognized a net gain on the repurchase of $3.8 million, which included a $4.0 million discount, offset by a write-off of debt issuance costs of $175,000.

2 Interest expense primarily relates to interest payable on our long-term debt. The decrease in the first half of 2009 is due to the reduced outstanding principal balance which resulted from our February 2008, August 2008, February 2009 and May 2009 repurchases of long-term debt.

3 Interest income is earned on cash equivalents and short- and long-term marketable securities. The decrease in the first half of 2009 is due to lower balances of marketable securities which resulted from our repurchases of long-term debt as well as decreased yields.

4 The fees associated with the 2004 issuance of our long-term debt have been capitalized and are being amortized over a period of seven years. The decrease in the first half of 2009 is due to the write-offs of fees associated with the portions of our long-term debt repurchased in February 2008, August 2008, February 2009 and May 2009. The remaining amortization period is approximately two years as of June 30, 2009.

5 In the first quarter of 2008, we recognized an other-than-temporary impairment of $6.5 million on an investment in a publicly-traded equity security, due to the duration of time that the investment had been below cost, as well as decreased target price estimates, analyst downgrades and macroeconomic factors.

6 In the second quarter of 2008 we recognized a gain of $218,000 on the sale of a non-marketable equity security.

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Provision (benefit) for income taxes

The provision for income taxes recorded for the second quarter of 2009 and 2008 included current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. The benefit for income taxes recorded for the first half of 2009 was primarily due to a benefit of $1.8 million recorded in the first quarter of 2009 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. The benefit for income taxes recorded for the first half of 2008 was primarily due to benefits recorded in the first quarter of 2008 of $1.0 million for refundable research and experimentation credits, $559,000 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, and a deferred tax benefit of $446,000 which resulted from an increase in the tax rate of a single foreign jurisdiction. These benefits were partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions.

Business Outlook

On July 23, 2009, we provided an outlook for the third quarter of 2009 in our earnings release, which was furnished on a current report on Form 8-K. The outlook provided the following anticipated financial results prepared in accordance with U.S. generally accepted accounting principles:

We expect to record net loss per share in the third quarter of 2009 of $(0.06) to $(0.28), based on the following estimates:

Third quarter revenue of $15 million to $17 million.

Gross profit margin of approximately 40% to 46%.

Operating expenses of $8.5 million to $9.5 million.

Liquidity and Capital Resources

Cash and short- and long-term marketable securities

Our cash and cash equivalents and short- and long-term marketable securities were as follows (dollars in thousands):

	June 30, 2009	December 31, 2008	$ change	% change
Cash and cash equivalents	$ 18,795	$ 53,149	$ (34,354)	(65)%
Short-term marketable securities	6,848	8,058	(1,210)	(15)
Long-term marketable securities	2,550	2,110	440	21
Total cash and marketable securities	$ 28,193	$ 63,317	$ (35,124)	(55)%

Total cash and marketable securities decreased 55% from December 31, 2008 to June 30, 2009. The net decrease in the first half of 2009 resulted primarily from $31.5 million used for the repurchase of long-term debt, $2.6 million used by operating activities, $727,000 in payments on property and equipment and other asset financing and $412,000 for purchases of property and equipment and other long-term assets.

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At June 30, 2009, cash equivalents and short-term marketable securities included $17.9 million in money market funds, $2.4 million in commercial paper, $3.5 million in U.S. government agencies debt securities, and $1.0 million in corporate debt securities. At June 30, 2009, we also held a $2.6 million long-term strategic equity investment in a publicly traded corporation. All of our investments were denominated in U.S. dollars, and our portfolio did not contain direct exposure to subprime mortgages or structured vehicles that derive their value from subprime collateral.

Despite the difficult credit environment, the quality of our short-term investment portfolio remains high. Our investment policy requires that at least 25% of our portfolio matures within 90 days. Additionally, no maturities can extend beyond one year and concentrations with individual securities are limited. Investments must be rated at least A-1 / P-1 by Standard & Poor s / Moody s, and our investment policy is reviewed at least annually by our Audit Committee.

The valuations of our short-term marketable securities are affected by a variety of factors, including changes in interest rates and the actual or perceived financial stability of the issuer. However, due to the high quality of our investments and their short-term nature, there has not been, and we do not expect there to be, a significant fluctuation in the valuation of these investments. Accordingly, we do not expect a materially negative impact on our financial condition from fluctuations in the value of our short-term investments. As of June 30, 2009, we had a total unrealized gain of $38,000 on these investments.

The valuation of our long-term equity investment has fluctuated significantly, and could continue to fluctuate significantly, due to a variety of factors including changes in the global economy and changes in the actual or expected performance of the issuing company. We recorded other-than-temporary impairments related to this investment of $6.5 million and $1.4 million in the first and fourth quarter of 2008, respectively. We may record additional impairment charges in the future if we determine that further declines in value of the investment are other-than-temporary. Such an impairment would negatively impact our results of operations, but would not materially impact our financial condition.

We anticipate that our existing cash and investment balances will be adequate to fund our operating and investing needs for the next twelve months. From time to time, we may evaluate acquisitions of businesses, products or technologies that complement our business. We may also repurchase additional amounts of our long-term debt and common stock. Any further transactions, if consummated, may consume a material portion of our working capital or require the issuance of equity securities that may result in dilution to existing shareholders.

Accounts receivable, net

Accounts receivable, net decreased to $5.1 million at June 30, 2009 from $6.1 million at December 31, 2008. The average number of days sales outstanding increased to 33 days at June 30, 2009 from 29 days at December 31, 2008. The increase in days sales outstanding was primarily due to the timing of sales within the second quarter of 2009.

Inventories, net

Inventories, net decreased to $3.7 million at June 30, 2009 from $5.0 million at December 31, 2008 as a result of tightened inventory management. Inventory turnover on an annualized basis was 6.9 at June 30, 2009, relatively unchanged from 7.0 at December 31, 2008.

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Capital resources

In 2004, we issued $150.0 million of 1.75% convertible subordinated debentures (the debentures) due 2024. In 2006, we repurchased and retired $10.0 million of the debentures. In 2008 we repurchased and retired $79.4 million principal amount of the debentures for $58.5 million in cash. In the first half of 2009, we repurchased and retired $44.8 million of the debentures for $31.5 million in cash, reducing the balance of our outstanding debentures to $15.8 million.

We may redeem some or all of the debentures for cash on or after May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest. The holders of the debentures have the right to require us to purchase all or a portion of the debentures outstanding at each of the following dates: May 15, 2011, May 15, 2014, and May 15, 2019, at a purchase price equal to 100% of the principal amount plus accrued and unpaid interest. The debentures are unsecured obligations and are subordinated in right of payment to all of our existing and future senior debt.

The Board of Directors has authorized the repurchase of up to $10.0 million of the Company s common stock under a share repurchase program that extends through September 2009. The program does not obligate the Company to acquire any particular amount of common stock and may be modified or suspended at any time at the Company s discretion. Share repurchases under the program may be made through open market and privately negotiated transactions at the Company s discretion, subject to market conditions and other factors. We repurchased 228,600 shares for $167,000 in the first quarter of 2009 and no shares during the second quarter of 2009. As of June 30, 2009, $2.9 million remained available for repurchase under the plan.

Contractual Payment Obligations

Our contractual obligations for 2009 and beyond are included in our Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission on March 16, 2009. Our obligations for 2009 and beyond have not changed materially as of June 30, 2009, except for the reduction to the principal and interest amounts of long-term debt that we expect the holders of the outstanding debentures to require us to purchase in 2011, as presented above in Liquidity and Capital Resources.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have, or are reasonably likely to have, a material current or future effect on our financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Interest rate fluctuations impact the interest income that we earn on our investment portfolio and the value of our investments. Factors that could cause interest rates to fluctuate include volatility in the credit and equity markets, such as the current uncertainty in global economic conditions; changes in the monetary policies of the United States and other countries and inflation. We mitigate risks associated with such fluctuations, as well as the risk of loss of principal, by investing in high-credit quality securities and limiting concentrations of issuers and maturity dates. Derivative financial instruments are not part of our investment portfolio.

Applying a hypothetical 1% decrease in interest rates to the average balances of our interest bearing cash and investment accounts would not have a significant impact on our results of operations for the first half

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of 2009 or on our financial position as of June 30, 2009. As of June 30, 2009 a significant majority of our cash and investments are held as cash or cash equivalents with yields approaching zero and our interest income is relatively insensitive to future decreases in interest rates.

As of June 30, 2009, we had convertible subordinated debentures of $15.8 million outstanding with a fixed interest rate of 1.75%. Interest rate changes affect the fair value of the debentures, but do not affect our earnings or cash flow.

All of our sales are denominated in U.S. dollars and, as a result, we have relatively little exposure to foreign currency exchange risk with respect to our sales. We have employees located in offices in Japan, Taiwan and the People s Republic of China and as such, a portion of our operating expenses as well as foreign income taxes payable are denominated in foreign currencies. Accordingly, our operating results are affected by changes in the exchange rate between the U.S. dollar and those currencies. Any future strengthening of those currencies against the U.S. dollar could negatively impact our operating results by increasing our operating expenses as measured in U.S. dollars. We cannot reasonably estimate the effect that an immediate change in foreign currency exchange rates would have on our operating results or cash flows. Currently, we do not hedge against foreign currency rate fluctuations.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Based on management s evaluation (with the participation of our Chief Executive Officer (CEO) and Chief Financial Officer (CFO)), as of the end of the period covered by this report, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the Exchange Act)) are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes to our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures will prevent or detect all errors and all fraud. Disclosure controls and procedures, no matter how well designed, operated and managed, can provide only reasonable assurance that the objectives of the disclosure controls and procedures are met. Because of the inherent limitations of disclosure controls and procedures, no evaluation of such disclosure controls and procedures can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

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PART II OTHER INFORMATION

Item 1A. Risk Factors.

Investing in our shares of common stock involves a high degree of risk, and investors should carefully consider the risks described below before making an investment decision. If any of the following risks occur, the market price of our shares of common stock could decline and investors could lose all or part of their investment. Additional risks that we currently believe are immaterial may also impair our business operations. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2008, including our consolidated financial statements and related notes, and our other filings made from time to time with the Securities and Exchange Commission.

Macroeconomic Risks

The current global recession and volatility in global credit and financial markets could materially and adversely affect our business and results of operations.

Financial, commercial and consumer markets have experienced extreme disruption in the past year and there can be no assurance that there will not be further deterioration of these markets. While we do not currently require access to credit markets to finance our operations, these economic developments have adversely affected, and are likely to continue to affect, our business in a number of ways. For instance, the economic crisis has decreased, and may continue to decrease, market acceptance of, and reduce the demand for, our products and the success of our product strategy. We face an increased risk that our customers will be unable to continue their operations and it may become more difficult to collect payments from them on a timely basis, or at all. In addition, the current tightening of credit in financial markets may also adversely affect the ability of our customers to obtain financing for significant purchases and operations. This has resulted, and could continue to result, in a decrease or cancellation of orders for our products. As a result of the worldwide economic slowdown, it is extremely difficult for us and our customers to forecast future sales levels based on historical information and trends. Portions of our expenses are fixed and other expenses are tied to expected levels of sales activities. To the extent that we do not achieve our anticipated level of sales, our gross profit and net income, have, and could continue to be adversely affected until such expenses are reduced to an appropriate level. Additionally, if we are unable to reduce our costs to respond to future decreases in revenue, we may utilize more of our cash resources than we planned. Any future actions that we take to limit our usage of cash may also reduce our ability to execute on our plans and strategies, which may weaken our competitive positioning and cause us to lose market share. We are unable to predict the likely duration and severity of the current disruption in financial markets and adverse economic conditions in the U.S. and other countries.

Company Specific Risks

Our product strategy, which is targeted at markets demanding superior video and image quality, may not lead to increased revenue or gross profit in a timely manner or at all, which could materially adversely affect our results of operations.

We have adopted a product strategy that focuses on our core competencies in pixel processing and delivering high levels of video and image quality. With this strategy, we continue to make further investments in the development of our ImageProcessor architecture for the digital projector market, with particular focus on adding increased performance and functionality. For the advanced television market,

we are shifting away from our previous approach of implementing our intellectual property (IP) exclusively in system-on-chip integrated circuits (ICs), to an approach designed to improve video performance of our customers image processors through the use of our new line of Motion Estimation Motion Compensation (MEMC) co-processor ICs. This strategy is designed to address the needs of the large-screen, high-resolution, high-quality segment of the advanced television market. Additionally, we are focusing certain of our research and development efforts on new areas beyond our traditional applications, which may not result in increased revenue or gross profit.

We have designed our new strategy to help us take advantage of expected market trends. While we have secured design wins with our new products, our expectations may not be accurate and these markets may not develop or they may take longer to develop than we expect. We cannot assure you that the products we are developing to address our new strategy will adequately address the needs of our target customers, that we will be able to produce our new products at costs that enable us to price these products competitively or that our customers or potential customers will accept our products quickly enough or in sufficient volume to grow revenue and gross profit. Additionally, the current economic crisis may alter current market trends and reduce the demand for our products and the success of our product strategy. A lack of market acceptance or insufficient market acceptance would materially and adversely affect our results of operations.

We have incurred substantial indebtedness as a result of the sale of convertible debentures and may be unable to meet our future capital requirements.

As of June 30, 2009, $15.8 million of our 1.75% convertible subordinated debentures due 2024 were outstanding. Although the remaining debt obligations are due in 2024, the holders of debentures have the right to require us to purchase all or a portion of the outstanding debentures at each of the following dates: May 15, 2011, May 15, 2014 and May 15, 2019. Since the market price of our common stock is significantly below the conversion price of the debentures, the holders of our outstanding debentures are unlikely to convert the debentures into common stock in accordance with the existing terms of the debentures. Accordingly, we expect holders of the debentures to exercise their put option, requiring us to purchase all of the outstanding debentures on May 15, 2011, the earliest date allowed. Our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, some of which are beyond our control. Even if we have sufficient cash and cash equivalents to finance the repurchase of such debentures, the repurchase would likely result in cash reserves too low for us to continue our business as a going concern and could cause our customers to cease purchasing our products in favor of competitors with stronger balance sheets. Additionally, due to recent turmoil in the credit markets and the continued decline in the economy, we may not be able to refinance the debentures at terms that are as favorable as those currently contained in the debentures, or at terms that are acceptable to us at all. These debentures could materially and adversely affect our ability to obtain additional debt or equity financing for working capital, acquisitions or other purposes, limit our flexibility in planning for or reacting to changes in our business, reduce funds available for use in our operations and make us more vulnerable to industry downturns and competitive pressures.

While we believe that our current cash and marketable securities balances will be sufficient to meet our capital requirements for the next twelve months, we cannot assure you that we will be able to maintain sufficient cash and marketable security balances to refinance or pay off the convertible debentures when and if the put option is exercised. We may need, or could elect to seek, additional funding through public or private equity or debt financing, which we may not be able to obtain. If we issue equity securities, our shareholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of our common stock.

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Additionally, one of the covenants of the indenture governing the debentures could possibly be interpreted such that if we are late with any of our required filings under the Securities Exchange Act of 1934, as amended (1934 Act), and if we fail to affect a cure within 60 days, the holders of the debentures can put the debentures back to the Company, whereby the debentures become immediately due and payable. As a result of our restructuring efforts, we have fewer employees to perform day-to-day controls, processes and activities and additionally, certain functions have been transferred to new employees who are not as familiar with our procedures. These changes increase the risk that we will be unable to make timely filings in accordance with the 1934 Act. Any resulting default under our debentures would have a material adverse effect on our cash position and operating results.

We may be unable to maintain compliance with NASDAQ Marketplace Rules which could cause our common stock to be delisted from the NASDAQ Global Market, resulting in the lack of a market for our common stock, which could cause a decrease in the value of an investment in us and adversely affect our business, financial condition and results of operations.

On June 4, 2008, we effected a one-for-three reverse split of our common stock. We effected the reverse split to attempt to regain compliance with NASDAQ Marketplace Rules, particularly the minimum $1.00 per share requirement for continued inclusion on the NASDAQ Global Market. Though the per share price of our common stock increased to over $2.00 per share immediately following the reverse split, the price has fluctuated significantly and was below $1.00 as recently as May 6, 2009. We cannot guarantee that it will remain at or above $1.00 per share and if the price again drops below $1.00 per share, the stock could become subject to delisting again, and we may seek shareholder approval for an additional reverse split.

A second reverse split could produce negative effects. We could not guarantee that an additional reverse split would result in a long-term or permanent increase in the price of our common stock. The market might perceive a decision to effect an additional reverse split as a negative indicator of our future prospects, and as a result, the price of our common stock might decline after such a reverse split (perhaps by an even greater percentage than would have occurred in the absence of such a reverse split). An additional reverse split could also make it more difficult for us to meet certain other requirements for continued listing on the NASDAQ Global Market, including rules related to the minimum number of shares that must be in the public float, the minimum market value of the public float and the minimum number of round lot holders. Investors might consider the increased proportion of unissued authorized shares to issued shares to have an anti-takeover effect under certain circumstances by allowing for dilutive issuances which could prevent certain shareholders from changing the composition of the board, or could render tender offers for a combination with another entity more difficult to complete successfully. Additionally, customers, suppliers or employees might consider a company with low trading volume risky and might be less likely to transact business with us.

If our common stock is delisted, trading of the stock will most likely take place on an over-the-counter market established for unlisted securities, such as the Pink Sheets or the OTC Bulletin Board. An investor is likely to find it less convenient to sell, or to obtain accurate quotations in seeking to buy, our common stock on an over-the-counter market, and many investors may not buy or sell our common stock due to difficulty in accessing over-the-counter markets, or due to policies preventing them from trading in securities not listed on a national exchange or other reasons. In addition, as a delisted security, our common stock would be subject to SEC rules regarding penny stock, which impose additional disclosure requirements on broker-dealers. The regulations relating to penny stocks, coupled with the typically higher cost per trade to investors in penny stocks due to factors such as broker commissions generally representing a higher percentage of the price of a penny stock than of a higher priced stock, would further limit the ability and willingness of investors to trade in our common stock. For these reasons and others, delisting would adversely affect the liquidity, trading volume and price of our

common stock, causing the value of an investment in us to decrease and having an adverse effect on our business, financial condition and results of operations, including our ability to attract and retain qualified executives and employees and to raise capital.

If we do not achieve additional design wins in the future, our ability to grow will be seriously limited. Even if we achieve additional design wins in the future, we may not realize significant revenue from the design wins.

Our future success depends on developers of advanced display products designing our products into their systems. To achieve design wins, we must define and deliver cost-effective, innovative and integrated semiconductors. Once a supplier s products have been designed into a system, the developer may be reluctant to change its source of components due to the significant costs associated with qualifying a new supplier. Accordingly, it may be difficult for us to achieve additional design wins. The failure on our part to obtain additional design wins with leading branded manufacturers or integrators, and to successfully design, develop and introduce new products and product enhancements could seriously limit our ability to grow.

Additionally, achieving a design win does not necessarily mean that a developer will order large volumes of our products. A design win is not a binding commitment by a developer to purchase our products. Rather, it is a decision by a developer to use our products in the design process of that developer s products. Developers can choose at any time to discontinue using our products in their designs or product development efforts. If our products are chosen to be incorporated into a developer s products, we may still not realize significant revenue from that developer if that developer s products are not commercially successful or if that developer chooses to qualify, or incorporate the products of, a second source, and any of those circumstances might cause our revenue to decline.

Despite our restructuring efforts, we may not achieve profitability in the future and, if we do, we may not be able to sustain or increase profitability on a quarterly or annual basis. If we are not profitable in the future, we may be unable to continue our operations.

In 2006, we initiated restructuring plans aimed at returning the Company to profitability. In December 2008, we initiated an additional restructuring plan to reduce our operating expenses in response to decreases in current and forecasted revenue which resulted primarily from the global economic recession. This plan reduced operations, research and development and administrative headcount in our San Jose, Taiwan and China offices and was completed during the second quarter of 2009.

Despite our restructuring efforts, we may not achieve profitability in the future and, if we do, we may not be able to sustain or increase profitability on a quarterly or annual basis. The years ended December 31, 2004 and December 31, 2008 are our only years of profitability since inception and we may be unable to achieve profitability in future periods. Additionally, our profitability in 2008 and the first half of 2009 is the result of gains we recognized on the repurchase of a portion of our convertible subordinated debentures. We did not achieve operating profits in 2008 or the first half of 2009. If we are not profitable in the future, we may be unable to continue our operations.

If we engage in further restructuring efforts, we may be unable to successfully implement new products or enhancements to our current products, which will adversely affect our future sales and financial condition.

We expect to continue to introduce new and enhanced products, and our future sales will depend on customer acceptance of our new products and the enhancements that we may make to our current products. However, if our recent restructuring efforts are insufficient to reduce our cost structure to a

level that is commensurate with our revenue, we may be forced to make additional headcount reductions or implement additional cost saving initiatives. These actions could impact our research and development and engineering activities, which may slow our development of new or enhanced products. If we are unable to successfully introduce new or enhanced products, our sales and financial condition will be adversely affected.

A significant amount of our revenue comes from a limited number of customers and distributors. Any decrease in revenue from, or loss, of any of the customers or distributors could significantly reduce our revenue.

The display manufacturing market is highly concentrated and we are, and will continue to be, dependent on a limited number of customers and distributors for a substantial portion of our revenue. Sales to distributors represented 50%, 53% and 57% of revenue for the six month period ended June 30, 2009 and years ended December 31, 2008 and 2007, respectively. Revenue attributable to our top five end customers represented 53%, 55% and 47% of revenue for the six month period ended June 30, 2009 and years ended December 31, 2008 and 2007, respectively. A reduction, delay or cancellation of orders from one or more of our significant customers, or a decision by one or more of our significant customers to select products manufactured by a competitor or to use its own internally-developed semiconductors, would significantly impact our revenue.

The concentration of our accounts receivable with a limited number of customers exposes us to increased credit risk and could harm our operating results and cash flows.

As of June 30, 2009 and December 31, 2008 we had three customers that each represented 10% or more of accounts receivable. The concentration of our accounts receivable with a limited number of customers increases our credit risk. The failure of these customers to pay their balances, or any other customer to pay future outstanding balances, would result in an operating expense and reduce our cash flows.

Dependence on a limited number of sole-source, third-party manufacturers for our products exposes us to shortages based on capacity allocation or low manufacturing yield, errors in manufacturing, price increases with little notice, volatile inventory levels and delays in product delivery, which could result in delays in satisfying customer demand, increased costs and loss of revenue.

We contract with third-party foundries for wafer fabrication and other manufacturers for packaging, assembly and testing of our products. We do not own or operate a semiconductor fabrication facility and do not have the resources to manufacture our products internally. Our wafers are fabricated by Semiconductor Manufacturing International Corporation, Taiwan Semiconductor Manufacturing Corporation and Toshiba Corporation. The wafers used in each of our products are fabricated by only one of these manufacturers.

Sole sourcing each product increases our dependence on our suppliers. We have limited control over delivery schedules, quality assurance, manufacturing yields, potential errors in manufacturing and production costs. We do not have long-term supply contracts with our third-party manufacturers, so they are not obligated to supply us with products for any specific period of time, quantity or price, except as may be provided in a particular purchase order. From time to time, our suppliers increase prices charged to produce our products with little notice. If the prices charged by our contract manufacturers increase we may increase our prices, which could harm our competitiveness.

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Our requirements represent only a small portion of the total production capacity of our contract manufacturers, who have in the past re-allocated capacity to other customers even during periods of high demand for our products. We expect this may occur again in the future. In addition, the current tightening of credit in financial markets may affect the ability of our suppliers to maintain their production capacity and result in a reduction in their supply to us. If we are unable to obtain our products from our contract manufacturers on schedule, or at all, our ability to satisfy customer demand will be harmed, revenue from the sale of products may be lost or delayed, and we may not obtain future design wins. If orders for our products are cancelled, expected revenue would not be realized.

Our dependence on selling to distributors and integrators increases the complexity of managing our supply chain and may result in excess inventory or inventory shortages.

Selling to distributors and integrators reduces our ability to forecast sales accurately and increases the complexity of our business. Since our distributors act as intermediaries between us and the companies using our products, we must rely on our distributors to accurately report inventory levels and production forecasts. We must similarly rely on our integrators. Our integrators are original equipment manufacturers (OEMs) that build display devices based on specifications provided by branded suppliers. Selling to distributors and OEMs adds another layer between us and the ultimate source of demand for our products, the consumer. These arrangements require us to manage a complex supply chain and to monitor the financial condition and creditworthiness of our distributors, integrators and customers. They also make it more difficult for us to predict demand for our products. Our failure to manage one or more of these challenges could result in excess inventory or inventory shortages that could materially impact our operating results or limit the ability of companies using our semiconductors to deliver their products.

Because we do not have long-term commitments from our customers and plan inventory purchases based on estimates of customer demand which may be inaccurate, we contract for the manufacture of our products based on potentially inaccurate estimates.

Our sales are made on the basis of customer purchase orders rather than long-term purchase commitments. Our customers may cancel or defer purchase orders at any time but we must order wafer inventory from our subcontract manufacturers three to four months in advance. This process requires us to make numerous assumptions concerning demand, each of which may introduce error into our estimates of inventory requirements and the current financial crisis and economic downturn has made it more difficult for us and our customers to accurately forecast demand. If our customers or we overestimate demand, we may purchase components or have products manufactured that we may not be able to use or sell. As a result, we would have excess inventory, which would negatively affect our operating results. For example, we overestimated demand for certain of our products which led to significant charges for obsolete inventory in 2008 and 2007. Conversely, if our customers or we underestimate demand, or if sufficient manufacturing capacity is not available, we would forego revenue opportunities, lose market share and damage our customer relationships.

International sales account for almost all of our revenue, and if we do not successfully address the risks associated with international sales, our revenue could decrease.

Sales outside the U.S. accounted for approximately 96% of revenue for the first half of 2009, and 95% and 96% of revenue for the years ended December 31, 2008 and 2007, respectively. We anticipate that sales outside the U.S. will continue to account for a substantial portion of our revenue in future periods. In addition, customers who incorporate our products into their products sell a substantial portion of their products outside of the U.S., and all of our products are manufactured outside of the U.S. We are, therefore, subject to many international risks, including, but not limited to:

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- increased difficulties in managing international distributors and manufacturers due to varying time zones, languages and business customs;
- foreign currency exchange fluctuations in the currencies of Japan, the People s Republic of China (PRC), Taiwan or Korea;
- reduced or limited protection of our IP, particularly in software, which is more prone to design piracy;
- difficulties in collecting outstanding accounts receivable balances;
- potentially adverse tax consequences;
- difficulties regarding timing and availability of export and import licenses;
- political and economic instability, particularly in the PRC, Japan, Taiwan, or Korea;
- difficulties in maintaining sales representatives outside of the U.S. that are knowledgeable about our industry and products;
- changes in the regulatory environment in the PRC, Japan, Taiwan and Korea that may significantly impact purchases of our products by our customers;
- outbreaks of SARS, bird flu or other pandemics in the PRC or other parts of Asia; and
- increased transaction costs related to sales transactions conducted outside of the U.S., such as charges to secure letters of credit.

Our presence and investment within the People s Republic of China subjects us to risks of economic and political instability in the area, which could adversely impact our results of operations.

A substantial portion of our products are manufactured by foundries located in the PRC. In addition, a significant percentage of our employees are located in this area. Disruptions from natural disasters, health epidemics (including new outbreaks of SARS or bird flu) and political, social and economic instability may affect the region and would have a negative impact on our results of operations. In addition, the economy of the PRC differs from the economies of many countries in respects such as structure, government involvement, level of development, growth rate, capital reinvestment, allocation of resources, self-sufficiency, rate of inflation and balance of payments position, among others. In the past, the economy of the PRC has been primarily a planned economy subject to state plans. Since the entry of the PRC into the World Trade Organization in 2002, the PRC government has been reforming its economic and political systems. These reforms have resulted in significant economic growth and social change. We cannot be assured that the PRC s policies for economic reforms will be consistent or effective. Our results of operations and financial position may be harmed by changes in the PRC s political, economic or social conditions.

The concentration of our manufacturers and customers in the same geographic region increases our risk that a natural disaster, labor strike or political unrest could disrupt our operations.

Most of our current manufacturers and customers are located in the PRC, Japan, Korea or Taiwan. The risk of earthquakes in the Pacific Rim region is significant due to the proximity of major earthquake fault lines in the area. Common consequences of earthquakes include power outages and disruption or impairment of production capacity. Earthquakes, fire, flooding, power outages and other natural disasters in the Pacific Rim region, or political unrest, labor strikes or work stoppages in countries where our manufacturers and customers are located, would likely result in the disruption of our manufacturers and customers operations. Any disruption resulting from extraordinary events could cause significant delays in shipments of our products until we are able to shift our manufacturing from the affected contractor to another third-party vendor. There can be no assurance that alternative capacity could be obtained on favorable terms, or in a timely manner, if at all.

Our future success depends upon the continued services of key personnel, many of whom would be difficult to replace, and the loss of one or more of these employees could seriously harm our business by delaying product development.

We believe our success depends, in large part, upon our ability to identify, attract and retain qualified hardware and software engineers, sales, marketing, finance and managerial personnel. Competition for talented personnel is intense and we may not be able to retain our key personnel or identify, attract or retain other highly qualified personnel in the future. Because of the highly technical nature of our business, the loss of key engineering personnel could delay product introductions and significantly impair our ability to successfully create future products. If we do not succeed in hiring and retaining employees with appropriate qualifications, our product development efforts, revenue and business could be seriously harmed.

We have experienced, and may continue to experience, difficulty in hiring and retaining employees with appropriate qualifications. In the last two years a significant portion of our executive management team has turned over, including the Chief Executive Officer, Chief Financial Officer, Vice President of Sales, Vice President of Marketing, Vice President of Business Operations and Vice President, Strategy and Market Development. During 2006 and 2007, we also experienced difficulties hiring and retaining qualified engineers in our Shanghai design center.

Decreased effectiveness of share-based payment awards could adversely affect our ability to attract and retain employees, officers and directors.

We have historically used stock options and other forms of share-based payment awards as key components of our total compensation program in order to retain employees, officers and directors and to provide competitive compensation and benefit packages. In accordance with Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, (SFAS 123R), we began recording stock-based compensation expense for share-based awards in the first quarter of 2006. As a result, we have incurred and will continue to incur significant compensation costs associated with our share-based programs, making it more expensive for us to grant share-based payment awards to employees, officers and directors. To the extent that SFAS 123R makes it more expensive to grant stock options we may decide to incur cash compensation costs in the future. Actions that we take to reduce stock-based compensation expense that might be more aggressive than actions implemented by our competitors could make it difficult to attract, retain and motivate employees, officers, or directors, which could adversely affect our competitive position as well as our business and results of operations.

Failure to manage any future expansion efforts effectively could adversely affect our business and results of operations.

To manage any future expansion efforts effectively in a rapidly evolving market, we must be able to maintain and improve our operational and financial systems, train and manage our employee base and attract and retain qualified personnel with relevant experience. We must also manage multiple relationships with customers, business partners, contract manufacturers, suppliers and other third parties. We could spend substantial amounts of time and money in connection with expansion efforts for which we may not realize any profit. Our systems, procedures or controls may not be adequate to support our operations and we may not be able to expand quickly enough to exploit potential market opportunities. If we do not manage any future expansion efforts effectively, our operating expenses could increase more rapidly than our revenue, adversely affecting our financial condition and results of operations.

We may be unable to successfully integrate any future acquisition or equity investment we make, which could disrupt our business and severely harm our financial condition.

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We may not be able to successfully integrate businesses, products, technologies or personnel of any entity that we might acquire in the future, and any failure to do so could disrupt our business and seriously harm our financial condition. In addition, if we acquire any company with weak internal controls, it will take time to get the acquired company up to a level of operating effectiveness acceptable to us and to implement adequate internal control, management, financial and operating reporting systems. Our inability to address these risks could negatively affect our operating results.

To date, we have acquired Panstera, Inc. (Panstera) in January 2001, nDSP Corporation (nDSP) in January 2002, Jaldi Semiconductor Corporation (Jaldi) in September 2002 and Equator Technologies, Inc. (Equator) in June 2005. In March 2003, we announced the execution of a definitive merger agreement with Genesis Microchip, Inc.; however, the merger was terminated in August 2003, and we incurred $8.9 million of expenses related to the transaction.

The acquisitions of Panstera, nDSP, Jaldi and Equator contained a very high level of risk primarily because the decisions to acquire these companies were made based on unproven technological developments and, at the time of the acquisitions, we did not know if we would complete the unproven technologies or, if we did complete the technologies, if they would be commercially viable.

These and any future acquisitions and investments could result in any of the following negative events, among others:

- issuance of stock that dilutes current shareholders percentage ownership;
- incurrence of debt;
- assumption of liabilities;
- amortization expenses related to acquired intangible assets;
- impairment of goodwill;
- large and immediate write-offs; or
- decreases in cash and marketable securities that could otherwise serve as working capital.

Our operation of any acquired business would also involve numerous risks, including, but not limited to:

- problems combining the acquired operations, technologies or products;
- unanticipated costs;
- diversion of management s attention from our core business;
- adverse effects on existing business relationships with customers;
- risks associated with entering markets in which we have no or limited prior experience; and
- potential loss of key employees, particularly those of the acquired organizations.

Continued compliance with regulatory and accounting requirements will be challenging and will require significant resources.

We spend a significant amount of management time and external resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including evolving Securities and Exchange Commission rules and regulations, NASDAQ Global Market rules and the Sarbanes-Oxley Act of 2002 which requires management s annual review and evaluation of internal control over financial reporting. While we invest significant time and money in our effort to evaluate and test our internal control over financial reporting, there are inherent limitations to the effectiveness of any system of internal controls and procedures, including cost limitations, the possibility of human error, judgments and assumptions regarding the likelihood of future events, and the circumvention or overriding

of the controls and procedures. Accordingly, even effective controls and procedures can provide only reasonable assurance of achieving their control objectives.

Company Risks Related to the Semiconductor Industry and Our Markets

Intense competition in our markets may reduce sales of our products, reduce our market share, decrease our gross profit and result in large losses.

Rapid technological change, evolving industry standards and customer requirements, compressed product life cycles and declining average selling prices are characteristics of our market and could have a material adverse effect on our business, financial condition and results of operations. As the overall price of digital projectors and advanced flat panel displays continues to fall, we may be required to offer our products to customers at discounted prices due to increased price competition. At the same time, new alternative technologies and industry standards may emerge that directly compete with technologies we offer. We may be required to increase our investment in research and development at the same time that product prices are falling. In addition, even after making this investment, we cannot assure you that our technologies will be superior to those of our competitors or that our products will achieve market acceptance, whether for performance or price reasons. Failure to effectively respond to these trends could reduce the demand for our products.

We compete with specialized and diversified electronics and semiconductor companies that offer display processors or scaling components. Some of these include Broadcom Corporation, i-Chips Technologies Inc., Integrated Device Technology, Inc., MediaTek Inc., MStar Semiconductor, Inc., Realtek Semiconductor Corp., Renesas Technology Corp., Sigma Designs, Inc., Silicon Image, Inc., STMicroelectronics N.V., Sunplus Technology Co., Ltd., Techwell, Inc., Topro Technology Inc., Trident Microsystems, Inc., Weltrend Semiconductor, Inc., Zoran Corporation and other companies. Potential and current competitors may include diversified semiconductor manufacturers and the semiconductor divisions or affiliates of some of our customers, including Intel Corporation, LG Electronics, Inc., Matsushita Electric Industrial Co., Ltd., Mitsubishi Digital Electronics America, Inc., National Semiconductor Corporation, NEC Corporation, NVIDIA Corporation, NXP Semiconductors, Samsung Electronics Co., Ltd., SANYO Electric Co., Ltd., Seiko Epson Corporation, Sharp Electronics Corporation, Sony Corporation, Texas Instruments Incorporated and Toshiba America, Inc. In addition, start-up companies may seek to compete in our markets.

Many of our competitors have longer operating histories and greater resources to support development and marketing efforts than we do. Some of our competitors operate their own fabrication facilities. These competitors may be able to react more quickly and devote more resources to efforts that compete directly with our own. Our current or potential customers have developed, and may continue to develop, their own proprietary technologies and become our competitors. Increased competition from both competitors and our customers internal development efforts could harm our business, financial condition and results of operations by, for example, increasing pressure on our profit margin or causing us to lose sales opportunities. We cannot assure you that we can compete successfully against current or potential competitors.

Because of the complex nature of our semiconductor designs and associated manufacturing processes and the rapid evolution of our customers product designs, we may not be able to develop new products or product enhancements in a timely manner, which could decrease customer demand for our products and reduce our revenue.

The development of our semiconductors is highly complex. These complexities require us to employ advanced designs and manufacturing processes that are unproven. The result can be longer and less

predictable development cycles. Timely introduction of new or enhanced products depends on a number of other factors, including, but not limited to:

- accurate prediction of customer requirements and evolving industry standards;
- development of advanced display technologies and capabilities;
- use of advanced foundry processes and achievement of high manufacturing yields; and
- market acceptance of new products.

If we are unable to successfully develop and introduce products in a timely manner, our business and results of operations will be adversely affected. We have experienced increased development time and delays in introducing new products that have resulted in significantly less revenue than originally expected for those products. Our international structure has significantly added to the complexity of our product development efforts as we must now coordinate very complex product development programs between multiple geographically dispersed locations. Our restructuring plans have also significantly affected our product development efforts by reducing the number of personnel dedicated to product development efforts. We may not be successful in timely delivery of new products with reduced numbers of employees. Any such failure could cause us to lose customers or potential customers, which would decrease our revenue.

We may not be able to respond to the rapid technological changes in the markets in which we compete, or seek to compete, or we may not be able to comply with industry standards in the future, making our products less desirable or obsolete.

The markets in which we compete or seek to compete are subject to rapid technological change, frequent new product introductions, changing customer requirements for new products and features and evolving industry standards. The introduction of new technologies and emergence of new industry standards could render our products less desirable or obsolete, which could harm our business. Examples of changing industry standards include the growing use of broadband to deliver video content, faster screen refresh rates, the proliferation of new display devices and the drive to network display devices together. Our failure to adequately respond to such technological changes could render our products obsolete and significantly decrease our revenue.

The cyclical nature of the semiconductor industry may lead to significant variances in the demand for our products and could harm our operations.

In the past, the semiconductor industry has been characterized by significant downturns and wide fluctuations in supply and demand. Also, the industry has experienced significant fluctuations in anticipation of changes in general economic conditions, including economic conditions in Asia and North America. The current global economic crisis has caused a slowdown in the demand for our products and other semiconductor products in general, and such slowdown may continue for an extended period of time. The cyclical nature of the semiconductor industry has also led to significant variances in product demand and production capacity. We have experienced, and may continue to experience, periodic fluctuations in our future financial results because of changes in industry-wide conditions.

Because of our long product development process and sales cycles, we may incur substantial costs before we earn associated revenue and ultimately may not sell as many units of our products as we originally anticipated.

We develop products based on anticipated market and customer requirements and incur substantial product development expenditures, which can include the payment of large up-front, third-party license fees and royalties, prior to generating associated revenue. Our work under these projects is technically challenging

and places considerable demands on our limited resources, particularly on our most senior engineering talent. Because the development of our products incorporates not only our complex and evolving technology but also our customers specific requirements, a lengthy sales process is often required before potential customers begin the technical evaluation of our products. Our customers typically perform numerous tests and extensively evaluate our products before incorporating them into their systems. The time required for testing, evaluation and design of our products into a customer s system can take up to nine months or more. It can take an additional nine months or longer before a customer commences volume shipments of systems that incorporate our products. We cannot assure you that the time required for the testing, evaluation and design of our products by our customers would not be significantly longer than nine months.

Because of the lengthy development and sales cycles, we will experience delays between the time we incur expenditures for research and development, sales and marketing and inventory and the time we generate revenue, if any, from these expenditures. Additionally, if actual sales volumes for a particular product are substantially less than originally anticipated, we may experience large write-offs of capitalized license fees, software development tools, product masks, inventories or other capitalized or deferred product-related costs, or increased amortization of non-cancelable prepaid royalties, any of which would negatively affect our operating results. For example, our provisions for obsolete inventory were $1.5 million and $4.4 million for the years ended December 31, 2008 and 2007, respectively. Additionally, in 2007, we wrote-off assets with a net book value of $6.9 million due to reductions in research and development personnel and changes in product development strategy.

Our products are characterized by average selling prices that decline over relatively short periods of time, which will negatively affect our financial results unless we are able to reduce our product costs or introduce new products with higher average selling prices.

Average selling prices for our products decline over relatively short periods of time, while many of our product costs are fixed. When our average selling prices decline, our gross profit declines unless we are able to sell more units or reduce the cost to manufacture our products. Our operating results are negatively affected when revenue or gross profit declines. We have experienced declines in our average selling prices and expect that we will continue to experience them in the future, although we cannot predict when they may occur or how severe they will be. The current crisis in global credit and financial markets may result in more rapid declines in average selling prices as our competitors reduce their prices in attempts to gain market share or as our potential customers have less cash available for purchases and operations and, in some instances, exit the market. Our financial results will suffer if we are unable to offset any reductions in our average selling prices by increasing our sales volumes, reducing our costs, adding new features to our existing products or developing new or enhanced products in a timely basis with higher selling prices or gross profits.

The competitiveness and viability of our products could be harmed if necessary licenses of third-party technology are not available to us or are only available on terms that are not commercially viable.

We license technology from independent third parties that is incorporated into our products or product enhancements. Future products or product enhancements may require additional third-party licenses that may not be available to us or may not be available on terms that are commercially reasonable. In addition, in the event of a change in control of one of our licensors, it may become difficult to maintain access to its licensed technology. If we are unable to obtain or maintain any third-party license required to develop new products and product enhancements, we may have to obtain substitute technology with lower quality or performance standards, or at greater cost, either of which could seriously harm the competitiveness of our products.

Our limited ability to protect our IP and proprietary rights could harm our competitive position by allowing our competitors to access our proprietary technology and to introduce similar products.

Our ability to compete effectively with other companies will depend, in part, on our ability to maintain the proprietary nature of our technology, including our semiconductor designs and software. We provide the computer programming code for our software to customers in connection with their product development efforts, thereby increasing the risk that customers will misappropriate our proprietary software. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to help protect our proprietary technologies. As of June 30, 2009 we held 95 patents and had 55 patent applications pending for protection of our significant technologies. Competitors in both the U.S. and foreign countries, many of whom have substantially greater resources than we do, may apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell our products, or they may develop similar technology independently or design around our patents. Effective copyright, trademark and trade secret protection may be unavailable or limited in foreign countries.

We cannot assure you that the degree of protection offered by patent or trade secret laws will be sufficient. Furthermore, we cannot assure you that any patents will be issued as a result of any pending applications or that any claims allowed under issued patents will be sufficiently broad to protect our technology. In addition, it is possible that existing or future patents may be challenged, invalidated or circumvented.

Others may bring infringement actions against us that could be time consuming and expensive to defend.

We may become subject to claims involving patents or other IP rights. IP claims could subject us to significant liability for damages and invalidate our proprietary rights. In addition, IP claims may be brought against customers that incorporate our products in the design of their own products. These claims, regardless of their success or merit and regardless of whether we are named as defendants in a lawsuit, would likely be time consuming and expensive to resolve and would divert the time and attention of management and technical personnel. Any IP litigation or claims also could force us to do one or more of the following:

- stop selling products using technology that contains the allegedly infringing IP;
- attempt to obtain a license to the relevant IP, which may not be available on reasonable terms or at all;
- attempt to redesign those products that contain the allegedly infringing IP; or
- pay damages for past infringement claims that are determined to be valid or which are arrived at in settlement of such litigation or threatened litigation.

If we are forced to take any of the foregoing actions, we may incur significant additional costs or be unable to manufacture and sell our products, which could seriously harm our business. In addition, we may not be able to develop, license or acquire non-infringing technology under reasonable terms. These developments could result in an inability to compete for customers or otherwise adversely affect our results of operations.

If we have to qualify a new foundry or packaging, assembly and testing supplier for any of our products, we may experience delays that result in lost revenue and damaged customer relationships.

Our products require manufacturing with state-of-the-art fabrication equipment and techniques. The lead-time needed to establish a relationship with a new contract manufacturer is at least nine months, and the estimated time for us to adapt a product s design to a particular contract manufacturer s process is at least four months. If we have to qualify a new foundry or packaging, assembly and testing supplier for any of our

products, we could incur significant delays in shipping products, which may result in lost revenue and damaged customer relationships.

Manufacturers of our semiconductor products periodically discontinue older manufacturing processes, which could make our products unavailable from our current suppliers.

Semiconductor manufacturing technologies change rapidly and manufacturers typically discontinue older manufacturing processes in favor of newer ones. For instance, a portion of our products use embedded dynamic random access memory, (DRAM) technology, which requires manufacturing processes that are being phased out. We also utilize 0.18um, 0.15um and 0.13um standard logic processes, which may only be available for the next five to seven years. Once a manufacturer makes the decision to retire a manufacturing process, notice is generally given to its customers. Customers will then either retire the affected part or develop a new version of the part that can be manufactured with a newer process. In the event that a manufacturing process is discontinued, our current suppliers may be unwilling or unable to manufacture our current products. Additionally, migrating to a new, more advanced process requires significant expenditures for research and development and takes significant time. We cannot assure you that we will be able to place last time buy orders in the future or that we will find alternate manufacturers of our products.

We are dependent on our foundries to implement complex semiconductor technologies and our operations could be adversely affected if those technologies are unavailable, delayed or inefficiently implemented.

In order to increase performance and functionality and reduce the size of our products, we are continuously developing new products using advanced technologies that further miniaturize semiconductors. However, we are dependent on our foundries to develop and provide access to the advanced processes that enable such miniaturization. We cannot be certain that future advanced manufacturing processes will be implemented without difficulties, delays or increased expenses. Our business, financial condition and results of operations could be materially adversely affected if advanced manufacturing processes are unavailable to us, substantially delayed or inefficiently implemented.

Our highly integrated products and high-speed mixed signal products are difficult to manufacture without defects and the existence of defects could result in increased costs, delays in the availability of our products, reduced sales of products or claims against us.

The manufacture of semiconductors is a complex process and it is often difficult for semiconductor foundries to produce semiconductors free of defects. Because many of our products are more highly integrated than other semiconductors and incorporate mixed analog and digital signal processing and embedded memory technology, they are even more difficult to produce without defects. Defective products can be caused by design or manufacturing difficulties. Therefore, identifying quality problems can occur only by analyzing and testing our semiconductors in a system after they have been manufactured. The difficulty in identifying defects is compounded because the process technology is unique to each of the multiple semiconductor foundries we contract with to manufacture our products. Despite testing by both our customers and us, errors or performance problems may be found in existing or new semiconductors. Failure to achieve defect-free products may result in increased costs and delays in the availability of our products. Additionally, customers could seek damages from us for their losses and shipments of defective products may harm our reputation with our customers.

We have experienced field failures of our semiconductors in certain customer system applications that required us to institute additional testing. As a result of these field failures, we incurred warranty costs due to customers returning potentially affected products. Our customers have also experienced delays in

receiving product shipments from us that resulted in the loss of revenue and profits. Shipments of defective products could cause us to lose customers or to incur significant replacement costs, either of which would harm our business.

We use a customer owned tooling process for manufacturing most of our products which exposes us to the possibility of poor yields and unacceptably high product costs.

We are building most of our products on a customer owned tooling basis, also known in the semiconductor industry as COT, where we directly contract the manufacture of wafers and assume the responsibility for the assembly and testing of our products. As a result, we are subject to increased risks arising from wafer manufacturing yields and risks associated with coordination of the manufacturing, assembly and testing process. Poor product yields result in higher product costs, which could make our products less competitive if we increase our prices to compensate for our higher costs, or could result in lower gross profit margins if we do not increase our prices.

Shortages of materials used in the manufacturing of our products may increase our costs or limit our revenue and impair our ability to ship our products on time.

From time to time, shortages of materials that are used in our products may occur. In particular, we may experience shortages of semiconductor wafers and packages. If material shortages occur, we may incur additional costs or be unable to ship our products to our customers in a timely fashion, both of which could harm our business and adversely affect our results of operations.

Shortages of other key components for our customers products could delay our ability to sell our products.

Shortages of components and other materials that are critical to the design and manufacture of our customers products could limit our sales. These components include display components, analog-to-digital converters, digital receivers and video decoders.

Integration of software with our products adds complexity and cost that may affect our ability to achieve design wins and may affect our profitability.

The integration of software with our products adds complexity, may extend our internal development programs and could impact our customers development schedules. This complexity requires increased coordination between hardware and software development schedules and may increase our operating expenses without a corresponding increase in product revenue. This additional level of complexity lengthens the sales cycle and may result in customers selecting competitive products requiring less software integration.

Our software development tools may be incompatible with industry standards and challenging to implement, which could slow product development or cause us to lose customers and design wins.

We provide software development tools to help customers evaluate our products and bring them into production. Software development is a complex process and we are dependent on software development languages and operating systems from vendors that may compromise our ability to design software in a timely manner. Also, as software tools and interfaces change rapidly, new software languages introduced to the market may be incompatible with our existing systems and tools. New software development languages may not be compatible with our own, requiring significant engineering efforts to migrate our existing systems in order to be compatible with those new languages. Existing or new software development tools

could make our current products obsolete or hard to use. Software development disruptions could slow our product development or cause us to lose customers and design wins.

If products incorporating our semiconductors are not compatible with computer display protocols, video standards and other devices, the market for our products will be reduced and our business prospects could be significantly limited.

Our products are incorporated into our customers products, which have different parts and specifications and utilize multiple protocols that allow them to be compatible with specific computers, video standards and other devices. If our customers products are not compatible with these protocols and standards, consumers will return, or not purchase, these products and the markets for our customers products could be significantly reduced. As a result, a portion of our market would be eliminated, and our business would be harmed.

Environmental laws and regulations have caused us to incur, and may cause us to continue to incur, significant expenditures to comply with applicable laws and regulations, and may cause us to incur significant penalties for noncompliance.

We are subject to numerous environmental laws and regulations. Compliance with current or future environmental laws and regulations could require us to incur substantial expenses which could harm our business, financial condition and results of operations. We have worked, and will continue to work, with our suppliers and customers to ensure that our products are compliant with enacted laws and regulations. Failure by us or our contract manufacturers to comply with such legislation could result in customers refusing to purchase our products and could subject us to significant monetary penalties in connection with a violation, either of which would have a material adverse effect on our business, financial condition and results of operations. Current environmental laws and regulations could become more stringent over time, imposing even greater compliance costs and increasing risks and penalties associated with violations, which could seriously harm our business, financial condition and results of operations. There can be no assurance that violations of environmental laws or regulations will not occur in the future as a result of our inability to obtain permits, human error, equipment failure or other causes.

Other Risks

The price of our common stock has and may continue to fluctuate substantially.

Our stock price and the stock prices of technology companies similar to Pixelworks have been highly volatile. Market fluctuations, particularly over the past year, as well as general economic and political conditions, including recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of our common stock. Therefore, the price of our common stock may decline, and the value of your investment may be reduced regardless of our performance. Any inability or perceived inability of investors to realize a gain on an investment in our common stock could have an adverse effect on our business, financial condition and results of operations, by potentially limiting our ability to retain our customers, to attract and retain qualified employees and to raise capital. Additional factors that could negatively impact our stock price include:

- actual or anticipated fluctuations in our operating results;
- changes in expectations as to our future financial performance;
- changes in financial estimates of securities analysts;
- announcements by us or our competitors of technological innovations, design wins, contracts, standards or acquisitions;

- the operating and stock price performance of other comparable companies;
- announcements of future expectations by our customers;
- changes in market valuations of other technology companies; and
- inconsistent trading volume levels of our common stock.

The anti-takeover provisions of Oregon law and in our articles of incorporation could adversely affect the rights of the holders of our common stock by preventing a sale or takeover of us at a price or prices favorable to the holders of our common stock.

Provisions of our articles of incorporation and bylaws and provisions of Oregon law may have the effect of delaying or preventing a merger or acquisition of us, making a merger or acquisition of us less desirable to a potential acquirer or preventing a change in our management, even if our shareholders consider the merger, acquisition or change in management favorable or if doing so would benefit our shareholders. In addition, these provisions could limit the price that investors would be willing to pay in the future for shares of our common stock. The following are examples of such provisions in our articles of incorporation or bylaws:

- our board of directors is authorized, without prior shareholder approval, to change the size of the board. Our articles of incorporation provide that if the board is increased to eight or more members, the board will be divided into three classes serving staggered terms, which would make it more difficult for a group of shareholders to quickly change the composition of our board;
- our board of directors is authorized, without prior shareholder approval, to create and issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us or to effect a change of control, commonly referred to as blank check preferred stock;
- members of our board of directors can be removed only for cause and at a meeting of shareholders called expressly for that purpose, by the vote of 75 percent of the votes then entitled to be cast for the election of directors;
- our board of directors may alter our bylaws without obtaining shareholder approval; and
- shareholders are required to provide advance notice for nominations for election to the board of directors or for proposing matters to be acted upon at a shareholder meeting.

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Item 4. Submission of Matters to a Vote of Security Holders.

The 2009 Annual Meeting of Shareholders of Pixelworks, Inc. was held on May 19, 2009 to conduct the following items of business:

1. To elect six Directors to serve one-year terms and until their successors are duly elected and qualified;
2. Approval of amendments to the 2006 Stock Incentive Plan;
3. To ratify the appointment of KPMG LLP as Pixelworks independent registered public accounting firm for the current fiscal year; and
4. To transact any other business that properly came before the meeting or any postponement or adjournment of the meeting.

The following nominees were elected to serve on the board of directors by the votes and for terms indicated below:

Nominee	For	Withheld	Term Ending
Allen H. Alley	10,350,965	1,091,946	2010
Mark A. Christensen	10,417,238	1,025,673	2010
James R. Fiebiger	10,379,847	1,063,064	2010
C. Scott Gibson	10,244,450	1,198,461	2010
Daniel J. Heneghan	10,538,120	904,791	2010
Bruce A.Walicek	10,782,003	660,908	2010

The proposal to approve amendments to the 2006 Stock Incentive Plan was approved and received the following votes:

	No. of Votes
For	3,781,865
Against	584,972
Abstain	62,760
Broker Non-Votes	7,013,314

The proposal to ratify the appointment of KPMG LLP as Pixelworks independent registered public accounting firm for the current fiscal year was approved and received the following votes:

	No. of Votes
For	11,125,419
Against	247,029
Abstain	70,462

There were no other matters of business that properly came before the meeting that were voted upon.

Item 6. Exhibits.

10.1	Pixelworks, Inc. 2006 Stock Incentive Plan, as amended. +
31.1	Certification of Chief Executive Officer.
31.2	Certification of Chief Financial Officer.
32.1*	Certification of Chief Executive Officer.
32.2*	Certification of Chief Financial Officer.

\+ Indicates a management contract or compensation arrangement.

* Exhibits 32.1 and 32.2 are being furnished and shall not be deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or otherwise subject to the liability of that section, nor shall such exhibits be deemed to be incorporated by reference in any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as

otherwise stated
in such filing.

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SIGNATURE

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

PIXELWORKS, INC.

Dated: August 6, 2009

/s/ Steven L. Moore

Steven L. Moore
Vice President, Chief Financial Officer, Secretary and Treasurer