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

FORM 10-K

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

For the fiscal year ended December 31, 2010

or

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

For the transition period from __________ to __________

Commission File Number: 000-30269

PIXELWORKS, INC.
(Exact name of registrant as specified in its charter)

Oregon	**91-1761992**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
224 Airport Parkway, Suite 400, San Jose, CA	**95110**
(Address of principal executive offices)	(Zip Code)

408-200-9200
(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Stock	**NASDAQ Global Market**

Securities registered pursuant to Section 12(g) of the Act:
None

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

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

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

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

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

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 definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☒

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

Aggregate market value of voting Common Stock held by non-affiliates of the registrant at June 30, 2010: $32,875,160. For purposes of this calculation, executive officers and directors are considered affiliates.

Number of shares of Common Stock outstanding as of February 28, 2011: 13,630,558.

Documents Incorporated by Reference

Part III incorporates information by reference to the registrant's definitive proxy statement, to be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year ended December 31, 2010.

PIXELWORKS, INC.
FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2010

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Forward-looking Statements

This Annual Report on Form 10-K, including Management's Discussion and Analysis of Financial Condition and Results of Operation in Part II, Item 7, 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 variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve numerous risks, uncertainties and assumptions that are difficult to predict. Actual results could vary materially from those contained in forward looking statements due to many factors, including, without limitation: our ability to deliver new products in a timely fashion; our new product yield rates; changes in estimated product costs; product mix; supply of products from third-party foundries; failure or difficulty in achieving design wins; timely customer transition to new product designs; competitive factors, such as rival chip architectures, introduction or traction by competing designs, or pricing pressures; the success of our products in expanded markets; current global economic challenges; levels of inventory at distributors and customers; changes in the digital display and projection markets; changes in customer ordering patterns or lead times; seasonality in the consumer electronics market; our efforts to achieve profitability from operations; insufficient, excess or obsolete inventory and variations in inventory valuation; litigation related to our intellectual property rights; our lower cash position as a result of our prior and any future debt repurchases, and other risks identified in the risk factors contained in Part I, Item 1A of this Annual Report on Form 10-K. 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 Annual Report on Form 10-K. 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 Annual Report on Form 10-K, the terms "Pixelworks," the "Company," "we," "us" and "our" mean Pixelworks, Inc., an Oregon corporation, and its wholly-owned subsidiaries.

PART I

Item 1. Business.

Overview

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications and hold 138 patents related to the visual display of digital image data. Our solutions enable manufacturers of digital display and projection devices, such as large-screen flat panel televisions and digital front projectors, to manufacture 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 was founded in 1997 and is incorporated under the laws of the state of Oregon.

Pixelworks' flexible design architecture enables our technology to produce outstanding image quality in our customers' products with a range of single-purpose integrated circuits ("ICs"), to system-on-chip ("SoC") ICs that integrate microprocessor, memory and image processing functions. Additionally, we provide full solutions, including a software development environment and operating system, which enable our customers to more quickly develop and customize their display products, thus reducing their time to market and allowing them to incorporate differentiated features and functions.

Our primary target markets are liquid crystal display ("LCD") large-screen televisions and 3LCD and digital light processing ("DLP") digital front projectors, however we also target other segments within the flat panel display market, including digital signage.

We have adopted a product strategy that leverages our core competencies in video processing to address the evolving needs of the advanced flat panel display, digital projection and other markets that require superior image quality. We focus our product investments on developing video enhancement solutions for these markets, with particular focus on adding increased performance and functionality. Additionally, we look for ways to leverage our research and development investment into products that address other high-value markets where our innovative proprietary technology provides differentiation for us and our customers. We continually seek to expand our technology portfolio through internal development, co-development with business partners and evaluation of acquisition opportunities.

Digital Video Technology Trends

Over the course of the last several years, video technology has moved rapidly from analog technology, which utilizes waveform signals, to a new generation of digital technologies that utilize a grid of thousands of tiny picture elements, or pixels. Consequently, digital display devices have rapidly evolved to incorporate higher pixel counts and faster rates of screen refresh, both of which contribute to a sharper, clearer image. At the same time, digital display devices have increased in size and begun to incorporate newer video capabilities such as high-definition and, most recently, 3D. Accordingly, the video image processors that drive newer displays have had to increase their capabilities as well to keep pace with the ever growing needs for greater resolution, size and speed that digital technology affords.

The number and variety of digital video applications is increasing rapidly, and video is expanding to play a pervasive role across many aspects of business and personal lifestyle. Digital video content is being delivered from an increasing array of sources that vary dramatically in quality—on Blu-ray DVDs, via cable and satellite, across the Internet and on cell phones and smart devices. The sources and quality of video content range from very high-resolution programming produced by network or movie studios to very poor quality clips created by individuals.

Regardless of the source or quality, increasingly, consumers are sharing video with others and viewing video on a growing array of form factors—from handheld devices to large screen displays. At the same time, the consumer expectation for ever higher quality video continues to rise, driven by higher display resolutions on larger TVs. These trends place new demands on video signal and pixel processing technology to enable display and projection devices to provide the best viewing experience possible across multiple display formats. For example, content created for one type of display device, such as a PC, must be scaled up or down to play back clearly on a different device, such as a television. On larger, higher-resolution TV screens, image quality deteriorates significantly, and must be compensated for with video processing technology that restores or even creates higher video quality.

The latest generations of advanced digital display devices enhance image performance in a number of ways, chief among them being increasing the size of the display, increasing the display resolution and increasing the number of times per second the image is refreshed. Premium displays currently feature “full HD” resolutions of 1920 columns by 1080 rows of pixels progressively scanned (“1080p”), display frame rates of 240Hz or more, are 3D ready and measure from 32 inches to 70 inches or more diagonally. In addition to the need for image enhancement, various applications, such as digital signage, Internet- enabled televisions and connected classroom environments, are creating a need for new networking capabilities that can enable the sharing of video across display devices and display environments.

Large-Screen Flat Panel Display Market

The market for flat panel displays has risen rapidly over the past decade and is projected to be worth more than $100 billion in sales annually by 2012, according to the industry research firm DisplaySearch. Key segments of growth within the flat panel display industry are consumer applications, such as PC monitors and digital televisions. Digital TVs in particular have transformed the flat panel market, as consumers have enthusiastically embraced advanced television displays that offer sharper and more lifelike images on larger and thinner screens. Increasingly, commercial applications such as public-space advertising, a form of digital signage, are also contributing to the growth of the flat panel market and the drive to improve the image and video quality of the panels themselves.

Flat panel display technologies include LCD, plasma display, rear-projection using LCDs, digital micro-mirror, and newer technologies, such as liquid crystal on silicon (“LCoS”) and organic light emitting diodes (“OLED”). Within flat panel displays, LCD and plasma have emerged as the preferred digital display technologies, with LCD leading the market in growth. The digital TV market and its high volume penetration with consumers has helped to secure the dominance of LCD technology. Shipments of LCD TVs are expected to account for around 77% of all TVs sold and grow from 190 million units in 2010 to 215 million units in 2011, according to DisplaySearch.

A large consumer market has pressured flat panel manufacturers to continually improve the quality of their displays, and as a result LCDs and other flat panel displays continue to increase in resolution and size. 1080p resolution is now the high-end standard, and larger flat panel displays are shifting rapidly from refresh rates of 50/60Hz to faster rates of 100/120Hz, 200/240Hz and even 400/480Hz. The shift to large, high-resolution flat panel displays combined with the transition to 1080p content and higher refresh rates is driving the need for high performance processor solutions to meet the enhanced video quality requirements of next generation display products. As flat panel display resolution and size increase, the challenge of “judder” becomes more of an issue. Judder occurs when content recorded at one rate of frames per second for film content must be converted to faster video rates, and as a result there is a jerkiness, or judder in the resulting video performance. This problem is intensified in larger displays and can be a problem regardless of the panel technology being used.

In addition to judder, LCD panels also suffer from blur in motion images as a result of the way the human brain processes the longer frame durations produced by an LCD panel. In the past, LCD panel manufacturers have tried to reduce blur by increasing the refresh rate of the panel to higher rates and inserting an extra “black” frame to reduce frame duration. But the black frame insertion method has had drawbacks—one of which was to make LCD screens seem less bright. Newer motion estimation/motion compensation (“MEMC”) technology uses the insertion of interpolated frames based on complex mathematical algorithms to shorten the duration of the video frame and create a clearer, crisper picture. MEMC also provides de-judder processing that smoothes out the jerkiness often apparent with large screen displays.

In recent years TV manufacturers have added new design elements and performance features to differentiate their products and slow price declines. Among these are the adoption of light emitting diode (“LED”) backlighting, an emphasis on lower power consumption, Internet connectivity and the development of 3D-enabled TVs. All of these trends are driving the need for high performance processor solutions to meet the enhanced video quality requirements of next generation display products.

LED backlighting enables higher contrast images in more advanced TVs. Manufacturers can use either dynamic color LEDs that are positioned behind the panel and allow for local area dimming, which provides higher contrast on selected sections of the screen; or white edge-LEDs positioned around the rim of the screen, which use a special diffusion panel to spread the light evenly behind the screen. LED backlighting also serves as a critical enabler of reduced power consumption. Because of its advantages, LED backlighting is expected to surpass traditional backlights that use fluorescent tubes by 2011 and achieve 74% penetration in 2013, according to DisplaySearch. LED backlighting requires a video processing control mechanism that determines when certain LEDs are lit, and how brightly, based on the video being displayed.

The combination of LED backlighting and 200/240 Hz technologies provides an enabling platform for new feature developments in LCD TVs, particularly 3D technology, which is an area of intense interest to television manufacturers and consumers alike. DisplaySearch forecasts that worldwide 3D TV shipments will rise from 3.2 million in 2010 to more than 91 million in 2014.

Consumers’ desire to use their televisions to view Internet content ranging from YouTube videos to downloaded high definition movies from Netflix and other vendors is driving TV manufacturers to incorporate Internet connectivity into their products. In addition to simple connectivity, these devices must also be able to scale and enhance Internet content so as to be optimally viewed on a large flat panel display. Limitations in bandwidth, latency, noise and content resolution create significant challenges, and video processors must be able to scale poorer quality video, reduce signal noise inherent to networks and enhance image quality in order to ensure optimal video performance. DisplaySearch estimates that approximately 45 million units, or 21% of all TVs shipped in 2010 were Internet enabled, and the number of connected TVs is expected to grow to more than 122 million in 2014.

Increasing screen sizes, higher frame rates, the desire to view Internet content on high-resolution displays, LED backlighting, 3D and other trends all present video performance challenges that must be addressed and are exacerbated with each new cycle of additional features. To differentiate their products, advanced flat panel manufacturers must implement video processing technologies that address these video performance issues as rapidly, as fully and as cost effectively as possible. Additionally, the interplay of performance, features, cost and power consumption is a key area of differentiation for digital television manufacturers. Most features and performance improvements carry cost premiums and increased power consumption, but intelligent design and utilization of appropriate video processing technologies can enable simultaneous improvements.

Digital Projection Market

Increasingly affordable price points are driving continued adoption of digital projectors in business and education, as well as among consumers. Technology improvements are helping reduce the size and weight of projection devices and increasing their performance. Projector models range from larger units designed to be permanently installed in a conference hall or other venue, to ultra portable devices weighing less than two pounds for maximum portability. According to Pacific Media Associates (PMA), the worldwide front projector market grew to a total of 8.49 million units sold in 2010 from 6.33 million units in 2009.

Currently, the largest segment of the installed front projector market consists of business users who employ multimedia projectors to display both still and video presentation materials from PCs or other sources. Requirements for the business market include portability, compatibility with multiple software and hardware applications and features that ensure simple operation. In educational environments from elementary schools to university campuses, projectors help teachers integrate media-rich instruction into classrooms. Growth in overall projector sales is expected to come both from the business sector and the education market. Tiny, battery powered “pico” projectors embedded in a cell phone or PC, or available as independent devices weighing less than a pound, also are beginning to take hold in the consumer and business markets, fueled by their capability to display video content at high resolutions.

Consistent with the trends of other consumer products, digital projectors are increasingly incorporating networking capabilities that enable the sharing of video and other content among multiple devices. This in turn is enabling new use models for digital projection in both the education and business environments. For example, one teacher can present the same material simultaneously in multiple classrooms, and students in different classrooms can display and discuss their work. Such connectivity allows instant access to content and sharing of content, which promotes interaction and collaboration among dispersed groups. In the business setting, this connectivity enables teleconferencing and the seamless sharing of content for more effective meetings.

Additional Markets

In addition to the large-screen flat panel display and digital projection markets, other sectors are also taking advantage of the trend towards higher performance and connectivity in digital video technology. Some of the applications expected to grow as a result of enhanced video quality include digital signage, video conferencing and specialty monitors.

Worldwide, the emerging economies of Brazil, Russia, India and China, commonly referred to collectively as “BRIC,” are expected to be a leading driver of demand for information technology of all kinds, including projectors for business, education and the consumer sectors.

Our Core Technologies and Products

We have developed a portfolio of advanced video algorithms and intellectual property (“IP”) to address a broad range of challenges in digital video. Our technologies can dramatically improve video quality and are increasingly important as screen size and resulting quality issues increase. Our products are designed with a flexible architecture that allows us to combine algorithms and functional blocks of digital and mixed signal circuitry. Accordingly, our technologies can be implemented across multiple products and in powerful combinations within single products. The majority of our products include one or more technologies to provide high-quality video solutions to our customers .

Some of our proprietary core technologies include:

- ***MEMC (motion estimation/motion compensation).*** Our proprietary MEMC technology significantly improves the performance and viewing experience of large advanced LCD panels by solving problems such as motion blur and judder. It also supports significant digital TV trends such as 3D, LED backlight local dimming (both edge-lit and full array) and 240Hz and higher frame rates. Additionally, our MEMC technology improves video performance in non-TV applications such as video conferencing, 3D gaming and projection.
- ***Networking***. Our networking technology enables the same video stream to be networked across multiple displays, for applications such as connected video projection and digital signage.
- ***Digital keystone correction.*** Our technology provides enhanced keystone and image correction performance for digital projection systems, particularly for “short throw” projectors which must project clearly at severe angles due to space limitations.

Our product development strategy is to leverage our expertise in video processing to address the evolving needs of the advanced flat panel display, digital projection and other markets that require superior image quality. We plan to continue to focus our development resources to maintain our market lead and provide leading edge solutions for the advanced LCD and DLP in the digital projection market and to enhance our video processing solutions for advanced flat panel displays and other markets. Additionally, we look for ways to leverage our research and development investment into products that address high-value markets where our innovative proprietary technology provides differentiation for us and our customers. We deliver our technology in a variety of offerings, which take the form of single-purpose chips, highly integrated SoCs that incorporate specialized software, and full solutions incorporating software and other tools.

Our primary product categories include the following:

- ***ImageProcessor ICs.*** Our ImageProcessor ICs include embedded microprocessors, digital signal processing technology and software that control the operations and signal processing within high-end display systems such as projectors and high-resolution flat panels. ImageProcessor ICs were our first product offerings and continue to comprise the majority of our business. We have continued to refine the architectures for optimal performance, manufacturing our products on process technologies that align with our customers' requirements. Additionally, we provide a software development environment and operating system that enables our customers to more quickly develop and customize the "look and feel" of their products.
- ***Video Co-Processor ICs.*** Products in this category work in conjunction with an image processor to post-process video signals in order to enhance the performance or feature set of the overall video solution (for example, by significantly reducing judder and motion blur). Our video co-processor ICs can be used with our ImageProcessor ICs or with image processing solutions from other manufacturers, and in most cases can be incorporated by a display manufacturer without assistance from the supplier of the base image processor. This flexibility enables manufacturers to augment their existing or new designs to enhance their video display products.
- ***Networked Display ICs.*** Our Networked Display ICs allow the same video stream to be networked across multiple displays, for example to connect projectors in different classrooms or to enable networked streaming of video in digital signage applications. Our Networked Display IC combines video sharing capabilities with video image processing, wireless connectivity and Internet connection to ensure high quality, multi-source video output and enhanced value to our projection display customers.

Customers, Sales and Marketing

The key focus of our global sales and marketing strategy is to achieve design wins with industry leading branded manufacturers in targeted markets and to continue building strong customer relationships. Once a design win has been achieved, sales and marketing efforts are focused on building long-term mutually beneficial business relationships with our customers by providing superior technology and reducing their costs, which complements our customers' product development objectives and meets their expectations for price-performance and time to market. Marketing efforts are focused on building market-leading brand awareness and preference for our solutions.

We utilize direct sales and marketing resources in the U.S., China, Taiwan, Japan and Korea as well as indirect resources in several regions. In addition to sales and marketing representatives, we have field application engineers who provide technical expertise and assistance to manufacturing customers on final product development.

Our global distribution channel is multi-tiered and involves both direct and indirect distribution channels, as described below:

- ***Distributors.*** Distributors are resellers in local markets who provide engineering support and stock our semiconductors in direct relation to specific manufacturing customer orders. Our distributors often have valuable and established relationships with our end customers, and in certain countries it is customary to sell to distributors. While distributor payment to us is not dependent upon the distributor's ability to resell the product or to collect from the end customer, our distributors may provide longer payment terms to end customers than those we would offer. Sales to distributors accounted for 61%, 51% and 53% of revenue in 2010, 2009 and 2008, respectively.

Our largest distributor, Tokyo Electron Device Ltd. ("TED"), is located in Japan. TED represented 44%, 35% and 32% of revenue in 2010, 2009 and 2008, respectively, and accounted for 45% and 22% of accounts receivable at December 31, 2010 and 2009, respectively. No other distributor accounted for more than 10% of revenue in 2010, 2009 and 2008.

We also have distributor relationships in Taiwan, China, Korea, Europe, Southeast Asia and the U.S.

- ***Direct Relationships.*** We have established direct relationships with companies that manufacture high-end display systems. Some of our direct relationships are supported by commission-based manufacturers' representatives, who are independent sales agents that represent us in local markets and provide engineering support but do not carry inventory. Revenue through direct relationships accounted for 39%, 49% and 47% of total revenue in 2010, 2009 or 2008, respectively.

  We have direct relationships with companies falling into the following three classifications:

  - *Integrators.* Integrators are original equipment manufacturers who build display devices based on specifications provided by branded suppliers.
  - *Branded Manufacturers*. Branded manufacturers are globally recognized manufacturers who develop display device specifications, and manufacture, market and distribute display devices either directly or through resellers to end-users.
  - *Branded Suppliers*. Branded suppliers are globally recognized suppliers who develop display device specifications and then source them from integrators, typically in Asia, and distribute them either directly or through resellers to end-users.

Revenue attributable to our top five end customers represented 58%, 56% and 55% of revenue in 2010, 2009 and 2008, respectively. End customers include customers who purchase directly from us as well as customers who purchase products indirectly through distributors. Sales to Seiko Epson Corporation represented more than 10% of revenue in 2010, 2009, and 2008. Sales to SANYO Electric Co., Ltd. represented more than 10% of revenue in 2010 and 2009. Sales to Hitachi represented more than 10% of revenue in 2010. No other end customer accounted for more than 10% of revenue in 2010, 2009 or 2008.

Seasonality

Our business is subject to seasonality related to the markets we serve and the location of our customers. We have historically experienced higher revenue from the multimedia projector market in the third quarter of the year, and lower revenue in the first quarter of the year, as our Japanese customers reduce inventories in anticipation of their March 31 fiscal year end. Additionally, holiday demand for consumer electronics, including high-end televisions, has sometimes contributed to increased revenue in the second half of the year. Our sales in 2010, 2009 and 2008, however, did not follow our historical trends due in part to the global crisis in the credit and financial markets, continued economic uncertainty and reductions in consumer spending. As a result, it is extremely difficult for us to predict when or if historical trends are likely to resume.

Geographic Distribution of Sales

Sales outside the U.S. accounted for approximately 96%, 97% and 95% of our revenue in 2010, 2009 and 2008, respectively.

Financial information regarding our domestic and foreign operations is presented in Note 11 of the Notes to Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.

Backlog

Our sales are made pursuant to customer purchase orders for delivery of standard products. The volume of product actually purchased by our customers, as well as shipment schedules, are subject to frequent revisions that reflect changes in both the customers' needs and product availability. Our entire order backlog is cancelable, with a portion subject to cancellation fees. In light of industry practice and our own experience, we do not believe that backlog as of any particular date is indicative of future results.

Competition

In general, the semiconductor industry is intensely competitive. The markets for higher performance display and projection devices, including the markets for advanced flat panel display televisions, multimedia projectors and other applications demanding high quality video, are characterized by rapid technological change, evolving industry standards, compressed product life cycles and declining average selling prices. We believe the principal competitive factors in our markets are product performance, time to market, cost, functional versatility provided by software, customer relationships and reputation, patented innovative designs, levels of product integration, compliance with industry standards and system design cost.

Our current products face competition from specialized display controller developers and in-house display controller ICs designed by our customers and potential customers. Additionally, new alternative display processing technologies and industry standards may emerge that directly compete with technologies that we offer.

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., Trident Microsystems, 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, N.V., 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.

Research and Development

Our internal research and development efforts are focused on the development of our solutions for the multimedia projector and high-end television markets. Our development efforts are focused on pursuing higher levels of video performance, integration and new features in order to provide our customers with solutions that enable them to introduce market leading products and help lower final systems costs for our customers.

We have invested, and expect to continue to invest, significant resources in research and development activities. Our research and development expense was $22.8 million, $20.1 million and $26.5 million in 2010, 2009 and 2008, respectively.

Manufacturing

Within the semiconductor industry we are known as a "fabless" company, meaning that we do not manufacture the semiconductors that we design and develop, but instead contract with four third-party foundries for wafer fabrication and other manufacturers for packaging, assembly and testing of our products. The fabless approach allows us to concentrate our resources on product design and development where we believe we have greater competitive advantages.

See “Risk Factors” in Part I, Item 1A of this Annual Report on Form 10-K for information on risks related to our manufacturing strategy and processes.

Intellectual Property

We rely on a combination of nondisclosure agreements and patent, copyright, trademark and trade secret laws to protect the algorithms, design and architecture of our technology. Currently, we hold 138 patents and have 31 patent applications pending, which relate generally to improvements in the visual display of digital image data including, but not limited to, improvements in image scaling, image correction, automatic image optimization and video signal processing for digital displays. Our U.S. and foreign patents are generally enforceable for 20 years from the date they were filed. Accordingly, our issued patents have from approximately 7 to 16 years remaining in their respective term, depending on their filing date. We believe that the remaining term of our patents is adequate relative to the expected lives of our related products.

We intend to seek patent protection for other significant technologies that we have already developed and expect to seek patent protection for future products and technologies as necessary. Patents may not be issued as a result of any pending applications and any claims allowed under issued patents may be insufficiently broad to protect our technology. Existing or future patents may be invalidated, diluted, circumvented, challenged or licensed to others. Furthermore, the laws of certain foreign countries in which our products are or may be developed, manufactured or sold, including various countries in Asia, may not protect our products or intellectual property rights to the same extent as do the laws of the United States and, thus, make the possibility of piracy of our technology and products more likely in these countries.

The semiconductor industry is characterized by vigorous protection of intellectual property rights, which have resulted in significant and often protracted and expensive litigation. We, our customers or our foundries from time to time may be notified of claims that we may be infringing patents or other intellectual property rights owned by third parties. Litigation by or against us relating to patent infringement or other intellectual property matters could result in significant expense to us and divert the efforts of our technical and management personnel, whether or not such litigation results in a determination favorable to us. In the event of an adverse result in any such litigation, we could be required to pay substantial damages, cease the manufacture, use and sale of infringing products, expend significant resources to develop non-infringing technology, discontinue the use of certain processes or obtain licenses to the infringing technology. We may not be able to settle any alleged patent infringement claim through a cross-licensing arrangement. In the event any third party made a valid claim against us, our customers or our foundries, and a license was not made available to us on terms that are acceptable to us or at all, we would be adversely affected.

See “Risk Factors” in Part I, Item 1A, and “Note 7: Commitments and Contingencies” in Part II, Item 8 of this Annual Report on Form 10-K for information on risks related to intellectual property.

Environmental Matters

Environmental laws and regulations are complex, change frequently and have tended to become more stringent over time. We have incurred, and may continue to incur, significant expenditures to comply with these laws and regulations and we may incur additional capital expenditures and asset impairments to ensure that our products and our vendors’ products are in compliance with these regulations. We would be subject to significant penalties for failure to comply with these laws and regulations.

See “Risk Factors” in Part I, Item 1A of this Annual Report on Form 10-K for information on environmental risks.

Employees

As of December 31, 2010, we had a total of 243 employees compared to 222 employees as of December 31, 2009. We consider our relations with our employees to be good.

Availability of Securities and Exchange Commission Filings

We make available through our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports free of charge as soon as reasonably practicable after we electronically file such material with the Securities and Exchange Commission. Our Internet address is *www.pixelworks.com*. The content on, or that can be accessed through, our website is not incorporated by reference into this filing.

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 Annual Report on Form 10-K for the year ended December 31, 2010, including our consolidated financial statements and related notes, and our other filings made from time to time with the Securities and Exchange Commission.

Company Specific Risks

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

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, our strategy focuses on implementing our intellectual property (“IP”) to improve the video performance of our customers’ image processors through the use of our Motion Estimation Motion Compensation (“MEMC”) co-processor integrated circuits (“ICs”). This strategy is designed to address the needs of the large-screen, high-resolution, high-quality segment of the television market. Although our product strategy is developed to take advantage of market trends, such markets may not develop or may take longer to develop than we expect. We cannot assure you that the products we are developing will adequately address the demands of our target customers, or that we will be able to produce our new products at costs that enable us to price these products competitively.

Even if our product strategy is properly targeted, we cannot assure you that the products we are developing will lead to a significant increase in revenue from new design wins. To achieve design wins, we must design and deliver cost-effective, innovative and integrated semiconductors that overcome the significant costs associated with qualifying a new supplier and which make developers reluctant to change component sources. Additionally, potential developers may be less likely or unwilling to select our products due to concerns over our financial strength. Further, design wins do not necessarily result in developers ordering large volumes of our products. Developers can choose at any time to discontinue using our products in their designs or product development efforts. A design win is not a binding commitment by a developer to purchase our products, but rather a decision by a developer to use our products in its design process. Even if our products are chosen to be incorporated into a developer’s products, we may still not realize significant revenue from the developer if its products are not commercially successful or it chooses to qualify, or incorporate the products, of a second source. Additionally, even if our product strategy is successful at achieving design wins and increasing our revenue, we may continue to incur operating losses due to the significant research and development costs that are required to develop competitive products for the advanced television market.

We have incurred indebtedness as a result of the sale of convertible debentures. We anticipate that we must repay or refinance the debentures by May 2011. We may be unable to meet this, or other, future capital requirements.

As of December 31, 2010, $15.8 million of our 1.75% convertible subordinated debentures (the "debentures") were outstanding. Although the debentures are not due until 2024, the holders have the right to require us to purchase all or a portion of the 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, we expect the holders to exercise their put option on May 15, 2011. 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, or at all. While we believe that our existing working capital, as well as funds available under our short-term line of credit 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 debentures when and if the put option is exercised, or that such a repurchase would not result in cash reserves too low for us to continue our business as a going concern. 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.

We may not be able to borrow funds under our credit facility or secure future financing.

In December 2010, we entered into a Loan and Security Agreement with Silicon Valley Bank to provide for a secured, working capital-based, revolving line of credit. We view this line of credit as a source of available liquidity to fund fluctuations in our working capital requirements. For example, if we experience an increase in order activity from our customers, our cash balance may decrease due to the need to purchase inventories to fulfill those orders. If this occurs, we may have to draw on this facility in order to maintain our liquidity. As of December 31, 2010, we had borrowed $3.0 million on this line of credit.

This facility contains various conditions, covenants and representations with which we must be in compliance in order to borrow funds. We cannot assure you that we will be in compliance with these conditions, covenants and representations in the future when we may need to borrow funds under this facility. In addition, this facility expires on December 21, 2012 after which time we may need to secure new financing to continue funding fluctuations in our working capital requirements. We cannot assure you that we will be able to secure new financing, or financing on terms that are acceptable to us.

Dependence on a limited number of sole-source, third-party manufacturers for our products exposes us to shortages based on low manufacturing yield, errors in manufacturing, uncontrollable lead-times for manufacturing, capacity allocation, 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 do not own or operate a semiconductor fabrication facility and do not have the resources to manufacture our products internally. We rely on four third-party foundries to produce all of our wafers and three assembly and test vendors for completion of finished products. The wafers used in any one of our products are fabricated by only one foundry. 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. Our suppliers can increase the prices of the products we purchase from them with little notice, which may cause us to increase the prices to our customers and harm our competitiveness. Because our requirements represent only a small portion of the total production capacity of our contract manufacturers, they could reallocate capacity to other customers even during periods of high demand for our products, as they have done in the past. We expect this may occur again in the future.

Establishing a relationship with a new contract manufacturer in the event of delays or increased prices would be costly and burdensome. The lead time to make such a change would be 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. Additionally, we have, and may continue to choose new foundries to manufacture our wafers which may require us to modify our design methodology flow for the process technology and intellectual property cores of the new foundry. If we have to qualify a new foundry or packaging, assembly and testing supplier for any of our products or if we are unable to obtain our products from our contract manufacturers on schedule, at costs that are acceptable to us, or at all, we could incur significant delays in shipping products, our ability to satisfy customer demand could be harmed, our revenue from the sale of products may be lost or delayed and our customer relationships and ability to obtain future design wins could be damaged.

We may fail to retain or attract the specialized technical and management personnel required to successfully operate our business.

Our success depends on the continued services of our executive officers and other key management, engineering, and sales and marketing personnel and on our ability to continue to attract, retain and motivate qualified personnel. Competition for skilled engineers and management personnel is intense within our industry, and we may not be successful in hiring and retaining qualified individuals. The loss of, or inability to hire, key personnel could limit our ability to develop new products and adapt existing products to our customers' requirements, and may result in lost sales and a diversion of management resources. We have experienced, and may continue to experience difficulty in hiring and retaining qualified engineering personnel in our Shanghai design center.

We may be unable to successfully manage any future growth, including the integration of any future acquisition or equity investment, which could disrupt our business and severely harm our financial condition.

We may determine that it is beneficial to increase our capacity to develop new and enhanced products in the future. If we fail to effectively manage internal growth, our operating expenses may increase more rapidly than our revenue, adversely affecting our financial condition and results of operations. To manage any future growth 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, controls or financial resources may not be adequate to support our operations and we may not be able to grow quickly enough to exploit potential market opportunities.

In addition, we may not be able to successfully integrate the 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. Our operation of any acquired business would involve numerous risks, including, but not limited to:

- problems combining the acquired operations, technologies or products;
- unanticipated costs;
- diversion of management's attention from existing operations;
- adverse effects on existing business relationships with customers;
- risks associated with entering markets in which we have no or limited prior experience;

- potential loss of key employees, particularly those of the acquired organizations; and
- risks associated with implementing adequate internal control, management, financial and operating reporting systems.

Any future acquisitions and investments could also 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 other charges;
- loss of investment; and
- decreases in cash and marketable securities that could otherwise serve as working capital.

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 and lower of cost or market write–downs were $1.6 million, $1.2 million and $1.5 million in 2010, 2009 and 2008, respectively.

If we are not profitable in the future, we may be unable to continue our operations.

We have incurred operating losses since 2004. If and when we achieve profitability depends upon a number of factors, including our ability to develop and market innovative products, accurately estimate inventory needs, contract effectively for manufacturing capacity and maintain sufficient funds to finance our activities. If we are not profitable in the future, we may be unable to continue our operations.

A significant amount of our revenue comes from a limited number of customers and distributors, exposing us to increased credit risk and subjecting our cash flow to the risk that any of our customers or distributors could decrease or cancel its orders.

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 our top distributor represented 44%, 35% and 32% of revenue in 2010, 2009 and 2008, respectively. Revenue attributable to our top five end customers represented 58%, 56% and 55% of revenue in 2010, 2009 and 2008, respectively. As of December 31, 2010 we had two accounts that represented 10% or more of accounts receivable. As of December 31, 2009, we had three accounts that each represented 10% or more of accounts receivable. All of the orders included in our backlog are cancelable. 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. Further, 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 customer to pay future outstanding balances, would result in an operating expense and reduce our cash flows.

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 original equipment manufacturers (“OEMs”) that build display devices based on specifications provided by branded suppliers, also referred to as integrators, reduces our ability to forecast sales accurately and increases the complexity of our business. Our sales are made on the basis of customer purchase orders rather than long-term purchase commitments. Our distributors, integrators and customers may cancel or defer purchase orders at any time but we must order wafer inventory from our contract manufacturers three to four months in advance.

The estimates we use for our advance orders from contract manufacturers are based, in part, on reports of inventory levels and production forecasts from our distributors and integrators, which act as intermediaries between us and the companies using our products. This process requires us to make numerous assumptions concerning demand and to rely on the accuracy of the reports and forecasts of our distributors and integrators, each of which may introduce error into our estimates of inventory requirements. Our failure to manage this challenge 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. For example, we overestimated demand for certain of our products which led to significant charges for obsolete inventory in 2010, 2009 and 2008. On the other hand, if we underestimate demand, 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%, 97% and 95% of revenue in 2010, 2009 and 2008, 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:

- increased difficulties in managing international distributors and manufacturers due to varying time zones, languages and business customs;
- compliance with U.S. laws affecting operations outside of the U.S., such as the Foreign Corrupt Practices Act;
- 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;
- changes in tax laws and the interpretation of those laws;
- 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; and
- outbreaks of health epidemics in the PRC or other parts of Asia.

In addition, jurisdictions in which we do business could impose more or new tariffs, quotas, trade barriers and similar trade restrictions on our sales. Moreover, economic changes, geopolitical conflicts, territory activity, political unrest, civil strife, acts of war, public corruption and other economic and political uncertainties could interrupt and negatively affect our business operations. All of these factors could result in increased costs or decreased revenues, and could materially affect our product sales, financial condition and results of operations.

The concentration of our employees, manufacturers and customers in the PRC, Japan, Korea, Taiwan and Singapore increases our risk that a natural disaster, work stoppage or economic or political instability in the region could disrupt our operations or increase .

Most of our current manufacturers and customers are located in the PRC, Japan, Korea, Taiwan or Singapore. In addition, a majority of our employees are located in this region. Disruptions from natural disasters, health epidemics 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, foreign currency flows and balance of payments position, among others. We cannot be assured that the PRC's economic policies 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.

In addition, 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 operations in certain foreign and developing markets expose us to political, economic and regulatory risks.

Our growth strategy depends in part on our ability to expand our operations in developing markets, including Brazil, Russia, India, China and Southeast Asia. However, some developing markets have greater political and economic volatility and greater vulnerability to infrastructure and labor disruptions than established markets. In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by laws and regulations applicable to us, such as the Foreign Corrupt Practices Act or similar local anti-bribery laws. These laws generally prohibit companies and their agents or intermediaries from making improper payments to government officials for the purpose of obtaining or retaining business. Failure to comply with these laws could subject us to civil and criminal penalties that could materially and adversely impact our financial condition and results of operations.

Additionally, we have employees located in offices in Japan, Taiwan, Korea and the PRC 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 analyze our exposure to foreign currency fluctuations and may engage in financial hedging techniques in the future to attempt to minimize the effect of these potential fluctuations; however, foreign currency exchange rate fluctuations may adversely affect our financial results in the future.

We may be unable to successfully implement new products or enhancements to our current products due to our prior or any potential future restructuring actions, which could adversely affect our future sales and financial condition.

We initiated restructuring plans in November 2006 and December 2008 which were completed in December 2008 and June 2009, respectively. These restructuring plans included consolidation and closure of certain offices, reductions in headcount and significant write-offs of assets. Although our restructuring plans were intended to improve efficiency and return the Company to profitability, these restructuring plans and any future restructuring actions may slow our development of new or enhanced products by limiting our research and development and engineering activities. If we are unable to successfully introduce new or enhanced products, our sales and financial condition will be adversely affected.

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, the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Sarbanes-Oxley Act of 2002, which requires management's annual review and evaluation of internal control over financial reporting. If we are unable to maintain an effective system of internal controls, our shareholders could lose confidence in the accuracy and completeness of our financial reports which in turn could cause our stock price to decline.

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 ("Exchange 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 Exchange Act. Any resulting default under our debentures would have a material adverse effect on our cash position and operating results.

Our net operating loss carryforwards may be limited or they may expire before utilization

As of December 31, 2010, we had U.S. federal tax net operating loss carryforwards of approximately $173.1 million, which expire at various dates from 2011 through 2027. These net operating loss carryforwards may be used to offset future taxable income and thereby reduce our U.S. federal income taxes otherwise payable. Section 382 of the Internal Revenue Code of 1986, as amended ("the Code"), imposes an annual limit on the ability of a corporation that undergoes an "ownership change" to use its net operating loss carry forwards to reduce its tax liability. In the event of certain changes in our shareholder base, we may at some point in the future experience an "ownership change" as defined in Section 382 of the Code. Accordingly, our use of the net operating loss carryforwards may be limited by the annual limitations described in Section 382 of the Code. In addition, all or a portion of these net operating loss carryforwards may expire unutilized.

Our effective income tax rate is subject to unanticipated changes in, or different interpretations of tax rules and regulations and forecasting our effective income tax rate is complex and subject to uncertainty.

As a global company, we are subject to taxation by a number of taxing authorities and as such, our tax rates vary among the jurisdictions in which we operate. Unanticipated changes in our tax rates could affect our future results of operations. Our effective tax rates could be adversely affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in tax laws or the interpretation of tax laws either in the United States or abroad, or by changes in the valuation of our deferred tax assets and liabilities. The ultimate outcomes of any future tax audits are uncertain, and we can give no assurance as to whether an adverse result from one or more of them would have a material effect on our operating results and financial position.

The computation of income tax expense is complex as it is based on the laws of numerous tax jurisdictions and requires significant judgment on the application of complicated rules governing accounting for tax provisions under U.S. generally accepted accounting principles. Income tax expense for interim quarters is based on a forecast of our global tax rate for the year, which includes forward looking financial projections, including the expectations of profit and loss by jurisdiction, and contains numerous assumptions. For these reasons, our global tax rate may be materially different than our forecast.

Company Risks Related to the Semiconductor Industry and Our Markets

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 signal analog and digital signal processing, multi-chip modules 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 applications that required us to institute additional testing. As a result of these field failures, we have incurred warranty costs due to customers returning potentially affected products and have experienced reductions in revenues due to delays in production. Our customers have also experienced delays in receiving product shipments from us that resulted in the loss of revenue and profits. In 2010, for example, we incurred higher than expected yield losses due to defective third party IP incorporated into certain of our products, which resulted in higher direct material cost and a temporary inability to meet our customer's requested demand. Although we were able to resolve the issue without incurring material losses and have implemented additional processes to control this type of risk, similar issues may occur again in the future. Additionally, shipments of defective products could cause us to lose customers or to incur significant replacement costs, either of which would harm our business.

The development of new products is extremely complex and we may be unable to develop our new products in a timely manner and without defects, errors or bugs, or at all, which would result in a failure to obtain new design wins and/or maintain our current revenue levels.

The manufacture of semiconductors is a complex process and many of our products are highly integrated and incorporate mixed analog and digital signal processing, multichip modules and embedded memory technology, further complicating the development process. In addition to the inherent difficulty of designing complex ICs, product development delays may result from:

- difficulties in hiring and retaining necessary technical personnel;
- difficulties with contract manufacturers;
- difficulties in reallocating engineering resources and overcoming resource limitations;
- changes to product specifications and customer requirements;
- changes to market or competitive product requirements; and
- unanticipated engineering complexities.

Even if we are able to meet our customers' design windows, the highly complex products we provide to our customers may contain defects, errors and bugs when they are first introduced. We have in the past and may in the future experience these defects, errors and bugs. In addition, if any of our products do contain defects, errors or bugs when first introduced, we may be unable to correct the problems at an acceptable cost or at all. Consequently, our reputation may be damaged and customers may be reluctant to buy our products, which could harm our ability to retain existing customers and to attract new customers. In addition, any defects, errors or bugs could interrupt or delay sales of our new products to our customers. If we are not successful in development of new products, our financial results will be adversely affected.

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 build most of our products on a customer-owned tooling basis, also known in the semiconductor industry as COT, whereby we directly contract the manufacture of our products, including wafer production, assembly and test. 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.

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

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., Intersil Corporation, MediaTek Inc., MStar Semiconductor, Inc., Realtek Semiconductor Corp., Renesas Electronics America, Sigma Designs, Inc., Silicon Image, Inc., STMicroelectronics N.V., Sunplus Technology Co., Ltd., Trident Microsystems, 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., NEC Corporation, NVIDIA Corporation, 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. In 2010, for example, frame rate conversion technology similar to that used in our line of MEMC co-processors continued to be integrated into the SoC products of our competitors, particularly in lower refresh rate television products. We cannot assure you that we can compete successfully against current or potential competitors.

If we are not able to respond to the rapid technological changes and evolving industry standards in the markets in which we compete, or seek to compete, our products may become less desirable or obsolete.

The markets in which we compete or seek to compete are subject to rapid technological change and miniaturization capabilities, 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 and significantly decrease our revenue. Examples of changing industry standards include the growing use of broadband to deliver video content, increased display resolution and size, faster screen refresh rates, video capability such as high definition and 3D, the proliferation of new display devices and the drive to network display devices together. 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. Additionally, if the technology used by our customers becomes less competitive due to cost, customer preferences or other factors relative to alternative technologies, sales of our products could decline.

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

We provide our customers with software development tools and with software that provides basic functionality for our ICs and enables enhanced connectivity of our customers' products. Software development is a complex process and we are dependent on software development languages and operating systems from vendors that may limit 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, requiring significant engineering efforts to migrate our existing systems in order to be compatible with those new languages. Software development disruptions could slow our product development or cause us to lose customers and design wins. 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 increases 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.

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

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 on terms that are acceptable to us or at all. 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 code. 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. We hold 138 patents and have 31 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 patent, 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 invalidated, diluted, circumvented, challenged or licensed to others.

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. Additionally, certain of our customer agreements include limited indemnification provisions for claims from third-parties related to our IP. 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 terms that are acceptable to us 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.

We are dependent on manufacturers of our semiconductor products not only to respond to changes in technology and industry standards but also to continue the manufacturing processes on which we rely.

To respond effectively to changes in technology and industry standards, we are dependent on our foundries to implement advanced 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 and 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.

Creating the capacity for new technological changes may cause manufacturers to discontinue older manufacturing processes in favor of newer ones. We must 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. We may not be able to place last time buy orders for the old technology or find alternate manufacturers of our products to allow us to continue to produce products with the older technology while we expend the significant costs for research and development and time to migrate to new, more advanced processes. For instance, we also utilize 0.18um and 0.15um standard logic processes, which may only be available for the next five to seven years. Additionally, a portion of our products use 0.11um technology for memory die, which is being phased out in favor of 65nm memory die to increase yields and decrease cost. Because of this transition, our customers must re-qualify the affected parts.

Shortages of materials used in the manufacturing of our products and other key components of our customers' products may increase our costs, impair our ability to ship our products on time and delay our ability to sell our products.

From time to time, shortages of components and materials that are critical to the manufacture of our products and our customers' products may occur. Such critical components and materials include semiconductor wafers and packages, double data rate memory die, display components, analog-to-digital converters, digital receivers, video decoders and voltage regulators. 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.

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. 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. 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 manner with higher selling prices or gross profits.

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, Europe and North America. 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 financial results because of changes in industry-wide conditions.

Environmental laws and regulations have caused us to incur, and may again cause us to incur, significant expenditures to comply with applicable laws and regulations, and we may be assessed considerable 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 current adverse global economic environment and volatility in global credit and financial markets could materially and adversely affect our business and results of operations.

Slow economic activity, increased unemployment, decreased business and consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns have contributed to and continue to contribute to a challenging economic environment. This environment has led to reduced spending in the markets in which we compete and made it difficult for our customers, our vendors and us to accurately forecast and plan future business activities. Furthermore, the constraints in the capital and credit markets may limit the ability of our customers to meet their liquidity needs, which could result in an impairment of their ability to make timely payments to us and to reduce their demand for our products, adversely impacting our results of operations and cash flows.

Future sales or other dilution of our equity could depress the market price of our common stock.

Sales of our common stock in the public market, or the perception that such sales could occur, could negatively impact the price of our common stock. We have a number of institutional shareholders that own significant blocks of our common stock. If one or more of these shareholders were to sell large portions of their holdings in a relatively short time, for liquidity or other reasons, the prevailing market price of our common stock could be negatively affected.

In addition, the issuance of additional shares of our common stock, or issuances of securities convertible into or exercisable for our common stock or other equity-linked securities, including preferred stock or warrants, will dilute the ownership interest of our common shareholders and could depress the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

We may need to seek additional capital. If this additional financing is obtained through the issuance of equity securities, debt convertible into equity or options or warrants to acquire equity securities, our existing shareholders could experience significant dilution upon the issuance, conversion or exercise of such securities.

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. The price of our common stock may decline and the value of your investment may be reduced regardless of our performance. Market fluctuations, 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. 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, acquisitions or divestitures;
- the operating and stock price performance of other comparable companies;
- inconsistent trading volume levels of our common stock; and
- changes in market valuations of other technology companies.

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.

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. This could result in the lack of a market for our common stock, cause a decrease in the value of our common stock, 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 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 was $3.43 on February 28, 2011, 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 adverse effects and may not result in a long-term or permanent increase in the price of our common stock. In addition to the minimum $1.00 per share requirement, NASDAQ Global Market also requires satisfaction of one of the following in addition to certain other requirements: (i) a minimum of $50.0 million in total asset value and $50.0 million in revenues (in the latest fiscal year or in two of the last three fiscal years), (ii) a minimum of $50.0 million in market value of listed securities, or (iii) or a minimum of $10.0 million in stockholders' equity. At December 31, 2010, although not required because our shareholders' equity was in excess of $10.0 million, we achieved a $50.0 million total asset value by making a non-formula advance on our short-term line of credit. As recently as December 31, 2008, however, our shareholders' equity was below $10.0 million and in the future we may be unable to meet these continued listing requirements and our stock could become subject to delisting.

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. 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. 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 by limiting our ability to attract and retain qualified executives and employees and limiting our ability to raise capital.

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:

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- 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; and
- 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.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We lease facilities around the world to house our engineering, sales, sales support, administrative and operations functions. We do not own any of our facilities. As a result of our prior restructuring plans we consolidated office space and sublease portions of our facilities. At December 31, 2010, our major facilities consisted of the following:

Location	Function(s)	Total Square Feet Leased	Square Feet Utilized	Square Feet Subleased	Lease Expiration	Sublease Expiration
China	Engineering; sales; customer support	48,000	48,000	—	Various dates through May 2013	—
California	Administration; engineering; sales	37,000	23,000	14,000	June 2013	June 2013
Taiwan	Customer support; sales; operations; engineering	22,000	22,000	—	Various dates through November 2011	—
Oregon	Administration	5,000	5,000	—	November 2013	—
Japan	Sales; customer support	4,000	4,000	—	Various dates through January 2013	—
Washington	None; fully subleased	10,000	—	10,000	October 2011	October 2011

Item 3. Legal Proceedings.

For a discussion of legal proceedings, see "Note 7: Commitments and Contingencies" in Part II, Item 8 of this Annual Report on Form 10-K.

Item 4. (Removed and Reserved).

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Market for Registrant's Common Equity and Related Stockholder Matters

Our common stock is listed for trading on the NASDAQ Global Market under the symbol "PXLW". Our stock began trading on May 19, 2000. The following table sets forth, for the periods indicated, the highest and lowest sales prices of our common stock as reported on the NASDAQ Global Market.

Fiscal 2010	High	Low
Fourth Quarter	$ 3.91	$ 3.15
Third Quarter	3.62	2.62
Second Quarter	5.78	2.98
First Quarter	5.87	2.97

Fiscal 2009	High	Low
Fourth Quarter	$ 4.09	$ 2.15
Third Quarter	4.06	1.25
Second Quarter	1.97	0.56
First Quarter	0.84	0.37

As of February 28, 2011, there were 62 shareholders of record of our common stock and the last per share sales price of the common stock on that date was $3.43. The number of beneficial owners of our common stock is substantially greater than the number of shareholders of record because a significant portion of our outstanding common stock is held in broker "street name" for the benefit of individual investors.

Our financial covenants may limit our ability to pay dividends. There is no assurance as to the payment of future dividends as they are dependent upon future earnings, capital requirements, our operating and financial condition and approval by our board of directors. To date, we have not declared any cash dividends and we currently expect to retain any earnings to finance the expansion and development of our business.

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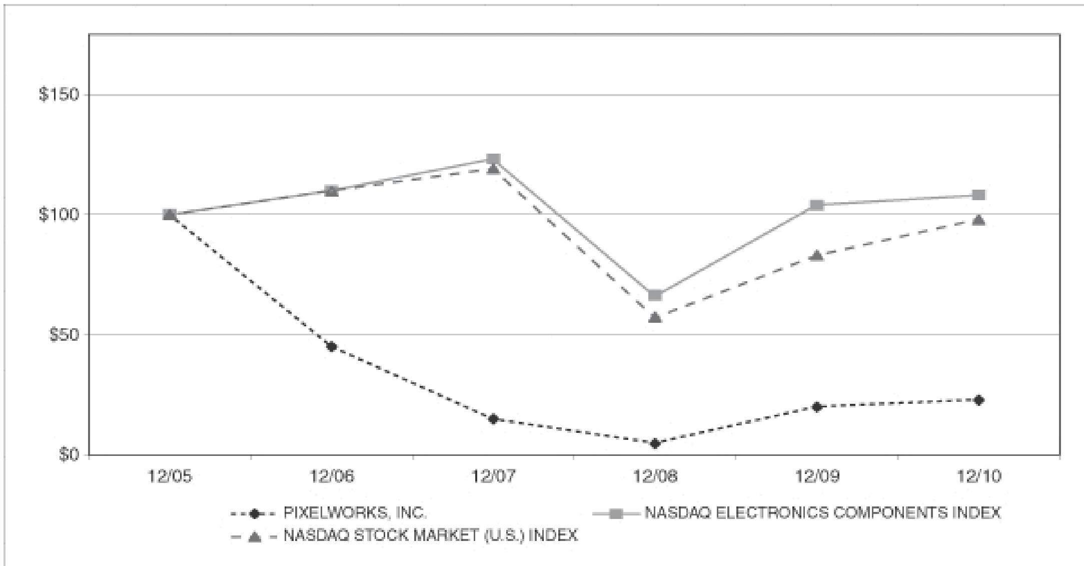
Performance Graph

Set forth below is a graph that compares the cumulative total shareholder return on our common stock with the cumulative total return on the NASDAQ Stock Market (U.S.) Index and the NASDAQ Electronics Components Index over the five-year period ended December 31, 2010. The graph assumes that $100 was invested on December 31, 2005 in our common stock, the NASDAQ Stock Market (U.S.) Index and the NASDAQ Electronics Components Index. In accordance with guidelines of the Securities and Exchange Commission, the shareholder return for each entity in the peer group index has been weighted on the basis of market capitalization. The stock price performance in the graph is not intended to forecast or indicate future stock price performance.

COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN AMONG PIXELWORKS, INC., THE NASDAQ STOCK MARKET (U.S.) INDEX AND THE NASDAQ ELECTRONICS COMPONENTS INDEX



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Item 6. Selected Financial Data.

The following consolidated selected financial data is not necessarily indicative of results of future operations and should be read in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation, and the Consolidated Financial Statements and notes thereto in Item 8. Financial Statements and Supplementary Data.

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	(In thousands, except per share data)				
Consolidated Statement of Operations Data					
Revenue, net	$ 69,529	$ 61,093	$ 85,164	$ 105,980	$ 133,607
Cost of revenue	37,366	33,798	42,963	59,273	107,506
Gross profit	32,163	27,295	42,201	46,707	26,101
Operating expenses:					
Research and development	22,810	20,075	26,512	38,792	57,019
Selling, general and administrative	15,167	13,745	17,945	25,437	35,053
Restructuring	94	235	1,589	13,285	13,316
Amortization of acquired intangible assets	—	—	164	359	602
Impairment loss on goodwill	—	—	—	—	133,739
Impairment loss on acquired intangible assets	—	—	—	—	1,753
Total operating expenses	38,071	34,055	46,210	77,873	241,482
Loss from operations	(5,908)	(6,760)	(4,009)	(31,166)	(215,381)
Interest and other income, net	886	12,338	11,979	2,483	10,254
Income (loss) before income taxes	(5,022)	5,578	7,970	(28,683)	(205,127)
Provision (benefit) for income taxes	(5,395)	(877)	(8)	2,237	(949)
Net income (loss)	$ 373	$ 6,455	$ 7,978	$ (30,920)	$ (204,178)
Net income (loss) per share:					
Basic	$ 0.03	$ 0.48	$ 0.55	$ (1.92)	$ (12.69)
Diluted	$ 0.03	$ 0.47	$ 0.55	$ (1.92)	$ (12.69)
Weighted average shares outstanding:					
Basic	13,442	13,318	14,399	16,069	16,096
Diluted	14,384	13,687	14,410	16,069	16,096

	December 31,				
	2010	2009	2008	2007	2006
	(In thousands)				
Consolidated Balance Sheet Data					
Cash and cash equivalents	$ 16,872	$ 17,797	$ 53,149	$ 74,572	$ 63,095
Short-and long-term marketable securities	12,969	13,062	10,168	44,385	71,489
Working capital	8,072	25,359	61,947	112,360	108,169
Total assets	52,414	56,078	91,732	161,916	207,771
Long-term liabilities, net of current portion	5,635	26,703	73,250	151,871	147,414
Total shareholders' equity (deficit)	13,931	13,073	4,711	(8,027)	21,948

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation.

Overview

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications and hold 138 patents related to the visual display of digital image data. Our solutions enable manufacturers of digital display and projection devices, such as large-screen flat panel televisions and digital front projectors, to manufacture 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 was founded in 1997 and is incorporated under the laws of the state of Oregon.

Pixelworks' flexible design architecture enables our technology to produce outstanding image quality in our customers' products with a range of single-purpose integrated circuits ("ICs"), to system-on-chip ("SoC") ICs that integrate microprocessor, memory and image processing functions. Additionally, we provide full solutions, including a software development environment and operating system, which enable our customers to more quickly develop and customize their display products, thus reducing their time to market and allowing them to incorporate differentiated features and functions.

Our primary target markets are liquid crystal display ("LCD") large-screen televisions and 3LCD and digital light processing ("DLP") digital front projectors, however we also target other segments within the flat panel display market, including digital signage.

We have adopted a product strategy that leverages our core competencies in video processing to address the evolving needs of the advanced flat panel display, digital projection and other markets that require superior image quality. We focus our product investments on developing video enhancement solutions for these markets, with particular focus on adding increased performance and functionality. Additionally, we look for ways to leverage our research and development investment into products that address other high-value markets where our innovative proprietary technology provides differentiation for us and our customers. We continually seek to expand our technology portfolio through internal development, co-development with business partners and evaluation of acquisition opportunities.

Historically, significant portions of our revenue have been generated by sales to a relatively small number of end customers and distributors. We sell our products worldwide through a direct sales force, distributors and manufacturers' representatives. We sell to distributors in Japan, Taiwan, China, Korea, Europe, Southeast Asia and the U.S, and our manufacturers' representatives support some of our Korean and European sales. Our distributors typically provide engineering support to our end customers and often have valuable and established relationships with our end customers. In certain countries in which we operate, it is customary to sell to distributors. While distributor payment to us is not dependent upon the distributor's ability to resell the product or to collect from the end customer, the distributors may provide longer payment terms to end customers than those we would offer.

Significant portions of our products are sold overseas. Sales outside the U.S. accounted for approximately 96%, 97% and 95% of revenue in 2010, 2009 and 2008, respectively. Our integrators, branded manufacturers and branded suppliers incorporate our products into systems that are sold worldwide. All of our revenue to date has been denominated in U.S. dollars.

Factors Affecting Results of Operations and Financial Condition

Financial, commercial and consumer markets experienced significant disruption during the last quarter of 2008 and throughout 2009 which adversely affected our results of operations during 2009. We responded to the economic downturn by initiating a restructuring plan in December 2008 to reduce our operating expenses by reducing operations, research and development and administrative headcount in our San Jose, Taiwan and China offices as well as implementing other cost reduction efforts, including company-wide salary reductions during the second and third quarters of 2009. During the first three quarters of 2010 we experienced an increase in revenue as customer demand strengthened as a result of improvements in the world wide economy. Although the macroeconomic environment and our business appeared to have stabilized since early 2009, in the fourth quarter of 2010 our revenue decreased due in part to inventory corrections by our customers as a result of weakening consumer demand. Additionally, consumer confidence and spending remain cautious and we are unable to predict how the challenging global economic environment may impact our future results of operations and financial position.

Results of Operations

Year ended December 31, 2010 compared with year ended December 31, 2009, and year ended December 31, 2009 compared with year ended December 31, 2008.

Revenue, net

Net revenue was as follows (in thousands):

	Year ended December 31,			2010 v. 2009		2009 v. 2008	
	2010	2009	2008	$ change	%change	$ change	%change
Revenue, net	$69,529	$61,093	$85,164	$8,436	14%	$(24,071)	(28)%

2010 v. 2009

Net revenue increased $8.4 million, or 14%, from 2009 to 2010. The increase was attributable to a 10% increase in units sold and a 4% increase in average selling price (“ASP”). The increase in units sold resulted primarily from increased sales of our new digital projector products, including increased sales in the DLP division of the digital projector market, as customer demand strengthened during 2010 as a result of improvements in the world wide economy. The increase was partially offset by a decrease in sales of our Motion Estimation Motion Compensation (“MEMC”) co-processor ICs as we transitioned customers to our next generation MEMC co-processor ICs. The increase in ASP was primarily the result of an increase in the percentage of total revenue from the digital projector market, which generally has higher ASPs than our other products.

2009 v. 2008

Net revenue decreased $24.1 million, or 28%, from 2008 to 2009 as the result of a 30% decrease in units sold, partially offset by a 3% increase in ASP. The decrease in units sold during 2009 compared to 2008 resulted primarily from weakened customer demand due to the worldwide economic downturn, particularly during the first half of 2009. Decreased revenue also resulted from lower sales of our legacy products, including those we acquired in our acquisition of Equator Technologies, Inc. (“Equator”) in June 2005, and lower sales into markets which we no longer pursue. These decreases were partially offset by an increase in sales of our MEMC co-processor ICs, and our next generation projector image processors.

We did experience some recovery in revenue levels in the second half of 2009 compared to the first half of 2009 as the worldwide economy strengthened. Our most significant recovery was in digital projector market sales, which were up slightly from the second half of 2008 to the second half of 2009, compared with a decrease of 50% from the first half of 2008 to the first half of 2009. Revenue from our advanced television market, which includes the panel market and our MEMC co-processor ICs, was approximately flat from the second half of 2008 to the second half of 2009, an improvement over the 24% decrease from the first half of 2008 to the first half of 2009. Our revenue from other markets did not experience a recovery during the second half of 2009, compared to the second half of 2008, primarily due to consistent decreases in unit sales of legacy products in markets which we no longer pursue.

Cost of revenue and gross profit

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

	Year ended December 31,					
	2010	% of revenue	2009	% of revenue	2008	% of revenue
Direct product costs and related overhead [1]	$34,629	50%	$ 30,630	50%	$39,362	46%
Amortization of acquired intangible assets	1,050	2	2,336	4	2,820	3
Inventory charges [2]	1,543	2	518	1	488	1
Other cost of revenue [3]	144	0	314	0	293	0
Total cost of revenue	$37,366	54%	$ 33,798	55%	$42,963	50%
Gross profit	$ 32,163	46%	$27,295	45%	$ 42,201	50%

[1] Includes purchased materials, assembly, test, labor, employee benefits, warranty expense and royalties.
[2] Includes the net provision for inventory reserves and lower of cost or market write-downs.
[3] Includes restructuring, stock-based compensation and additional amortization of non-cancelable prepaid royalty.

2010 v. 2009

Total cost of revenue decreased to 54% of revenue in 2010 from 55% of revenue in 2009. The decrease was primarily attributable to the decrease in amortization expense for acquired intangible assets that were fully amortized as of the second quarter of 2010. The decrease is partially offset by an increase in inventory charges as we transitioned customers to our next generation products. Direct product costs as a percentage of revenue remained flat in 2010 primarily due to favorable overhead cost absorption as a result of increased revenue without corresponding increases in our fixed costs, offset by a higher mix of our new products which have higher material costs than our legacy products.

We expect future cost improvements on our MEMC products and next generation projector processors as we continue to ramp production and realize production efficiencies; however, we are unable to predict the timing and extent of expected cost improvements.

2009 v. 2008

Total cost of revenue increased to 55% of revenue in 2009 from 50% of revenue in 2008. The increase was primarily attributable to an increase in direct product costs due to changes in the mix of products sold, including increased sales of our MEMC products and next generation projector processors and decreased sales of our legacy Equator products. Gross profit margins also decreased due to the impact of lower overhead cost absorption due to decreased revenue without corresponding reductions in our fixed costs.

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.

Research and development expense was as follows (in thousands):

	Year ended December 31,			2010 v. 2009		2009 v. 2008	
	2010	2009	2008	$ change	%change	$ change	%change
Research and development	$22,810	$20,075	$26,512	$2,735	14%	$(6,437)	(24)%

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2010 v. 2009

Research and development expense increased $2.7 million, or 14%, from 2009 to 2010. This increase is primarily attributable to the following:

- Compensation expense increased $1.2 million as a result of:
  - the elimination of a Company-wide salary reduction that was in effect during the second and third quarters of 2009;
  - an increase in the number of research and development employees; and
  - annual merit salary increases granted during the year.
- Depreciation and amortization expense, software maintenance expense and expensed equipment and software increased $0.7 million as a result of an increase in engineering software tools, and our purchase of additional equipment during 2010.
- Non-recurring engineering and outside services increased $0.6 million due to an increase in new product development.

2009 v. 2008

Research and development expense decreased $6.4 million, or 24%, from 2008 to 2009. This decrease was primarily attributable to the restructuring efforts that we initiated in November 2006 and December 2008, and which were completed in the fourth quarter of 2008 and second quarter of 2009, respectively. These efforts resulted in the following reductions in research and development expenses:

- Depreciation and amortization expense, software maintenance expense and expensed equipment and software decreased $2.7 million. This decrease resulted from fewer engineering software tools due to changes in product development strategy as well as decreased amortization from certain licensed technology which became fully amortized during the first and second quarters of 2009.
- Compensation expense decreased $1.9 million as a result of:
  - a Company-wide 10% salary reduction that was in effect during the second and third quarters of 2009;
  - a reduced senior management bonus for 2009 compared to 2008; and
  - continuous improvement in our engineering practices to lower costs and improve efficiency.
- Stock-based compensation expense decreased $0.8 million due to personnel reductions and reduced valuation of our stock options.
- Facilities and information technology expense allocations decreased $0.7 million, primarily due to reductions in rent and decreased depreciation of equipment and leasehold improvements.

Selling, general and administrative

Selling, general and administrative expense includes compensation and related costs for personnel, sales commissions, facilities and information technology expense allocations, 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 was as follows (in thousands):

	Year ended December 31,			2010 v. 2009		2009 v. 2008	
	2010	2009	2008	$ change	%change	$ change	%change
Selling, general and administrative	$15,167	$13,745	$17,945	$1,422	10%	$(4,200)	(23)%

2010 v. 2009

Selling, general and administrative expense increased $1.4 million, or 10%, from 2009 to 2010. The increase in selling, general and administrative expense is primarily attributable to the following:

- Compensation expense increased $0.7 million as a result of:
  - elimination of a Company-wide salary reduction in effect during the second and third quarters of 2009;
  - an increase in the number of sales, general and administrative employees; and
  - annual merit salary increases granted during the year.
- Travel related expense increased $0.3 million.

2009 v. 2008

Selling, general and administrative expense decreased $4.2 million, or 23%, from 2008 to 2009. The decrease in selling, general and administrative expense from 2008 to 2009 is primarily attributable to the restructuring efforts that we initiated in November 2006 and December 2008, and which were completed in the fourth quarter of 2008 and second quarter of 2009, respectively. These efforts resulted in the following reductions in selling, general and administrative expenses:

- Compensation expense decreased $1.6 million as a result of:
  - a Company-wide 10% salary reduction that was in effect during the second and third quarters of 2009;
  - a reduced senior management bonus for 2009 compared to 2008; and
  - headcount reductions during 2009.
- Stock-based compensation expense decreased $0.7 million due to personnel reductions and reduced valuation of our stock options.
- Facilities and information technology allocations decreased $0.5 million, primarily due to reductions in headcount, outsourced IT support, lower rent and decreased equipment depreciation.
- Sales commissions decreased $0.5 million primarily due to lower sales volume.

Restructuring

Restructuring expense was comprised of the following amounts (in thousands):

	Year ended December 31,		
	2010	2009	2008
Termination and retention benefits [1]	$ —	$ 118	$ 1,172
Consolidation of leased space [2]	94	160	508
Total restructuring expenses	$ 94	$ 278	$ 1,680
Included in cost of sales	$ —	$ 43	$ 91
Included in operating expenses	94	235	1,589

[1] Includes severance payments for terminated employees in 2009 and 2008 and retention payments for certain continuing employees in 2008.

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

In December 2008, we initiated a restructuring plan to reduce our operating expenses in response to decreases in current and forecasted revenue which resulted from global economic uncertainty. The 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. All termination benefits recorded during 2009 were attributable to the plan initiated in December 2008.

In November 2006, we initiated a restructuring plan that included consolidation of our operations in order to reduce compensation and rent expense, while at the same time making critical infrastructure investments in people, processes and information systems to improve our operating efficiency. Although this plan was completed in the fourth quarter of 2008, lease termination costs were recorded in 2010 and 2009 due to decreases in estimated future sublease income and related professional fees.

Other income, net

Net other income consisted of the following (in thousands):

	Year ended December 31,			$ change	
	2010	2009	2008	2010 v. 2009	2009 v. 2008
Gain on sale of marketable securities	$1,397	$ —	$ —	$ 1,397	$ —
Interest income (expense) and other, net [1]	(511)	(522)	199	11	(721)
Gain on repurchase of long-term debt, net [2]	—	12,860	19,670	(12,860)	(6,810)
Other-than-temporary impairment of marketable securities, net [3]	—	—	(7,890)	—	7,890
Total other income, net	$ 886	$ 12,338	$11,979	$ (11,452)	$ 359

[1] Interest income (expense) and other, net primarily relates to interest payable on our 1.75% convertible subordinated debentures (the "debentures"). The decrease in 2009 is due to the reduced outstanding principal balance which resulted from our repurchases of our debentures during the first half of 2009. This line also includes interest income from our cash and investments and amortization of debt issuance costs.

[2] In 2009, we repurchased and retired $44.9 million of our debentures for a net gain of $12.9 million. In 2008, we repurchased and retired $79.4 million of our debentures for a net gain of $19.7 million.

[3] In 2008, we recognized an other-than-temporary impairment of $7.9 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.

Benefit for income taxes

The benefit for income taxes was as follows (in thousands):

	Year ended December 31,		
	2010	2009	2008
Benefit for income taxes	$(5,395)	$ (877)	$ (8)

The income tax benefit recorded for the years ended December 31, 2010 and 2009 of $5.4 million and $0.9 million, respectively was primarily due to the reversal of previously recorded tax contingencies due to the expiration of the applicable statutes of limitation, partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions. The income tax benefit recorded for the year ended December 31, 2008 is comprised of current and deferred tax expense in profitable foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions, offset by a benefit of $0.9 million for refundable research and experimentation credits and a benefit of $0.6 million for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations.

At December 31, 2010, we continued to provide a full valuation allowance against our U.S. and Canadian deferred tax assets as we do not believe that it is more likely than not that we will realize those assets due to the inability to generate sufficient taxable income necessary to utilize the benefit of the deferred tax assets. We did not record a valuation allowance against our other foreign deferred tax assets as we believe that it is more likely than not that we will realize a benefit from those assets.

As of December 31, 2010, we have federal, state and foreign net operating loss carryforwards of approximately $173.1 million, $73.5 million and $0.4 million, respectively, which will expire between 2011 and 2027. As of December 31, 2010, we have available federal, state and foreign research and experimentation tax credit carryforwards of approximately $7.2 million, $2.4 million and $1.9 million, respectively, which begin expiring in 2011. We have a general foreign tax credit of $2.8 million which will begin expiring in 2018.

Business Outlook

On January 27, 2011, we provided an outlook for the first quarter of 2011 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:

- First quarter revenue of $14.5 million to $16.5 million.
- Gross profit margin of approximately 44% to 48%.
- Operating expenses of $9.5 million to $10.5 million.

Liquidity and Capital Resources

Cash and short- and long-term marketable securities

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

	December 31,			$ Change	
	2010	2009	2008	2010 v. 2009	2009 v. 2008
Cash and cash equivalents	$16,872	$17,797	$53,149	$ (925)	$(35,352)
Short-term marketable securities	12,366	9,822	8,058	2,544	1,764
Long-term marketable securities	603	3,240	2,110	(2,637)	1,130
Total cash and marketable securities	$ 29,841	$ 30,859	$ 63,317	$ (1,018)	$ (32,458)

Total cash and marketable securities decreased $1.0 million from 2009 to 2010. The decrease resulted primarily from $3.0 million in payments on property and equipment and other asset financing and $2.3 million for purchases of property and equipment and other assets. These decreases were partially offset by $0.6 million generated by operating activities, $0.5 million of realized and unrealized gains on marketable securities and a $3.0 million non-formula advance on our short-term line of credit, as discussed below under Capital Resources. Excluding the non-formula advance, our cash and marketable securities would have decreased $4.0 million from 2009 to 2010.

Total cash and marketable securities decreased $32.5 million from 2008 to 2009. The decrease resulted primarily from $31.5 million used for the repurchase of long-term debt, $2.2 million in payments on property and equipment and other asset financing and $1.6 million used for purchases of property and equipment and other long-term assets. The decreases were partially offset by $2.0 million of positive cash flow from operations and a $1.1 million increase in the valuation of our long-term marketable security.

At December 31, 2010, cash equivalents and short-term marketable securities included $14.1 million in money market funds and certificates of deposit, $5.5 million in U.S. government agencies debt securities, $6.9 million in commercial paper, and $1.6 million in corporate debt securities. At December 31, 2010, we also held a $0.6 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.

The quality of our short-term investment portfolio remains high during this difficult credit environment. Our investment policy requires that our portfolio maintains a weighted average maturity of less than 12 months.

Additionally, no maturities can extend beyond 24 months 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 December 31, 2010, we had a nominal unrealized gain on these investments.

The valuation of our long-term equity investment has fluctuated significantly and during the year ended December 31, 2008, we recorded other-than-temporary impairments of $7.9 million, decreasing our cost basis from $10.0 million to $2.1 million as of December 31, 2008. During the year ended December 31, 2010, we sold $1.8 million of our long-term equity investment for gross proceeds of $3.2 million and realized gains of $1.4 million. Our remaining cost basis in the investment at December 31, 2010 was $0.3 million.

Accounts receivable, net

Net accounts receivable decreased to $4.5 million at December 31, 2010 from $5.6 million at December 31, 2009. Average number of days sales outstanding increased to 29 days at December 31, 2010 from 26 days at December 31, 2009.

Inventories, net

Net inventories decreased to $4.9 million at December 31, 2010 from $6.2 million at December 31, 2009. Inventory turnover decreased to 5.8 at December 31, 2010 from 7.0 at December 31, 2009. The Company calculates inventory turnover using annualized operating results and inventory balances for the fourth quarter.

Capital resources

On December 21, 2010, we entered into a Loan and Security Agreement (the "Revolving Loan Agreement") with Silicon Valley Bank (the "Bank"). The Revolving Loan Agreement provides for a secured working capital-based revolving line of credit (the "Revolving Line") in an aggregate amount of up to the lesser of (i) $10.0 million, or (ii) 80% of eligible domestic accounts receivable and certain foreign accounts receivable. In addition, the Revolving Loan Agreement provides for non-formula advances of up to $10.0 million which may be made solely during the last five business days of any fiscal month or quarter and which must be repaid by the Company on or before the fifth business day after the applicable fiscal month or quarter end. Due to their repayment terms, non-formula advances do not provide the Company with usable liquidity and are utilized by the Company in order to maintain a $50.0 million total asset value.

The Revolving Loan Agreement contains customary affirmative and negative covenants, including with respect to the following: compliance with laws, provision of financial statements and periodic reports, payment of taxes, maintenance of inventory and insurance, maintenance of operating accounts at the Bank, the Bank's access to collateral, formation or acquisition of subsidiaries, incurrence of indebtedness, dispositions of assets, granting liens, changes in business, ownership or business locations, engaging in mergers and acquisitions, making investments or distributions and affiliate transactions. The covenants also require that the Company maintain a minimum ratio of qualifying financial assets to the sum of qualifying financial obligations.

The Revolving Loan Agreement also contains customary events of default, including the following: defaults with respect to covenant compliance, the occurrence of a material adverse change, the occurrence of certain bankruptcy or insolvency events, cross-defaults, judgment defaults and material misrepresentations. The occurrence of an event of default could result in the acceleration of the Company's obligations under the Revolving Loan Agreement and an increase to the applicable interest rate, and would permit the Bank to exercise remedies with respect to its security interest.

To secure the repayment of any amounts borrowed under the Revolving Loan Agreement, the Company granted to the Bank a security interest in substantially all of its assets, which assets do not include its intellectual property assets. The Company has agreed not to pledge or otherwise encumber its intellectual property assets without prior written permission from the Bank.

In 2004, we issued $150.0 million of 1.75% convertible subordinated debentures due 2024. In 2006, we repurchased and retired $10.0 million principal amount of the debentures. In 2008, we repurchased and retired $79.4 million principal amount of the debentures for $58.6 million in cash. In 2009, we repurchased and retired $44.9 million principal amount 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 outstanding 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.

As of December 31, 2010, the debentures are classified as current liabilities as we expect the holders to require us to purchase all of the debentures on May 15, 2011. We intend to refinance or repurchase the debentures on or before May 15, 2011, which may consume a significant portion of our working capital, require the issuance of new debt on less favorable terms than our existing obligations or require the issuance of equity securities that may result in dilution to existing shareholders.

In September 2007, the Board of Directors authorized the repurchase of up to $10.0 million of the Company's common stock under a share repurchase program that expired in September 2009. Total cumulative repurchases under the plan were $7.1 million.

Liquidity

Our cash and marketable securities totaling $29.8 million, are highly liquid with scheduled maturities prior to May 15, 2011, the date we expect to be required to repurchase our debentures. Although the repayment of our debentures would consume a significant portion of our cash and marketable securities, we anticipate that our existing working capital, as well as funds available under our Revolving Line, will be adequate to fund our operating, investing and financing needs for the next twelve months. If necessary, management will pursue financing arrangements including the issuance of debt or equity securities or will reduce expenditures, in order to meet the Company's cash requirements. There is no assurance that, if required, we will be able to raise additional capital or reduce discretionary spending to provide the required liquidity which, in turn, may have an adverse effect on our results of operations and financial position.

From time to time, we may evaluate acquisitions of businesses, products or technologies that complement our business. 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.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires us to make estimates and judgments that affect the amounts reported. On an ongoing basis, we evaluate our estimates, including those related to product returns, warranty obligations, bad debts, inventories, property and equipment, intangible assets, impairment of long-lived assets, valuation of investments, amortization of prepaid royalties, valuation of share-based payments, income taxes, litigation and other contingencies. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements:

Revenue Recognition. We recognize revenue when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed and determinable, and collection is reasonably assured. We require customers to provide purchase orders prior to shipment and we consider delivery to occur upon shipment provided title and risk of loss have passed to the customer based on the shipping terms. These conditions are generally satisfied upon shipment of the underlying product.

Sales Returns and Allowances. Our customers do not have a stated right to return product except for replacement of defective products under our warranty program discussed below. However, we have accepted customer returns on a case-by-case basis as customer accommodations in the past. As a result, we provide for these returns in our reserve for sales returns and allowances. At the end of each reporting period, we estimate the reserve for returns based on historical experience and knowledge of any applicable events or transactions.

Certain of our distributors have stock rotation provisions in their distributor agreements, which allow them to return 5-10% of the products purchased in the prior six months in exchange for products of equal value. We analyze historical stock rotations at the end of each reporting period. To date, returns under the stock rotation provisions have been nominal.

Certain distributors also have price protection provisions in their distributor agreements with us. Under the price protection provisions, we grant distributors credit if they purchased product for a specific end customer and we subsequently lower the price to the end customer such that the distributor can no longer earn its negotiated margin on in-stock inventory. At the end of each reporting period, we estimate a reserve for price protection credits based on historical experience and knowledge of any applicable events or transactions. The reserve for price protection, if required, is included in our reserve for sales returns and allowances.

Product Warranties. We warrant that our products will be free from defects in materials and workmanship for a period of twelve months from delivery. Warranty repairs are guaranteed for the remainder of the original warranty period. Our warranty is limited to repairing or replacing products, or refunding the purchase price.

At the end of each reporting period, we estimate a reserve for warranty returns based on historical experience and knowledge of any applicable events or transactions. While we engage in extensive product quality programs and processes, which include actively monitoring and evaluating the quality of our suppliers, should actual product failure rates or product replacement costs differ from our estimates, revisions to the estimated warranty liability may be required.

Allowance for Doubtful Accounts. We offer credit to customers after careful examination of their creditworthiness. We maintain an allowance for doubtful accounts for estimated losses that may result from the inability of our customers to make required payments. At the end of each reporting period, we estimate the allowance for doubtful accounts based on our account-by-account risk analysis of outstanding receivable balances. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventory Valuation. We record a reserve against our inventory for estimated obsolete, unmarketable, and otherwise impaired products by calculating the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. We review our inventory at the end of each reporting period for valuation issues. If actual market conditions are less favorable than those we projected at the time the reserve was recorded, additional inventory write-downs may be required.

Useful Lives and Recoverability of Equipment and Other Long-Lived Assets. We evaluate the remaining useful life and recoverability of equipment and other assets, including identifiable intangible assets with definite lives, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If there is an indicator of impairment, we prepare an estimate of future, undiscounted cash flows expected to result from the use of each asset and its eventual disposition. If these cash flows are less than the carrying value of the asset, we adjust the carrying amount of the asset to its estimated fair value. While we have concluded that the carrying value of our long-lived assets is recoverable as of December 31, 2010, our analysis is dependent upon our estimates of future cash flows and our actual results may vary.

Valuation of Investments. We apply judgment in determining whether our marketable securities are other-than-temporarily impaired. When performing our evaluation, we consider the duration of the decline, future prospects of the issuer and our ability and intent to hold the security to recovery.

Stock-Based Compensation. We estimate the fair value of share-based payments using the Black-Scholes option pricing model, which requires certain estimates, including an expected forfeiture rate and expected term of options granted. We also make decisions regarding the method of calculating expected volatilities and the risk-free interest rate used in the option-pricing model. The resulting calculated fair value of share-based payments is recognized as compensation expense over the requisite service period, which is generally the vesting period. When there are changes to the assumptions used in the option-pricing model, including fluctuations in the market price of our common stock, there will be variations in the calculated fair value of the share-based payments, which results in variation in the compensation cost recognized.

Income Taxes. We record deferred income taxes for temporary differences between the amount of assets and liabilities for financial and tax reporting purposes and we record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. We also regularly conduct a comprehensive review of our uncertain tax positions. In this regard, an uncertain tax position represents our expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return, that has not been reflected in measuring income tax expense for financial reporting purposes. Until these positions are sustained by the taxing authorities, we do not recognize the tax benefits resulting from such positions and report the tax effects as a liability for uncertain tax positions in our consolidated balance sheet.

Contractual Payment Obligations

A summary of our contractual obligations as of December 31, 2010 is as follows:

	Payments Due By Period				
Contractual Obligation	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating leases [1]	$ 3,117	$ 1,690	$ 1,427	$ —	$ —
Payments on accrued balances related to asset purchases	3,914	2,601	1,314	—	—
Estimated Q1 2011 purchase commitments to contract manufacturers	6,841	6,841	—	—	—
Other purchase obligations and commitments	300	300			
Total [2]	$ 14,172	$ 11,432	$ 2,741	$ —	$ —

1 The operating lease payments above are net of sublease rental income of $0.4 million, $0.3 million and $0.1 million for the years ending December 31, 2011, 2012 and 2013, respectively.

2 We are unable to reliably estimate the timing of future payments related to uncertain tax positions; therefore, $3.6 million of income taxes payable has been excluded from the table above.

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, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Interest Rate 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.

During 2010 and as of December 31, 2010, substantially all of our cash equivalents and investments were held in high quality securities or money market funds with yields approaching zero, accordingly, a hypothetical decrease in interest rates would not have a significant impact on our results of operations or financial position.

As of December 31, 2010, 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.

Exchange Rate Risk

All of our sales and inventory purchases 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 or cost of goods sold. We have employees located in offices in Japan, Taiwan, Korea 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 analyze our exposure to foreign currency fluctuations and may engage in financial hedging techniques in the future to attempt to minimize the effect of these potential fluctuations; however, foreign currency exchange rate fluctuations may adversely affect our financial results in the future.

Item 8. Financial Statements and Supplementary Data.

The following financial statements and reports are included in Item 8:

Report of Independent Registered Public Accounting Firm
The Board of Directors and Shareholders
Pixelworks, Inc:

We have audited the accompanying consolidated balance sheets of Pixelworks, Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, shareholders' equity (deficit) and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2010. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pixelworks, Inc. and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Pixelworks, Inc.'s internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 9, 2011 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ KPMG LLP

Portland, Oregon
March 9, 2011

PIXELWORKS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31, 2010	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 16,872	$ 17,797
Short-term marketable securities	12,366	9,822
Accounts receivable, net	4,487	5,619
Inventories, net	4,858	6,158
Prepaid expenses and other current assets	2,337	2,265
Total current assets	40,920	41,661
Long-term marketable securities	603	3,240
Property and equipment, net	5,830	5,121
Other assets, net	5,061	5,006
Acquired intangible assets, net	—	1,050
Total assets	$ 52,414	$ 56,078
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 4,804	$ 7,680
Accrued liabilities and current portion of long-term liabilities	8,983	8,513
Current portion of income taxes payable	282	109
Short-term line of credit	3,000	—
Debentures currently payable	15,779	—
Total current liabilities	32,848	16,302
Long-term liabilities, net of current portion	2,061	1,462
Income taxes payable, net of current portion	3,574	9,462
Long-term debt	—	15,779
Total liabilities	38,483	43,005
Commitments and contingencies (Note 7)		
Shareholders' equity:		
Preferred stock, $0.001 par value, 50,000,000 shares authorized, none issued	—	—
Common stock, $0.001 par value; 250,000,000 shares authorized, 13,566,021 and 13,403,057 shares issued and outstanding as of December 31, 2010 and 2009, respectively	336,254	334,849
Accumulated other comprehensive income	167	1,087
Accumulated deficit	(322,490)	(322,863)
Total shareholders' equity	13,931	13,073
Total liabilities and shareholders' equity	$ 52,414	$ 56,078

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31, 2010	2009	2008
Revenue, net	$69,529	$ 61,093	$ 85,164
Cost of revenue (1)	37,366	33,798	42,963
Gross profit	32,163	27,295	42,201
Operating expenses:			
Research and development (2)	22,810	20,075	26,512
Selling, general and administrative (3)	15,167	13,745	17,945
Restructuring	94	235	1,589
Amortization of acquired intangible assets	—	—	164
Total operating expenses	38,071	34,055	46,210
Loss from operations	(5,908)	(6,760)	(4,009)
Gain on sale of marketable securities	1,397	—	—
Interest income (expense) and other, net	(511)	(522)	199
Gain on repurchase of long-term debt, net	—	12,860	19,670
Other-than-temporary impairment of marketable securities	—	—	(7,890)
Total other income, net	886	12,338	11,979
Income (loss) before income taxes	(5,022)	5,578	7,970
Benefit for income taxes	(5,395)	(877)	(8)
Net income	$ 373	$ 6,455	$ 7,978
Net income per share			
Basic	$ 0.03	$ 0.48	$ 0.55
Diluted	$ 0.03	$ 0.47	$ 0.55
Weighted average shares outstanding			
Basic	13,442	13,318	14,399
Diluted	14,384	13,687	14,410
(1) Includes:			
Amortization of acquired developed technology	$ 1,050	$ 2,336	$ 2,820
Additional amortization of non-cancelable prepaid royalty	84	251	144
Stock-based compensation	60	20	58
Restructuring	—	43	91
(2) Includes stock-based compensation	437	464	1,250
(3) Includes stock-based compensation	707	540	1,198

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31,		
	2010	2009	2008
Cash flows from operating activities:			
Net income	$ 373	$ 6,455	$ 7,978
Adjustments to reconcile net income to net cash provided by operating activities:			
Reversal of uncertain tax positions	(6,194)	(1,819)	(559)
Depreciation and amortization	4,537	4,607	6,700
Gain on sale of marketable securities	(1,397)	(3)	—
Stock-based compensation	1,204	1,024	2,506
Amortization of acquired intangible assets	1,050	2,336	2,984
Deferred income tax expense	247	68	291
Amortization (accretion) on short-and long-term marketable securities	98	24	(345)
Amortization of debt issuance costs	74	124	426
Other non-cash tax benefit	(26)	—	—
(Gain) loss on asset disposals	(4)	4	180
Gain on repurchase of long-term debt, net	—	(12,860)	(19,670)
Other-than-temporary impairment of marketable securities	—	—	7,890
Write-off of assets to restructuring	—	—	14
Other	56	58	55
Changes in operating assets and liabilities:			
Accounts receivable, net	1,132	530	74
Inventories, net	1,300	(1,177)	6,284
Prepaid expenses and other current and long-term assets, net	1,117	931	974
Accounts payable	(3,106)	3,389	223
Accrued current and long-term liabilities	(303)	(2,377)	(1,454)
Income taxes payable	479	672	410
Net cash provided by operating activities	637	1,986	14,961
Cash flows from investing activities:			
Proceeds from sales and maturities of available-for-sale marketable securities	17,485	13,195	54,532
Purchases of available-for-sale marketable securities	(16,964)	(15,110)	(22,999)
Purchases of property and equipment	(1,795)	(1,481)	(2,158)
Purchases of licensed technology	(480)	(102)	—
Proceeds from sales of property and equipment	6	2	20
Net cash provided by (used in) investing activities	(1,748)	(3,496)	29,395
Cash flows from financing activities:			
Payments on asset financings	(3,015)	(2,161)	(4,646)
Proceeds from line of credit	3,000	—	—
Proceeds from issuances of common stock	201	18	47
Repurchase of long-term debt	—	(31,532)	(58,554)
Repurchase of common stock	—	(167)	(2,626)
Net cash provided by (used in) financing activities	186	(33,842)	(65,779)
Net change in cash and cash equivalents	(925)	(35,352)	(21,423)
Cash and cash equivalents, beginning of period	17,797	53,149	74,572
Cash and cash equivalents, end of period	$ 16,872	$ 17,797	$ 53,149

See accompanying notes to consolidated financial statements.

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PIXELWORKS, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT) AND COMPREHENSIVE INCOME (LOSS)
(In thousands, except share data)

	Common Stock		Exchangeable Shares		Accumulated Other Comprehensive Income (loss)	Comprehensive Income (loss)	Accumulated Deficit	Total Shareholders' Equity (Deficit)
	Shares	Amount	Shares	Amount				
Balance as of December 31, 2007	15,104,926	$ 333,934	4,009	$ 113	$ (4,778)		$ (337,296)	$ (8,027)
Stock issued under stock option and stock purchase plans	24,929	47	—	—	—		—	47
Repurchase of common stock	(1,625,737)	(2,626)	—	—	—		—	(2,626)
Conversion of exchangeable shares into common stock	4,009	113	(4,009)	(113)	—		—	—
Stock-based compensation expense	—	2,506	—	—	—		—	2,506
Net income	—	—	—	—	—	$ 7,978	7,978	7,978
Reclassification adjustment from accumulated other comprehensive income for other-than-temporary loss on marketable securities included in net income, net of tax of $0	—	—	—	—	4,810	4,810	—	4,810
Unrealized gain on available-for-sale securities, net of tax of $0	—	—	—	—	50	50	—	50
Pension adjustment, net of tax of $(7)	—	—	—	—	(27)	(27)	—	(27)
Comprehensive income	—	—	—	—	—	$ 12,811	—	—
Balance as of December 31, 2008	13,508,127	333,974	—	—	55		(329,318)	4,711
Stock issued under stock option and stock purchase plans	123,530	18	—	—	—		—	18
Repurchase of common stock	(228,600)	(167)	—	—	—		—	(167)
Stock-based compensation expense	—	1,024	—	—	—		—	1,024
Net income	—	—	—	—	—	$ 6,455	6,455	6,455
Unrealized gain on available-for-sale securities, net of tax of $0	—	—	—	—	1,003	1,003	—	1,003
Pension adjustment, net of tax of $11	—	—	—	—	29	29	—	29
Comprehensive income	—	—	—	—	—	$ 7,487	—	—
Balance as of December 31, 2009	13,403,057	$ 334,849	—	$ —	$ 1,087		$ (322,863)	$ 13,073
Stock issued under stock option and stock purchase plans	162,964	201	—	—	—		—	201
Stock-based compensation expense	—	1,204	—	—	—		—	1,204
Net income	—	—	—	—	—	$ 373	373	373
Reclassification of unrealized gain upon sale of available-for-sale securities	—	—	—	—	(944)	(944)	—	(944)
Unrealized gain on available-for-sale securities, net of tax of $26	—	—	—	—	47	47	—	47
Pension adjustment, net of tax of $14	—	—	—	—	(23)	(23)	—	(23)
Comprehensive loss	—	—	—	—	—	$ (547)	—	—
Balance as of December 31, 2010	13,566,021	$ 336,254	—	$ —	$ 167		$ (322,490)	$ 13,931

See accompanying notes to consolidated financial statements.

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

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 and hold 138 patents related to the visual display of digital image data. Our solutions enable manufacturers of digital display and projection devices, such as large-screen flat panel televisions 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 was founded in 1997 and is incorporated under the laws of the state of Oregon.

Consolidated Financial Statements

Our consolidated financial statements include the accounts of Pixelworks and its wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated. All foreign subsidiaries use the U.S. dollar as the functional currency, and as a result, transaction gains and losses are included in the statement of operations. Transaction gains (losses) were $6, $(69) and $(121) for the years ended December 31, 2010, 2009 and 2008, respectively.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles ("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 investments, 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.

Reclassifications

Certain reclassifications have been made to the 2009 and 2008 consolidated financial statements to conform with the 2010 presentation, including the reclassification of the reversal of uncertain tax positions within operating activities in the consolidated statements of cash flow.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

We classify all cash and highly liquid investments with original maturities of three months or less at the date of purchase as cash and cash equivalents. Cash equivalents totaled $15,835 and $17,073 at December 31, 2010 and 2009, respectively.

Marketable Securities

Our investments in marketable securities are classified as available-for-sale. Available-for-sale securities are stated at fair value based on quoted market prices with unrealized holding gains or losses, net of tax, included in accumulated other comprehensive income, a component of shareholders' equity. The cost of securities sold is based on the specific identification method.

We periodically evaluate whether declines in fair values of our investments below their cost are other-than-temporary. This evaluation includes qualitative and quantitative factors regarding the severity and duration of the unrealized loss, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer, and our ability and intent to hold the investment for a period of time to allow for an anticipated recovery in market value.

Short-term marketable debt securities have remaining maturities of less than twelve months.

Accounts Receivable

Accounts receivable are recorded at invoiced amount and do not bear interest when recorded or accrue interest when past due. We maintain an allowance for doubtful accounts for estimated losses that may result from the inability of our customers to make required payments. At the end of each reporting period, we estimate the allowance for doubtful accounts based on an account-by-account risk analysis of outstanding receivable balances. The determination to write-off specific accounts receivable balances is made based on likelihood of collection and past due status. Past due status is based on invoice date and terms specific to each customer.

Inventories

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.

Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated on a straight-line basis over the estimated useful life of the assets which are generally as follows:

Software	Lesser of 3 years or contractual license term
Equipment, furniture and fixtures	2 years
Tooling	2 - 4 years
Leasehold improvements	Lesser of lease term or estimated useful life

The cost of property and equipment repairs and maintenance is expensed as incurred.

Acquired Intangible Assets

Intangible assets are amortized on a straight-line basis over their estimated useful lives.

Licensed Technology

We have capitalized licensed technology assets in other long-term assets. These assets are stated at cost and are amortized on a straight-line basis over the term of the license or the estimated life of the asset, if the license is not contractually limited, which is generally three to five years.

Useful Lives and Recoverability of Equipment and Other Long-Lived Assets

We evaluate the remaining useful life and recoverability of equipment and other assets, including identifiable intangible assets with definite lives, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If there is an indicator of impairment, we prepare an estimate of future, undiscounted cash flows expected to result from the use of each asset and its eventual disposition. If these cash flows are less than the carrying value of the asset, we adjust the carrying amount of the asset to its estimated fair value.

Revenue Recognition

We recognize revenue when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed and determinable, and collection is reasonably assured. We require customers to provide purchase orders prior to shipment and we consider delivery to occur upon shipment provided title and risk of loss have passed to the customer based on the shipping terms. These conditions are generally satisfied upon shipment of the underlying product.

There are no customer acceptance provisions associated with our products, and except for replacement of defective products under our warranty program discussed below, we have no obligation to accept product returns from end customers; however, we have accepted returns on a case-by-case basis as customer accommodations in the past. As a result, we provide for estimated reductions to gross profit for these sales returns in our reserve for sales returns and allowances. At the end of each reporting period, we estimate the reserve based on historical experience and knowledge of any applicable events or transactions. The reserve is included in accrued liabilities in our consolidated balance sheet.

A portion of our sales are made to distributors under agreements that grant the distributor limited stock rotation rights and price protection on in-stock inventory. The stock rotation rights allow these distributors to exchange a limited amount of their in-stock inventory for other Pixelworks product. We analyze historical stock rotations at the end of each reporting period. To date, returns under the stock rotation provision have been nominal, and as a result, we have not recorded a reserve for stock rotations.

Under price protection provisions, we grant distributors credit if they purchased product for a specific end customer and we subsequently lower the price to the end customer such that the distributor can no longer earn its negotiated margin on in-stock inventory. At the end of each reporting period, we estimate a reserve for price protection credits based on historical experience and knowledge of any applicable events or transactions. The reserve for price protection, if required, is included in our reserve for sales returns and allowances, which is included in accrued liabilities in our consolidated balance sheet.

Warranty Program

We warrant that our products will be free from defects in material and workmanship for a period of twelve months from delivery. Warranty repairs are guaranteed for the remainder of the original warranty period. Our warranty is limited to repairing or replacing products, or refunding the purchase price. At the end of each reporting period, we estimate a reserve for warranty returns based on historical experience and knowledge of any applicable events or transactions. The reserve for warranty returns is included in accrued liabilities in our consolidated balance sheet.

Stock-Based Compensation

We currently sponsor a stock incentive plan that allows for issuance of employee stock options and restricted stock awards, including restricted stock units. We also have an employee stock purchase plan for all eligible employees. The fair value of share-based payment awards is expensed straight-line over the requisite service period, which is generally the vesting period, for the entire award. If we were to modify any awards, additional charges would be taken.

The fair values of our stock option grants and purchase rights under our employee stock purchase plan are estimated as of the grant date using the Black-Scholes option valuation model which is affected by our estimates of the risk free interest rate, our expected dividend yield, expected term and the expected share price volatility of our common shares over the expected term. The fair values of our restricted stock awards are based on the market value of our stock on the date of grant, adjusted for the effect of estimated forfeitures.

Research and Development

Costs associated with research and development activities are expensed as incurred, except for materials with alternate future uses which are capitalized and depreciated over their estimated useful life.

Interest Income (Expense) and Other, net

Interest income (expense) and other, consists of the following:

	Year Ended December 31,		
	2010	2009	2008
Interest income	$ 63	$ 242	$ 2,102
Interest expense	(500)	(640)	(1,695)
Amortization of debt issuance costs	(74)	(124)	(426)
Other income	—	—	218
	$ (511)	$ (522)	$ 199

Income Taxes

We account for income taxes under the asset and liability method. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between financial statement carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We establish a valuation allowance to reduce deferred tax assets if it is “more likely than not” that a portion or all of the asset will not be realized in future tax returns.

An uncertain tax position represents our expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return, that has not been reflected in measuring income tax expense for financial reporting purposes. Until these positions are sustained by the taxing authorities, we do not recognize the tax benefits resulting from such positions and report the tax effects as a liability for uncertain tax positions in our consolidated balance sheet.

Accumulated Other Comprehensive Income

Accumulated other comprehensive income, net of tax, consists of the following:

	December 31,	
	2010	2009
Accumulated net unrealized holding gain on available-for-sale and long-term marketable securities	$ 231	$ 1,128
Accumulated transition pension obligation	(48)	(48)
Actuarial gain (loss) on pension obligation	(16)	7
Accumulated other comprehensive income	$ 167	$ 1,087

Leases

Our various office space and equipment leases are classified as operating leases. Certain of our leases for office space contain provisions under which monthly rent escalates over time and certain leases also contain provisions for reimbursement of a specified amount of leasehold improvements. When lease agreements contain escalating rent clauses, we recognize rent expense on a straight-line basis over the term of the lease. When lease agreements provide allowances for leasehold improvements, we capitalize the leasehold improvement assets and amortize them on a straight-line basis over the lesser of the lease term or the estimated useful life of the asset, and reduce rent expense on a straight-line basis over the term of the lease by the amount of the asset capitalized.

Fair Value of Financial Instruments

See Note 4 for information regarding accounting policies related to the fair value of our financial instruments.

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 four third-party foundries to produce all of our wafers and three assembly and test vendors for completion of finished products. We do not have 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 material impact on our financial condition, results of operations and cash flows.

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 3. BALANCE SHEET COMPONENTS

Marketable Securities—See Note 4

Accounts Receivable, Net

Accounts receivable consists of the following:

	December 31,	
	2010	2009
Accounts receivable, gross	$ 4,886	$ 6,047
Allowance for doubtful accounts	(399)	(428)
Accounts receivable, net	$ 4,487	$ 5,619

The following is a summary of the change in our allowance for doubtful accounts:

	Year Ended December 31,		
	2010	2009	2008
Balance at beginning of year	$ 428	$ 542	$ 542
Additions charged (reductions credited)	(29)	(75)	—
Accounts written-off, net of recoveries	—	(39)	—
Balance at end of year	$ 399	$ 428	$ 542

Inventories, Net

Inventories consist of the following:

	December 31, 2010	December 31, 2009
Finished goods	$2,961	$ 2,888
Work-in-process	3,232	5,410
	6,193	8,298
Reserve for slow-moving and obsolete items	(1,335)	(2,140)
Inventories, net	$ 4,858	$6,158

The Company recorded lower of cost or market write-downs of $771 and zero for the periods ended December 31, 2010 and 2009, respectively.

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

	Year Ended December 31, 2010	2009	2008
Balance at beginning of period	$ 2,140	$ 4,994	$ 5,950
New provision	860	1,225	1,496
Sales of previously reserved inventory	(88)	(707)	(1,008)
Net provision for obsolete inventory	772	518	488
Final scrap of previously reserved inventory	(1,577)	(3,372)	(1,444)
Balance at end of period	$ 1,335	$ 2,140	$ 4,994

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 December 31, 2010. However, it is possible that a customer will decide in the future to purchase a portion of the reserved inventory. During the years ended December 31, 2010, 2009, and 2008, sales of previously reserved inventory were primarily due to unanticipated demand for products nearing end-of-life.

Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of current prepaid expenses, deposits, income taxes receivable, other receivables and deferred tax assets.

Property and Equipment, Net

Property and equipment consists of the following:

	December 31, 2010	December 31, 2009
Software	$ 8,273	$ 6,712
Equipment, furniture and fixtures	7,420	7,289
Tooling	2,085	1,837
Leasehold improvements	2,628	2,634
	20,406	18,472
Accumulated depreciation and amortization	(14,576)	(13,351)
Property and equipment, net	$ 5,830	$ 5,121

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Software amortization was $1,803, $1,973 and $2,634 for the years ended December 31, 2010, 2009 and 2008, respectively. Depreciation and amortization expense for equipment, furniture, fixtures, tooling and leasehold improvements was $1,563, $1,723 and $2,392 for the years ended December 31, 2010, 2009 and 2008, respectively.

Other Assets, Net

Other assets consist primarily of licensed technology as of December 31, 2010 and 2009. Amortization of licensed technology was $1,171, $911 and $1,674 for the years ended December 31, 2010, 2009 and 2008, respectively.

Acquired Intangible Assets, Net

Acquired intangible assets consist of the following developed technology:

	December 31, 2010	December 31, 2009
Gross carrying amount	$ 19,170	$ 19,170
Accumulated amortization	(19,170)	(18,120)
Acquired intangible assets, net	$ —	$ 1,050

Amortization expense was $1,050, $2,336 and $2,984 for the years ended December 31, 2010, 2009 and 2008, respectively.

Accrued Liabilities and Current Portion of Long-Term Liabilities

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

	December 31, 2010	December 31, 2009
Current portion of accrued liabilities for asset financings	$ 2,601	$ 2,068
Accrued payroll and related liabilities	2,365	2,279
Accrued commissions and royalties	1,139	853
Reserve for warranty returns	723	304
Accrued interest payable	358	257
Accrued costs related to restructuring	172	190
Other	1,625	2,562
Accrued liabilities and current portion of long-term liabilities	$ 8,983	$ 8,513

The following is a summary of the changes in our reserves for warranty returns:

	Year Ended December 31, 2010	2009	2008
Reserve for warranty returns:			
Balance at beginning of year	$ 304	$ 593	$ 932
Provision (benefit)	1,132	269	(203)
Charge-offs	(713)	(558)	(136)
Balance at end of year	$ 723	$ 304	$ 593

Long-Term Liabilities, Net of Current Portion

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

	December 31,	
	2010	2009
Accrued liabilities for asset financings	$ 1,314	$ 553
Deferred rent	302	494
Payroll and related liabilities	165	136
Accrued costs related to restructuring	119	218
Other	161	61
Long-term liabilities, net of current portion	$ 2,061	$ 1,462

Short-Term Line of Credit

On December 21, 2010, we entered into a Loan and Security Agreement (the "Revolving Loan Agreement") with Silicon Valley Bank (the "Bank"). The Revolving Loan Agreement provides for a secured working capital-based revolving line of credit (the "Revolving Line") in an aggregate amount of up to the lesser of (i) $10,000, or (ii) 80% of eligible domestic accounts receivable and certain foreign accounts receivable. In addition, the Revolving Loan Agreement also provides for non-formula advances of up to $10,000 which may be made solely during the last five business days of any fiscal month or quarter and which must be repaid by the Company on or before the fifth business day after the applicable fiscal month or quarter end.

Amounts advanced under the Revolving Line bear interest at an annual rate equal to the lender's prime rate plus 0.25%. Interest on the Revolving Line is due monthly, with the balance due on December 21, 2012, which is the scheduled maturity date for the Revolving Line.

The Revolving Loan Agreement contains customary affirmative and negative covenants, including with respect to the following: compliance with laws, provision of financial statements and periodic reports, payment of taxes, maintenance of inventory and insurance, maintenance of operating accounts at the Bank, the Bank's access to collateral, formation or acquisition of subsidiaries, incurrence of indebtedness, dispositions of assets, granting liens, changes in business, ownership or business locations, engaging in mergers and acquisitions, making investments or distributions and affiliate transactions. The covenants also require that the Company maintain a minimum ratio of qualifying financial assets to the sum of qualifying financial obligations.

The Revolving Loan Agreement also contains customary events of default, including the following: defaults with respect to covenant compliance, the occurrence of a material adverse change, the occurrence of certain bankruptcy or insolvency events, cross-defaults, judgment defaults and material misrepresentations. The occurrence of an event of default could result in the acceleration of the Company's obligations under the Revolving Loan Agreement and an increase to the applicable interest rate, and would permit the Bank to exercise remedies with respect to its security interest.

To secure the repayment of any amounts borrowed under the Revolving Loan Agreement, the Company granted to the Bank a security interest in substantially all of its assets, which assets do not include its intellectual property assets. The Company has agreed not to pledge or otherwise encumber its intellectual property assets without prior written permission from the Bank.

Short-term borrowings outstanding under the Revolving Line as of December 31, 2010 consisted of a non-formula advance of $3,000 which was repaid within required terms. The weighted-average interest rate on short-term borrowings outstanding as of December 31, 2010 was 3.5%.

Debentures Currently Payable

In 2004, we issued $150,000 of 1.75% convertible subordinated debentures (the "debentures") due 2024. In 2006, we repurchased and retired $10,000 principal amount of the debentures. In 2008, we repurchased and retired $79,366 principal amount of the debentures for $58,554 in cash. We recognized a net gain of $19,670 on the repurchase, which included a $21,567 discount, offset by legal and professional fees of $755 and a write-off of debt issuance costs of $1,142. In 2009, we repurchased and retired $44,855 principal amount of the debentures for $31,532 in cash. We recognized a net gain on the repurchase of $12,860, which included a $13,357 discount, offset by a write-off of debt issuance costs of $463 and other fees of $34. Gains on the repurchase of our debentures are included in other income in our statement of operations.

As of December 31, 2010, $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 cannot 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 their debentures on May 15, 2011, May 15, 2014 and May 15, 2019 at a price equal to 100% of the principal amount plus accrued and unpaid interest. As of December 31, 2010 we have classified the debentures as current liabilities as we expect the holders to require us to purchase all of the debentures on May 15, 2011.

The debentures are unsecured obligations and are subordinated in right of payment to all our existing and future senior debt, and are effectively subordinated to all existing and future debt of our subsidiaries. At December 31, 2010, we had $3,000 in senior debt outstanding and our subsidiaries had approximately $2,616 of liabilities to which the debentures were effectively subordinated. Although repayment of our debentures would consume a significant portion of our cash and marketable securities, we anticipate that our existing working capital, as well as funds available under our Revolving Line, will be adequate to fund our operating, investing and financing needs for the next twelve months.

We have evaluated each of the put, call and conversion features of the debentures and concluded that none of these features constitute embedded derivatives that must be bifurcated from the host contract and accounted for as derivatives.

The fees associated with the issuance of the convertible debentures included $4,500 withheld from the proceeds and $462 paid in cash. These debt issuance costs have been capitalized and are included in other assets, net in the consolidated balance sheets. The debt issuance costs are being amortized over seven years on a straight-line basis, which approximates the effective interest rate method. Debt issuance costs at December 31, 2010 and 2009 were $31 and $105, respectively.

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NOTE 4. MARKETABLE SECURITIES AND FAIR VALUE MEASUREMENTS

At December 31, 2010 and 2009, all of our marketable securities are classified as available-for-sale and consist of the following:

	Cost	Unrealized Gain (Loss)	Fair Value
Short-term marketable securities:			
As of December 31, 2010:			
US government agencies debt securities	$ 5,513	$ 3	$ 5,516
Commercial paper	5,747	—	5,747
Corporate debt securities	1,104	(1)	1,103
	$ 12,364	$ 2	$ 12,366
As of December 31, 2009:			
US government agencies debt securities	$ 6,286	$ (3)	$ 6,283
Commercial paper	2,996	—	2,996
Corporate debt security	542	1	543
	$ 9,824	$ (2)	$ 9,822

	Cost	Unrealized Gain	Fair Value
Long-term marketable securities:			
As of December 31, 2010:			
Equity securities	$ 348	$ 255	$ 603
As of December 31, 2009:			
Equity securities	$ 2,110	$ 1,130	$ 3,240

Unrealized holding gains and losses are recorded in accumulated other comprehensive income, a component of shareholders' equity, in the consolidated balance sheets. During the years ended December 31, 2010 and 2009, we sold available-for-sale marketable securities for gross proceeds of $6,759 and $1,798, respectively, and gross realized gains of $1,397 and $3, respectively. Net unrealized holding gains of $944 on available-for sale marketable securities were reclassified out of accumulated other comprehensive income during the year ended December 31, 2010.

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Three levels of inputs 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 inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

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.

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The following tables present information about our assets measured at fair value on a recurring basis in the consolidated balance sheets at December 31, 2010 and 2009:

	Level 1	Level 2	Level 3	Total
As of December 31, 2010:				
Money market funds	$ 13,933	$ —	$ —	$ 13,933
Certificates of deposit	200	—	—	200
U.S. government agencies debt securities	—	5,516	—	5,516
Commercial paper	—	6,947	—	6,947
Corporate debt securities	—	1,605	—	1,605
Long-term marketable securities	603	—	—	603
Total	$ 14,736	$ 14,068	$ —	$ 28,804
As of December 31, 2009:				
Money market funds	$ 16,873	$ —	$ —	$ 16,873
Certificates of deposit	200	—	—	200
U.S. government agencies debt securities	—	6,283	—	6,283
Commercial paper	—	2,996	—	2,996
Corporate debt security	—	543	—	543
Long-term marketable securities	3,240	—	—	3,240
Total	$ 20,313	$ 9,822	$ —	$ 30,135

The fair value of our current assets and liabilities, including accounts receivable, accounts payable, and our debentures currently payable approximates the carrying value due to the short-term nature of these balances. We have currently chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with GAAP.

NOTE 5. RESTRUCTURINGS

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 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 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. Although this plan was completed in the fourth quarter of 2008, lease termination costs were recorded in 2010 and 2009 due to decreases in estimated future sublease income and related professional fees.

Total restructuring expense included in our consolidated statements of operations is comprised of the following:

	Year Ended December 31, 2010	2009	2008
Cost of revenue—restructuring:			
Termination and retention benefits	$ —	$ 43	$ 91
Operating expenses—restructuring:			
Consolidation of leased space	94	160	508
Termination and retention benefits	—	75	1,081
	94	235	1,589
Total restructuring expense	$ 94	$ 278	$ 1,680

Termination and retention benefits included severance and retention payments for terminated employees and retention payments for certain continuing employees. Expenses related to the consolidation of leased space included future non-cancelable rent payments due for vacated space (net of estimated sublease income) and related professional fees.

Total cumulative restructuring expense recorded in our statement of operations related to the restructuring plans initiated in November 2006 and December 2008 is comprised of net write-off of assets and reversal of related liabilities of $15,296, termination and retention benefits of $8,133, consolidation of leased space of $2,192, a contract termination fee of $1,693, payments on non-cancelable contracts of $827, and other expenses of $88.

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 roll-forward of the accrued liabilities related to the restructuring plans for the years ended December 31, 2010 and 2009:

	Balance as of December 31, 2009	Expensed	Payments	Balance as of December 31, 2010
Lease termination costs	$ 408	$ 94	$ (211)	$ 291

	Balance as of December 31, 2008	Expensed	Payments	Balance as of December 31, 2009
Termination and retention benefits	$ 737	$ 118	$ (855)	$ —
Lease termination costs	465	160	(217)	408
Total	$ 1,202	$ 278	$ (1,072)	$ 408

NOTE 6. INCOME TAXES

Current and Deferred Income Tax Benefit

Domestic and foreign pre-tax income (loss) is as follows:

	Year Ended December 31, 2010	2009	2008
Domestic	$ (6,725)	$ 4,376	$ 6,141
Foreign	1,703	1,202	1,829
	$ (5,022)	$ 5,578	$ 7,970

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Income tax benefit attributable to continuing operations is comprised of the following:

	Year Ended December 31,		
	2010	2009	2008
Current:			
Federal	$ (178)	$ 55	$ 55
State	(150)	20	142
Foreign	(5,314)	(1,020)	(496)
Total current	(5,642)	(945)	(299)
Deferred:			
Federal	92	—	—
State	155	—	—
Foreign	—	68	291
Total deferred	247	68	291
Income tax benefit	$(5,395)	$ (877)	$ (8)

The significant differences between the U.S. federal statutory tax rate and our effective tax rate for financial statement purposes are as follows:

	Year Ended December 31,		
	2010	2009	2008
Federal statutory rate:	34%	34%	35%
Decrease resulting from:			
Change in valuation allowance	(37)	(30)	(67)
Tax contingencies, net of reversals	117	(20)	—
Impact of foreign earnings	(9)	(4)	26
State income taxes, net of federal tax benefit	1	4	2
Stock compensation	(2)	1	3
Other	4	(1)	1
Effective income tax rate	108%	(16)%	—%

Deferred Tax Assets, Liabilities and Valuation Allowance

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. Significant components of our deferred tax assets and liabilities are as follows:

	December 31, 2010	December 31, 2009
Deferred tax assets:		
Net operating loss carryforwards	$ 65,111	$ 65,666
Research and experimentation credit carryforwards	11,444	12,471
Foreign tax credit carryforwards	5,260	8,717
Depreciation	2,373	2,304
Deferred stock compensation	2,360	2,705
Capital loss carryforwards	1,849	—
Reserves and accrued expenses	1,495	1,316
Other-than-temporary impairment of marketable securities	373	2,873
Other	1,854	2,208
Total gross deferred tax assets	92,119	98,260
Deferred tax liabilities:		
Amortization	—	(382)
Foreign earnings	(553)	(129)
Other	(240)	(275)
Total gross deferred tax liabilities	(793)	(786)
Less valuation allowance	(90,866)	(96,767)
Net deferred tax assets	$ 460	$ 707

The current portion of the net deferred tax asset balance is $151 and $155 as of December 31, 2010 and 2009, respectively, and is included in prepaid expenses and other current assets in the consolidated balance sheets. The non-current portion of the net deferred tax asset balance is $356 and $608 as of December 31, 2010 and 2009, respectively, and is included in other assets, net in the consolidated balance sheets. Long-term deferred tax liabilities were $47 and $56 as of December 31, 2010 and 2009, respectively, and are included in long-term liabilities, net of current portion in the consolidated balance sheets.

We continue to record a full valuation allowance against our U.S. and Canadian net deferred tax assets at December 31, 2010 and 2009 as it is not more likely than not that we will realize a benefit from these assets in a future period. We have not provided a valuation allowance against any of our other foreign net deferred tax assets as we have concluded it is more likely than not that we will realize a benefit from these assets in a future period because our subsidiaries in these jurisdictions are cost-plus taxpayers. The net valuation allowance decreased $5,901, $7,323 and $8,246 for the years ended December 31, 2010, 2009, and 2008, respectively.

As of December 31, 2010, we have federal, state and foreign net operating loss carryforwards of approximately $173,063, $73,525 and $424, respectively, which will expire between 2011 and 2027. As of December 31, 2010, we have available federal, state and foreign research and experimentation tax credit carryforwards of approximately $7,246, $2,431 and $1,884, respectively, which begin expiring in 2011. We have a general foreign tax credit of $2,786 which will begin expiring in 2018.

We had undistributed earnings of foreign subsidiaries of approximately $607 as of December 31, 2010, for which deferred taxes have not been provided because they are considered indefinitely invested outside of the United States. If repatriated, some of these earnings could generate foreign tax credits that may reduce the federal tax liability associated with any future foreign dividend. We have recorded a deferred tax liability for the undistributed earnings and profits of subsidiaries in which we are no longer considered indefinitely reinvested.

During the year ended December 31, 2007, our Chinese subsidiary achieved designation as an integrated circuit design company, allowing us to benefit from a tax holiday resulting in reductions to our tax rates of 10%, 11% and 12% in 2009, 2010 and 2011, respectively. Our corporate tax rate will return to 25% in 2012 upon the expiration of the tax holiday.

Uncertain Tax Positions

We have recorded tax reserves to address potential exposures involving positions that could be challenged by taxing authorities. As of December 31, 2010 and 2009, the amount of our uncertain tax positions was a liability of $3,574 and $9,462, respectively.

The following is a summary of the change in our liability for uncertain tax positions and interest and penalties for the years ended December 31, 2010 and 2009:

	2010	2009
Uncertain tax positions:		
Balance at beginning of year	$ 7,186	$8,257
Accrual for positions taken in a prior year	95	150
Accrual for positions taken in current year	1	159
Reversals due to lapse of statute of limitations	(4,657)	(1,380)
Balance at end of year	$ 2,625	$7,186
Interest and penalties:		
Balance at beginning of year	$ 2,276	$ 2,324
Accrual for positions taken in prior year	210	391
Reversals due to lapse of statute of limitations	(1,537)	(439)
Balance at end of year	$ 949	$2,276

We recognize interest and penalties related to uncertain tax positions in income tax expense in our consolidated statements of operations.

We file income tax returns in the U.S. and various foreign jurisdictions. 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 unrecognized tax benefits of approximately $961 within the next twelve months due to the expiration of statutes of limitations in foreign jurisdictions.

We are no longer subject to U.S. federal examinations for years before 2007. We are subject to potential tax examinations in foreign locations for years 2004 through 2010. We do not anticipate that any potential tax adjustments will have a significant impact on our financial position or results of operations.

We were not subject to, nor had we received any notice of, income tax examinations as of December 31, 2010.

NOTE 7. COMMITMENTS AND CONTINGENCIES

Royalties

We license technology from third parties and have agreed to pay certain suppliers a royalty based on the number of chips sold or manufactured, the net sales price of the chips containing the licensed technology or a fixed non-cancelable fee. Royalty expense is recognized based on our estimated average unit cost for royalty contracts with non-cancelable prepayments and the stated contractual per unit rate for all other agreements. Royalty expense was $1,489, $1,119 and $1,378 for the years ended December 31, 2010, 2009 and 2008, respectively, which is included in cost of revenue in the consolidated statements of operations.

401(k) Plan

We sponsor a 401(k) plan for eligible employees. Participants may defer a percentage of their annual compensation on a pre-tax basis, not to exceed the dollar limit that is set by law. A discretionary matching contribution by the Company is allowed and is equal to a uniform percentage of the amount of salary reduction elected to be deferred, which percentage will be determined each year by the Company. The Company made no contributions to the 401(k) plan during the years ended December 31, 2010, 2009 or 2008.

Leases

At December 31, 2010, future minimum payments under operating leases are as follows:

Year Ending December 31:	
2011	$1,690
2012	1,043
2013	384
	$ 3,117

Minimum lease payments above are net of expected sublease rental income of $414, $266 and $135 for the years ending December 31, 2011, 2012 and 2013, respectively. Rent expense for the years ended December 31, 2010, 2009 and 2008 was $2,004, $2,014 and $2,421, respectively.

Contract Manufacturers

In the normal course of business, we commit to purchase products from our contract manufacturers to be delivered within the next 90 days. In certain situations, should we cancel an order, we could be required to pay cancellation fees. Such obligations could impact our immediate results of operations but would not materially affect our business.

Indemnifications

Certain of our agreements include limited indemnification provisions for claims from third-parties relating to our intellectual property. It is not possible for us to predict the maximum potential amount of future payments or indemnification costs under these or similar agreements due to the conditional nature of our obligations and the unique facts and circumstances involved in each particular agreement. We have not made any payments under these agreements in the past, and as of December 31, 2010, we have not incurred any material liabilities arising from these indemnification obligations. In the future, however, such obligations could immediately impact our results of operations but are not expected to materially affect our business.

Legal Proceedings

Effective October 1, 2010, the Company and Intersil Corporation (“Intersil”) entered into an agreement to resolve the previously disclosed dispute between the parties (Superior Court of the State of California for the County of Santa Clara, Case No. 1-10-CV-164894) (the “Action”). The agreement includes an amendment to the license agreement between Intersil and the Company reducing the total amount of remaining prepaid royalties to be paid by the Company from $1,250 to $900. Intersil and the Company each also agreed to dismiss with prejudice their respective claims against the other party in the Action and the Action was dismissed, with prejudice, on October 6, 2010.

In addition to the specific issue described above, 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.

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NOTE 8. EARNINGS PER SHARE

Basic earnings per share amounts are computed based on the weighted average number of common shares outstanding. Diluted weighted average shares outstanding include the weighted average number of common shares outstanding plus potentially dilutive common shares outstanding during the period.

Potentially dilutive common shares from employee equity incentive plans are determined by applying the treasury stock method to the assumed exercise of outstanding stock options, the assumed vesting of outstanding restricted stock awards and units, and the assumed issuance of common stock under the stock purchase plan. Potentially dilutive common shares issuable upon conversion of our convertible subordinated debentures are computed using the if-converted-method.

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

	Year Ended December 31,		
	2010	2009	2008
Net income used in basic net income per share	$ 373	$ 6,455	$ 7,978
Basic weighted average shares outstanding	13,442	13,318	14,399
Dilutive effect of employee equity incentive plans	942	369	11
Diluted weighted average shares outstanding	14,384	13,687	14,410
Net income per common share			
Basic	$ 0.03	$ 0.48	$ 0.55
Diluted	$ 0.03	$ 0.47	$ 0.55

The following weighted average shares were excluded from the calculation of diluted weighted average shares outstanding as their effect would have been anti-dilutive:

	Year Ended December 31,		
	2010	2009	2008
Employee equity incentive plans	1,650,320	1,500,767	1,793,187
Conversion of debentures	215,976	356,309	1,191,026

NOTE 9. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Supplemental disclosure of cash flow information is as follows:

	Year Ended December 31,		
	2010	2009	2008
Cash paid (received) during the year for:			
Interest	$ 401	$ 620	$ 1,882
Income taxes, net of refunds received	(48)	196	218
Non-cash investing and financing activities:			
Acquisitions of property and equipment and other assets under extended payment terms	$ 4,400	$ 2,966	$ 1,815
Unrealized gain on available-for-sale securities	47	1,003	50
Increase in leasehold improvements and deferred rent related to tenant improvement allowances received	—	—	140

NOTE 10. SHAREHOLDERS' EQUITY

Preferred Stock

The Company is authorized to issue 50,000,000 shares of preferred stock with a par value of $0.001 per share. The Board of Directors is authorized to fix or alter the rights, preferences, privileges and restrictions granted to, or imposed on, each series of preferred stock. There are no shares of preferred stock issued as of December 31, 2010 and 2009.

Common Stock

The Company is authorized to issue 250,000,000 shares of common stock with a par value of $0.001 per share. Shareholders of common stock have unlimited voting rights and are entitled to receive the net assets of the Company upon dissolution, subject to the rights of the preferred shareholders, if any.

Reverse Stock Split

On June 4, 2008, we effected a one-for-three reverse split of our common stock. The exercise price and number of shares of common stock issuable under our stock incentive plans, as well as the conversion price and number of shares issuable upon conversion of our debentures, were proportionately adjusted to reflect the reverse stock split. Basic and diluted weighted average shares outstanding and earnings per share have been calculated to reflect the reverse stock split in all periods presented, as have all disclosures that include a reference to the number of shares of our common stock or a related calculation.

Employee Equity Incentive Plans

On May 23, 2006, our shareholders approved the adoption of the Pixelworks, Inc. 2006 Stock Incentive Plan (the "2006 Plan"). Our shareholders approved increases to the total authorized shares of 1,000,000, 1,150,000, and 1,000,000 on May 18, 2010, May 19, 2009, and May 20, 2008, respectively, increasing the total authorized shares available for issuance as equity awards to employees and non-employee directors to 4,483,333 shares. The 2006 Plan replaced our previously existing stock incentive plans including our 1997 Stock Incentive Plan, as amended, our 2001 Nonqualified Stock Option Plan, the Equator Technologies, Inc. 1996 Stock Incentive Plan, as amended, and Equator Technologies, Inc. stand-alone option plans (collectively, "Old Stock Incentive Plans"). Upon adoption of the 2006 Plan, no additional options could be issued under the Old Stock Incentive Plans, although awards previously granted under the Old Stock Incentive Plans remain outstanding according to their original terms. As of December 31, 2010, 1,551,929 shares were available for grant under the 2006 Plan.

Stock Options

Options granted must generally be exercised while the individual is an employee. In May 2009, the 2006 Plan was modified to reduce the contractual life of newly issued stock awards from ten to six years. Our new hire vesting schedule provides that each option becomes exercisable at a rate of 25% on the first anniversary date of the grant and 2.083% on the last day of every month thereafter for a total of 36 additional increments. Our merit vesting schedule provides that merit-type awards become exercisable monthly over a period of three years.

The following is a summary of stock option activity:

	Number of shares	Weighted average exercise price
Options outstanding as of December 31, 2009:	2,487,836	$ 6.79
Granted	806,800	3.28
Exercised	(142,582)	1.29
Forfeited	(97,406)	2.12
Expired	(159,530)	24.33
Options outstanding as of December 31, 2010:	2,895,118	$ 5.27

The following table summarizes information about options outstanding as of December 31, 2010:

	Options Outstanding			Options Exercisable	
Range of Exercise prices	Number outstanding as of December 31, 2010	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable as of December 31, 2010	Weighted average exercise price
$0.21 - $0.80	687,974	8.14	$ 0.62	370,139	$ 0.61
0.81 - 3.00	498,915	6.90	2.09	348,672	2.09
3.01 - 4.00	1,006,767	5.08	3.23	255,546	3.23
4.01 - 10.00	379,815	5.47	6.13	327,516	6.31
10.01 - 26.00	174,688	3.49	19.60	174,688	19.60
26.01 - 57.00	146,959	3.05	32.61	146,959	32.61
$0.21 - $57.00	2,895,118	5.97	$ 5.27	1,623,520	$ 7.43

During the years ended December 31, 2010, 2009 and 2008 the total intrinsic value of options exercised was $340, $10 and $2, respectively, for which no income tax benefit has been recorded because a full valuation allowance has been provided for our U.S. deferred tax assets. As of December 31, 2010, options outstanding had a total intrinsic value of $2,919.

Options outstanding that have vested and are expected to vest as of December 31, 2010 are as follows:

	Number of shares	Weighted average exercise price	Weighted average remaining contractual term	Aggregate intrinsic value
Vested	1,623,520	$ 7.43	5.89	$1,610,775
Expected to vest	1,062,037	2.47	6.12	1,135,039
Total	2,685,557	$ 5.47	5.98	$ 2,745,814

The fair value of options vested in each of the years ended December 31, 2010, 2009 and 2008 approximates total stock-based compensation expense recorded in our statement of operations during each of the respective years.

Restricted Stock Awards

The 2006 Plan provides for the issuance of restricted stock, including restricted stock units, to employees and non-employee directors. During the years ended December 31, 2010 and 2009, we granted 48,000 and 100,000 shares, respectively, of restricted stock with a fair value of $4.26 and $0.60 per share, respectively. No restricted stock was granted during the year ended December 31, 2008. As of December 31, 2010 there were 81,666 unvested shares of restricted stock outstanding.

Employee Stock Purchase Plans

On January 31, 2010, the 2000 Employee Stock Purchase Plan (“2000 ESPP”) expired. During the years ended December 31, 2010, 2009 and 2008, we issued 12,382, 18,326, and 23,553 shares, respectively, for proceeds of $18, $11 and $45, respectively, under the 2000 ESPP.

On May 18, 2010, our shareholders approved the adoption of the 2010 Pixelworks, Inc. Employee Stock Purchase Plan (the “ESPP”) for U.S. employees and for certain foreign subsidiary employees. The ESPP provides for separate offering periods commencing on February 1 and August 1, with the first offering period beginning August 1, 2010. Each offering period continues for a period of 18 months with purchases every six months. Each eligible employee may purchase up to 3,000 shares of stock on each purchase date, with a maximum annual purchase amount of $25. The purchase price is equal to 85% of the lesser of the fair market value of the shares on the offering date or on the purchase date. A total of 1,300,000 shares of common stock have been reserved for issuance under the ESPP. As of December 31, 2010, there were no shares issued under the ESPP.

Stock-Based Compensation Expense

The fair value of stock-based compensation was determined using the Black-Scholes option pricing model and the following weighted average assumptions:

	Year Ended December 31,		
	2010	2009	2008
Stock Option Plans:			
Risk free interest rate	2.11%	2.24%	2.71%
Expected dividend yield	0%	0%	0%
Expected term (in years)	4.6	5.0	4.8
Volatility	92%	84%	68%
Employee Stock Purchase Plan:			
Risk free interest rate	0.33%	0.33%	2.05%
Expected dividend yield	0%	0%	0%
Expected term (in years)	1.1	0.5	0.5
Volatility	94%	137%	85%

The weighted average fair value of options granted during the years ended December 31, 2010, 2009 and 2008 was $2.27, $0.95 and $1.13, respectively. The risk free interest rate is estimated using an average of treasury bill interest rates. The expected dividend yield is zero as we have not paid any dividends to date and do not expect to pay dividends in the future. Expected volatility is estimated based on the historical volatility of our common stock over the expected term as this represents our best estimate of future volatility. For the year ended December 31, 2008 and from January 2009 to April 2009, the expected term of options was estimated using historical exercise behavior. Subsequent to the May 2009 amendment of our 2006 Stock Incentive Plan, which shortened the contractual life of newly issued stock options from ten to six years, we have elected to use the “simplified method” to estimate expected term. Under the simplified method, an option’s expected term is calculated as the average of its vesting period and original contractual life. The expected term of ESPP purchase rights is based on the estimated weighted average time to purchase.

As of December 31, 2010, unrecognized stock-based compensation cost is $2,190, which is expected to be recognized as compensation expense over a weighted average period of 2.1 years.

NOTE 11. SEGMENT INFORMATION

We have identified a single operating segment: the design and development of integrated circuits for use in electronic display devices. Substantially all 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 bill-to customer, was as follows:

	Year Ended December 31,		
	2010	2009	2008
Japan	$ 44,982	$ 34,030	$ 50,408
Taiwan	11,577	13,399	10,582
Europe	2,930	3,012	6,639
U.S.	2,774	2,047	3,872
Korea	2,674	3,182	5,583
China	1,351	2,809	1,734
Other	3,241	2,614	6,346
	$ 69,529	$ 61,093	$ 85,164

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:

	Year Ended December 31,		
	2010	2009	2008
Distributors:			
All distributors	61%	51%	53%
Distributor A	44%	35%	32%
End Customers: (1)			
Top five end customers	58%	56%	55%
End customer A	20%	21%	24%
End customer B	13%	10%	9%
End customer C	10%	11%	9%

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

Each of the following accounts represented 10% or more of total accounts receivable:

	December 31,	
	2010	2009
Account A	45%	22%
Account B	25%	34%
Account C	7%	11%

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NOTE 12. QUARTERLY FINANCIAL DATA (UNAUDITED)

	Quarterly Period Ended			
	March 31	June 30	September 30	December 31
2010				
Revenue, net	$ 18,692	$ 18,665	$ 18,027	$ 14,145
Gross profit	8,656	8,647	8,294	6,566
Loss from operations	(571)	(863)	(1,003)	(3,471)
Loss before income taxes	(699)	(642)	(814)	(2,867)
Net income (loss)	4,602	(1,015)	7	(3,221)
Net income (loss) per share:				
Basic	0.34	(0.08)	0.00	(0.24)
Diluted	0.32	(0.08)	0.00	(0.24)
2009				
Revenue, net	$ 10,780	$ 14,213	$ 16,732	$ 19,368
Gross profit	4,156	6,773	7,341	9,025
Loss from operations	(4,530)	(1,163)	(644)	(423)
Income (loss) before income taxes	4,280	2,577	(734)	(545)
Net income (loss)	5,897	2,219	(890)	(771)
Net income (loss) per share:				
Basic	0.44	0.17	(0.07)	(0.06)
Diluted	0.44	0.16	(0.07)	(0.06)

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Item 9A. Controls and Procedures.

Disclosure Controls and Procedures

As of the end of the period covered by this report, we conducted an evaluation under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(f) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)). Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2010, our disclosure controls and procedures were effective to ensure that information required to be disclosed in our periodic reports filed or submitted under the Securities Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

Our management, including our Chief Executive Officer and Chief Financial Officer, 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.

Management’s Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining a system of internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. All internal control systems, no matter how well designed, have inherent limitations.

We conducted an assessment of the effectiveness of our system of internal control over financial reporting as of December 31, 2010, the last day of our fiscal year. This assessment was based on criteria established in the framework *Internal Control—Integrated Framework,* issued by the Committee of Sponsoring Organizations of the Treadway Commission and included an evaluation of elements such as the design and operating effectiveness of key financial reporting controls, process documentation, accounting policies, and our overall control environment. Based on our assessment, management has concluded that our internal control over financial reporting was effective as of the end of the fiscal year to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles. We reviewed the results of management's assessment with the Audit Committee of our Board of Directors.

The effectiveness of our internal control over financial reporting as of December 31, 2010 has been audited by KPMG LLP, our independent registered public accounting firm, as stated in their report, which is presented below.

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.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Pixelworks, Inc.:

We have audited Pixelworks, Inc.'s internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control —Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Pixelworks, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Pixelworks, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Pixelworks, Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, shareholders' equity (deficit) and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2010, and our report dated March 9, 2011 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Portland, Oregon
March 9, 2011

Item 9B. Other Information.

Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

Information concerning the directors, executive officers and corporate governance of the Company is set forth in the Company's Proxy Statement for its 2011 Annual Meeting of Shareholders (the "2011 Proxy Statement") to be filed pursuant to Regulation 14A and is incorporated herein by reference.

Item 11. Executive Compensation.

Information concerning executive compensation is included in our 2011 Proxy Statement and is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information concerning security ownership of certain beneficial owners and management and related stockholder matters is included in our 2011 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Information concerning certain relationships and related transactions and director independence is included in our 2011 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

Information concerning principal accounting fees and services is set forth in our 2011 Proxy Statement and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) 1. Financial Statements.

The following financial statements are included in Item 8. Financial Statements and Supplementary Data:

(a) 2. Financial Statement Schedules.

All schedules have been omitted because the required information is included in the consolidated financial statements or the notes thereto, or is not applicable or required.

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(a) 3. Exhibits.

The exhibits are either filed with this report or incorporated by reference into this report.

Exhibit Number	Description
3.1	Sixth Amended and Restated Articles of Incorporation of Pixelworks, Inc., As Amended (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2004).
3.2	Third Amendment to Sixth Amended and Restated Articles of Incorporation of Pixelworks, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q filed on August 11, 2008).
3.3	Second Amended and Restated Bylaws of Pixelworks, Inc. (incorporated by reference to Exhibit 3.3 to the Company's Annual Report on Form 10-K filed March 10, 2010).
4.1	Reference is made to Exhibit 3.1 above (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
4.2	Third Amended Registration Rights Agreement dated February 22, 2000 (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
4.3	Indenture dated May 18, 2004 between Pixelworks, Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2004).
4.4	Form of 1.75% Convertible Subordinated Debentures due 2024 dated May 18, 2004 (incorporated by reference to Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2004).
4.5	Registration Rights Agreement, dated May 18, 2004 among Pixelworks, Inc., Citigroup Global Markets Inc. and D.A. Davidson & Co. (incorporated by reference to Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2004).
4.6	Purchase Agreement, dated May 12, 2004 among Pixelworks, Inc. and Citigroup Global Markets Inc. (incorporated by reference to Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2004).
10.1	Form of Indemnity Agreement between Pixelworks, Inc. and certain of its Officers and Directors (incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000). +
10.2	Form of Indemnity Agreement between Pixelworks, Inc. and each of the members of the Board and Steven Moore, the Company's Chief Financial Officer (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 2, 2010). +
10.3	Pixelworks, Inc. 1997 Stock Incentive Plan, as amended (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 filed on June 21, 2005). +
10.4	Pixelworks, Inc. 2010 Employee Stock Purchase Plan (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 filed on July 16, 2010). +
10.5	Pixelworks, Inc. 2001 Nonqualified Stock Option Plan (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 filed on May 31, 2001). +
10.6	Equator Technologies, Inc. 1996 Stock Option Plan, as amended (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 filed on June 17, 2005). +
10.7	Pixelworks, Inc. Amended and Restated 2006 Stock Incentive Plan (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8 filed on July 16, 2010). +

10.8	Pixelworks, Inc. Amended and Restated 2006 Stock Incentive Plan, Terms and Conditions of Restricted Stock Awards (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on May 7, 2009). +
10.9	Pixelworks, Inc. Amended and Restated 2006 Stock Incentive Plan, Terms and Conditions of Option Grants (incorporated by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed on May 7, 2009). +
10.10	Pixelworks, Inc. Amended and Restated 2006 Stock Incentive Plan, Terms and Conditions of Director Stock Unit Awards (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on November 4, 2010). +
10.11	Pixelworks, Inc. Amended and Restated 2006 Stock Incentive Plan, Terms and Conditions of Restricted Stock Unit Award. +
10.12	Summary of Pixelworks Non-Employee Director Compensation (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on November 4, 2010). +
10.13	2009 Executive Employment Agreement dated May 11, 2009 and effective April 1, 2009, by and between Bruce Walicek and Pixelworks, Inc (incorporated by reference to Exhibit 10.13 to the Company's Annual Report on Form 10-K filed March 10, 2010). +
10.14	Form of Pixelworks, Inc. Senior Management Bonus Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed December 31, 2009). +
10.15	Offer letter dated June 22, 2007 between Pixelworks, Inc. and Steven L. Moore (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed August 9, 2007). +
10.16	Change of Control Severance Agreement dated November 20, 2008, by and between Pixelworks, Inc. and Steven L. Moore (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed November 20, 2008). +
10.17	Change of Control Severance Agreement dated May 11, 2009 and effective April 1, 2009, by and between Pixelworks, Inc. and Steven L. Moore (incorporated by reference to Exhibit 10.18 to the Company's Annual Report on Form 10-K filed March 10, 2010). +
10.18	Change of Control Severance Agreement dated November 20, 2008, by and between Pixelworks, Inc. and Hongmin (Bob) Zhang (incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed November 20, 2008). +
10.19	Change of Control Severance Agreement dated November 22, 2008, by and between Pixelworks, Inc. and Tzoyao (T) Chan (incorporated by reference to Exhibit 10.21 to the Company's Annual Report on Form 10-K filed March 10, 2010). +
10.20	Intellectual Property Sublicense Agreement dated March 30, 1999 between VAutomation Incorporated and Pixelworks, Inc. (incorporated by reference to Exhibit 10.9 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
10.21	License Agreement dated February 22, 2000 between Pixelworks, Inc. and InFocus Systems, Inc. (incorporated by reference to Exhibit 10.10 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
10.22	Office Lease Agreement dated December 2005, by and between CA-The Concourse Limited Partnership and Pixelworks, Inc. (incorporated by reference to Exhibit 10.42 to the Company's Annual Report on Form 10-K filed March 13, 2006).
10.23	Office Lease dated April 12, 2001, by and between Equator Technologies, Inc. and Pike Street Delaware, Inc. (incorporated by reference to Exhibit 10.18 to the Company's Quarterly Report on Form 10-Q filed August 9, 2005).

10.24	Amendment No. 1 to Office Lease dated July 7, 2005, by and between Equator Technologies, Inc. and 520 Pike Street, Inc. (incorporated by reference to Exhibit 10.20 to the Company's Quarterly Report on Form 10-Q filed November 7, 2005).
10.25	Office Lease Agreement dated September 10, 2008 and commencing December 1, 2008 by and between Pixelworks, Inc. and Durham Plaza, LLC (incorporated by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q filed on November 7, 2008).
10.26	Loan and Security Agreement dated December 21, 2010 by and between Silicon Valley Bank and Pixelworks, Inc.
21	Subsidiaries of Pixelworks, Inc.
23	Consent of KPMG LLP.
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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SIGNATURES

Pursuant to the requirements of Sections 13 or 15(d) 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: March 9, 2011

By: /s/ Bruce A. Walicek
Bruce A. Walicek
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Bruce A. Walicek Bruce A. Walicek	President and Chief Executive Officer	March 9, 2011
/s/ Steven L. Moore Steven L. Moore	Vice President, Chief Financial Officer, Secretary and Treasurer	March 9, 2011
/s/ Richard L. Sanquini Richard L. Sanquini	Chairman of the Board	March 9, 2011
/s/ Mark A. Christensen Mark A. Christensen	Director	March 9, 2011
/s/ James R. Fiebiger James R. Fiebiger	Director	March 9, 2011
/s/ C. Scott Gibson C. Scott Gibson	Director	March 9, 2011
/s/ Daniel J. Heneghan Daniel J. Heneghan	Director	March 9, 2011
/s/ Stephen L. Domenik Stephen L. Domenik	Director	March 9, 2011
/s/ Bruce A. Walicek Bruce A. Walicek	Director	March 9, 2011

Exhibit 10.11

PIXELWORKS, INC.

AMENDED AND RESTATED 2006 STOCK INCENTIVE PLAN
TERMS AND CONDITIONS OF RESTRICTED STOCK UNIT AWARD

1. General. These Terms and Conditions of Restricted Stock Unit Award (these "**Terms**") apply to a particular award ("**Award**") of restricted stock units ("**Restricted Stock Units**") if referenced in the Notice of Grant of Restricted Stock Units (" **Grant Notice**") corresponding to that particular Award. The recipient of the Award identified in the Grant Notice is referred to as the "**Grantee**." The effective date of grant of the Award as set forth in the Grant Notice is referred to as the "**Award Date**."

The Award was granted under and subject to the Company's Amended and Restated 2006 Stock Incentive Plan (the " **Plan**"). Capitalized terms are defined in the Plan if not defined herein. The Award has been granted to the Grantee in addition to, and not in lieu of, any other form of compensation otherwise payable or to be paid to the Grantee. The Grant Notice and these Terms are collectively referred to as the " **Award Agreement**" applicable to the Award.

2. Restricted Stock Units. As used herein, the term "restricted stock unit" shall mean a non-voting unit of measurement which is deemed for bookkeeping purposes to be equivalent to one outstanding share of the Company's Common Stock (subject to adjustment as provided in Section 11.1 of the Plan) solely for purposes of the Plan and these Terms. The Restricted Stock Units shall be used solely as a device for the determination of the payment to eventually be made to the Grantee if such Restricted Stock Units vest pursuant to the terms hereof. The Restricted Stock Units shall not be treated as property or as a trust fund of any kind.

3. Vesting. The Award shall vest in percentage installments of the aggregate number of Restricted Stock Units subject to the Award as set forth on the Grant Notice. The Administrator reserves the right to accelerate the vesting of the Restricted Stock Units in such circumstances as it, in its sole discretion, deems appropriate and any such acceleration shall be effective only when set forth in a written instrument executed by an officer of the Company.

4. Continuance of Employment.

(a) The vesting schedule requires Continuous Status as an Employee or Consultant through each applicable vesting date as a condition to the vesting of the applicable installment of the Award and the rights and benefits under this Award Agreement. Employment or service for only a portion of the vesting period, even if a substantial portion, will not entitle the Grantee to any proportionate vesting or avoid or mitigate a termination of rights and benefits upon or following a termination of employment or services as provided in Section 7 below or under the Plan.

(b) Nothing contained in this Award Agreement or the Plan constitutes an employment or service commitment by the Company or any of its Subsidiaries, affects the Grantee's status, if he or she is an employee, as an employee at will who is subject to termination without cause, confers upon the Grantee any right to remain employed by or in service to the

Company or any of its Subsidiaries, interferes in any way with the right of the Company or any of its Subsidiaries at any time to terminate such employment or services, or affects the right of the Company or any of its Subsidiaries to increase or decrease the Grantee's other compensation or benefits. Nothing in this paragraph, however, is intended to adversely affect any independent contractual right of the Grantee without his or her consent thereto.

5. Limitations on Rights Associated with Restricted Stock Units . The Grantee shall have no rights as a shareholder of the Company, no dividend rights and no voting rights, with respect to the Restricted Stock Units and any shares of Common Stock underlying or issuable in respect of such Restricted Stock Units. Except as set forth in Section 11.1 of the Plan, no adjustments will be made for dividends or other rights of a holder for which the record date is prior to the date of issuance of the Common Stock underlying the Restricted Stock Units.

6. Restrictions on Transfer. Neither the Restricted Stock Units (whether vested or unvested), nor any interest therein, amount payable in respect thereof, or right to receive shares of Common Stock there under may be sold, assigned, transferred, pledged or otherwise disposed of, alienated or encumbered, either voluntarily or involuntarily. The transfer restrictions in the preceding sentence shall not apply to (a) transfers to the Company, or (b) transfers by will or the laws of descent and distribution.

7. Timing and Manner of Payment of Restricted Stock Units; Required Sale of Shares .

(a) For each Restricted Stock Unit subject to the Award that vests pursuant to the terms hereof, the Company shall issue in the name of the Grantee one share of Common Stock (subject to adjustment as provided in Section 11.1 of the Plan) by entering such share in book entry form. Subject to the following provisions of this Section 7, the issuance of shares of Common Stock in the name of the Grantee in respect of a vested Restricted Stock Unit shall be made on or as soon as administratively practical following the vesting date of such Restricted Stock Unit pursuant to the terms hereof and in all events not thirty (30) days following the applicable vesting date.

(b) The Grantee's acceptance of this Award Agreement constitutes the Grantee's instruction and authorization to the Company and any brokerage firm determined acceptable to the Company for such purpose to sell on the Grantee's behalf, upon the vesting of any Restricted Stock Units, as promptly as is reasonably practicable, all shares issued to the Grantee in connection with the vesting of such Restricted Stock Units. The portion of the proceeds from such sale that exceeds the Grantee's tax withholding obligations (as described in Section 10 hereof) will be disbursed to the Grantee as soon as administratively practicable. The Grantee will be responsible for all brokers' fees and other costs of sale, which fees and costs will be deducted from the proceeds of the foregoing sale of shares, and by accepting this Award Agreement the Grantee agrees to indemnify and hold the Company and any brokerage firm selling such shares harmless from any losses, costs, damages, or expenses relating to any such sale. By accepting this Award Agreement the Grantee acknowledges that the Company or its designee is under no obligation to arrange for the sale of shares hereunder at any particular price.

(c) The Company's obligation to issue shares of Common Stock or otherwise make payment with respect to vested Restricted Stock Units is subject to the condition precedent that the Grantee or other person entitled under the Plan to receive any payment with respect to the vested Restricted Stock Units deliver to the Company any representations or other documents or assurances required pursuant to Section 14 of the Plan.

(d) The Grantee shall have no further rights with respect to any Restricted Stock Units that are paid or that terminate pursuant to Section 8.

8. Effect of Termination of Employment or Services. If the Grantee's Continuous Status as an Employee or Consultant terminates (the last day of the Grantee's Continuous Status as an Employee or Consultant is referred to as the Grantee's " **Severance Date**"), the Grantee's Restricted Stock Units shall terminate to the extent such Restricted Stock Units have not become vested pursuant to Section 3 hereof or Section 11 of the Plan upon or prior to the Severance Date (regardless of the reason for such termination of Continuous Status as an Employee or Consultant, whether with or without cause, voluntarily or involuntarily, or due to death or Disability). If any unvested Restricted Stock Units are terminated hereunder, such Restricted Stock Units shall automatically terminate and be cancelled as of the Severance Date without payment of any additional consideration by the Company and without any other action by the Grantee, or the Grantee's beneficiary or personal representative, as the case may be.

9. Adjustments Upon Specified Events . The number of Restricted Stock Units then outstanding and the number and kind of securities that may be issued in respect of the Award are subject to adjustment upon the occurrence of certain events relating to the Company's stock pursuant to Section 11.1 of the Plan.

10. Tax Withholding. The Company shall reasonably determine the amount of any federal, state, local or other income, employment, or other taxes which the Company or any of its Subsidiaries may reasonably be obligated to withhold with respect to the grant, vesting, settlement or other event with respect to the Restricted Stock Units. Withholding shall be effected by the Company withholding from the proceeds resulting from the sale described in Section 7(b) hereof, an amount that the Company determines to be sufficient to satisfy the applicable tax withholding obligations. Notwithstanding anything herein to the contrary, Grantee will be solely responsible for payment of any tax withholding obligations in connection with the Award. In the event that the proceeds from the sale described in Section 7(b) hereof are not sufficient to cover all such tax withholding obligations, the Company (or any of its Subsidiaries last employing the Grantee) shall be entitled to require a cash payment by or on behalf of the Grantee and/or to deduct from other compensation payable to the Grantee any sums required to be withheld.

11. Notices. Any notice to be given under the terms of this Award Agreement shall be in writing and addressed to the Company at its principal office to the attention of the Secretary, and to the Grantee at the Grantee's last address reflected on the Company's payroll records. Any notice shall be delivered in person or shall be enclosed in a properly sealed envelope, addressed as aforesaid, registered or certified, and deposited (postage and registry or certification fee prepaid) in a post office or branch post office regularly maintained by the United States Government. Any such notice shall be given only when received, but if the Grantee is no longer employed by or provides services to the Company or a Subsidiary, shall be deemed to have been duly given five business days after the date mailed in accordance with the foregoing provisions of this Section 11.

12. Plan. The Award and all rights of the Grantee under this Award Agreement are subject to the terms and conditions of the provisions of the Plan, incorporated herein by reference. The Grantee agrees to be bound by the terms of the Plan and this Award Agreement. The Grantee acknowledges having read and understanding the Plan, the Prospectus for the Plan, and this Award Agreement. Unless otherwise expressly provided in other sections of this Award Agreement, provisions of the Plan that confer discretionary authority on the Board or the Administrator do not (and shall not be deemed to) create any rights in the Grantee unless such rights are expressly set forth herein or are otherwise in the sole discretion of the Board or the Administrator so conferred by appropriate action of the Board or the Administrator under the Plan after the date hereof.

13. Entire Agreement. This Award Agreement and the Plan together constitute the entire agreement and supersede all prior understandings and agreements, written or oral, of the parties hereto with respect to the subject matter hereof. The Plan may be amended pursuant to Section 13 of the Plan. This Award Agreement may be amended by the Board from time to time. Any such amendment must be in writing and signed by the Company. Any such amendment that materially and adversely affects the Grantee's rights under this Award Agreement requires the consent of the Grantee in order to be effective with respect to the Award. The Company may, however, unilaterally waive any provision hereof in writing to the extent such waiver does not adversely affect the interests of the Grantee hereunder, but no such waiver shall operate as or be construed to be a subsequent waiver of the same provision or a waiver of any other provision hereof.

14. Counterparts. This Award Agreement may be executed simultaneously in any number of counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

15. Section Headings. The section headings of this Award Agreement are for convenience of reference only and shall not be deemed to alter or affect any provision hereof.

16. Governing Law. This Award Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Oregon without regard to conflict of law principles thereunder.

17. Construction. It is intended that the terms of the Award will not result in the imposition of any tax liability pursuant to Section 409A of the Code. The Agreement shall be construed and interpreted consistent with that intent.

Exhibit 10.26

LOAN AND SECURITY AGREEMENT

THIS LOAN AND SECURITY AGREEMENT (this "**Agreement**") dated as of December 21, 2010 (the "**Effective Date**") between **SILICON VALLEY BANK**, a California corporation ("**Bank**"), and Pixelworks, Inc., an Oregon corporation ("**Borrower**") which does business in California as Oregon Pixelworks, Inc., provides the terms on which Bank shall lend to Borrower and Borrower shall repay Bank. The parties agree as follows:

1 ACCOUNTING AND OTHER TERMS

Accounting terms not defined in this Agreement shall be construed following GAAP. Calculations and determinations must be made following GAAP. Capitalized terms not otherwise defined in this Agreement shall have the meanings set forth in Section 13. All other terms contained in this Agreement, unless otherwise indicated, shall have the meaning provided by the Code to the extent such terms are defined therein.

2 LOAN AND TERMS OF PAYMENT

2.1 Promise to Pay. Borrower hereby unconditionally promises to pay Bank the outstanding principal amount of all Credit Extensions and accrued and unpaid interest thereon as and when due in accordance with this Agreement.

2.1.1 Revolving Advances.

(a) Availability. Subject to the terms and conditions of this Agreement, Bank shall make Advances not exceeding the Availability Amount. Amounts borrowed hereunder may be repaid and, prior to the Revolving Line Maturity Date, reborrowed, subject to the applicable terms and conditions precedent herein.

Notwithstanding anything to the contrary contained in this Section 2.1.1(a), Advances may be made in excess of the Availability Amount (but not in excess of the Revolving Line then in effect) (such Advances referred to herein as "**Nonformula Advances**") subject to the following terms and conditions: (i) such Nonformula Advances may be made solely during the last five (5) Business Days of any fiscal month or quarter, as the case may be, commencing with the month ending December 31, 2010; (ii) prior to any Nonformula Advance, the Borrower must provide (A) evidence satisfactory to Bank that it is in pro forma compliance in all respects with the financial covenants set forth in Section 6.7(a) of this Agreement and (B) a duly completed and executed Payment/Advance Form which requests such Nonformula Advance and directs the repayment of such Nonformula Advance within the time frame provided in clause (iv) herein, (iii) on the day of such Nonformula Advance, but no later than five (5) Business Days thereafter, the Borrower must provide a duly completed Borrowing Base Report, Deferred Revenue Report and a duly completed and executed Borrowing Base Certificate; *provided*, *however*, that the Borrower shall not be required to deliver the documentation required pursuant to this clause (iii) if the Borrower has repaid such Nonformula Advance within the time frame provided in clause (iv) herein; and (iv) the Borrower shall repay any and all Nonformula Advances on or before the fifth (5th) Business Day after the applicable fiscal month or quarter end. In the event that the Borrower shall fail to repay the principal amount of any Nonformula Advance as provided in this Section 2.1.1(a)(iii), such Advance shall be deemed an Advance that is not a Nonformula Advance and shall be subject to the terms and conditions of this Agreement, including, without limitation, the Availability Amount and the provisions set forth in Section 2.2.

(b) Termination; Repayment. The Revolving Line terminates on the Revolving Line Maturity Date, when the principal amount of all Advances, the unpaid interest thereon, and all other Obligations relating to the Revolving Line shall be immediately due and payable. Borrower shall have the right to terminate the Revolving Line at any time by delivering written notice to Bank at least 10 days prior to the effective date of termination specified in such notice (the "**Early Termination Date**"), provided that on such Early Termination Date, the principal amount of all outstanding Advances, all unpaid interest thereon, and all other Obligations relating to the Revolving Line (including, without limitation, Bank Expenses and the prorated portion of any Unused Revolving Line Facility Fee for the quarter in which termination occurs) shall be immediately due and payable.

2.1.2 Letters of Credit Sublimit.

(a) As part of the Revolving Line, Bank shall issue or have issued Letters of Credit denominated in Dollars or a Foreign Currency for Borrower's account. The aggregate Dollar Equivalent amount utilized for the issuance of Letters of Credit shall at all times reduce the amount otherwise available for Advances under the Revolving Line. The aggregate Dollar Equivalent amount available to be used for the issuance of Letters of Credit may not exceed (i) the lesser of (A) the Revolving Line or (B) the Borrowing Base, minus (ii) the sum of all outstanding principal amounts of any Advances (including any amounts used for Cash Management Services and the Dollar Equivalent of the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve) and minus (iii) the FX Reduction Amount.

(b) If, on the Revolving Line Maturity Date (or the effective date of any termination of this Agreement), there are any outstanding Letters of Credit, then on such date Borrower shall provide to Bank cash collateral in an amount equal to 105% of the Dollar Equivalent of the face amount of all such Letters of Credit plus all interest, fees, and costs due or to become due in connection therewith (as estimated by Bank in its good faith business judgment), to secure all of the Obligations relating to such Letters of Credit. All Letters of Credit shall be in form and substance acceptable to Bank in its sole discretion and shall be subject to the terms and conditions of Bank's standard Application and Letter of Credit Agreement (the "**Letter of Credit Application**"). Borrower agrees to execute any further documentation in connection with the Letters of Credit as Bank may reasonably request. Borrower further agrees to be bound by the regulations and interpretations of the issuer of any Letters of Credit guarantied by Bank and opened for Borrower's account or by Bank's interpretations of any Letter of Credit issued by Bank for Borrower's account, and Borrower understands and agrees that Bank shall not be liable for any error, negligence, or mistake, whether of omission or commission, in following Borrower's instructions or those contained in the Letters of Credit or any modifications, amendments, or supplements thereto.

(c) The obligation of Borrower to immediately reimburse Bank for drawings made under Letters of Credit shall be absolute, unconditional, and irrevocable, and shall be performed strictly in accordance with the terms of this Agreement, such Letters of Credit, and the Letter of Credit Application.

(d) Borrower may request that Bank issue a Letter of Credit payable in a Foreign Currency. If a demand for payment is made under any such Letter of Credit, Bank shall treat such demand as an Advance to Borrower of the Dollar Equivalent of the amount thereof (plus fees and charges in connection therewith such as wire, cable, SWIFT or similar charges).

(e) To guard against fluctuations in currency exchange rates, upon the issuance of any Letter of Credit payable in a Foreign Currency, Bank shall create a reserve (the "**Letter of Credit Reserve**") under the Revolving Line in an amount equal to ten percent (10%) of the face amount of such Letter of Credit. The amount of the Letter of Credit Reserve may be adjusted by Bank from time to time to account for fluctuations in the exchange rate. The availability of funds under the Revolving Line shall be reduced by the amount of such Letter of Credit Reserve for as long as such Letter of Credit remains outstanding.

2.1.3 Foreign Exchange Sublimit. As part of the Revolving Line, Borrower may enter into foreign exchange contracts with Bank under which Borrower commits to purchase from or sell to Bank a specific amount of Foreign Currency (each, a "**FX Forward Contract**") on a specified date (the "**Settlement Date**"). FX Forward Contracts shall have a Settlement Date of at least one (1) FX Business Day after the contract date and shall be subject to a reserve of ten percent (10%) of each outstanding FX Forward Contract (the "**FX Reserve**"). The aggregate amount of FX Forward Contracts at any one time may not exceed ten (10) times the lesser of the Revolving Line or the Borrowing Base, minus (i) the sum of all outstanding principal amounts of any Advances (including any amounts used for Cash Management Services), and minus (ii) the Dollar Equivalent of the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve). The amount otherwise available for Credit Extensions under the Revolving Line shall be reduced by an amount equal to ten percent (10%) of each outstanding FX Forward Contract (the "**FX Reduction Amount**"). Any amounts needed to fully reimburse Bank for any amounts not paid by Borrower in connection with FX Forward Contracts will be treated as Advances under the Revolving Line and will accrue interest at the interest rate applicable to Advances.

2.1.4 Cash Management Services Sublimit. Borrower may use the Revolving Line for Bank's cash management services, which may include merchant services, direct deposit of payroll, business credit card, and check cashing services identified in Bank's various cash management services agreements (collectively, the "**Cash Management Services**"), in an aggregate amount not to exceed the lesser of the Revolving Line or the Borrowing Base, minus (i) the sum of all outstanding principal amounts of any Advances, minus (ii) the Dollar Equivalent of the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve), and minus (iii) the FX Reduction Amount. Any amounts Bank pays on behalf of Borrower for any Cash Management Services will be treated as Advances under the Revolving Line and will accrue interest at the interest rate applicable to Advances.

2.2 Overadvances. If, at any time, the sum of (a) the outstanding principal amount of any Advances (including any amounts used for Cash Management Services, but excluding Nonformula Advances), plus (b) the face amount of any outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve), plus (c) the FX Reduction Amount exceeds the lesser of either the Revolving Line or the Borrowing Base, Borrower shall immediately pay to Bank in cash such excess.

2.3 Payment of Interest on the Credit Extensions.

(a) Interest Rate on Advances. Subject to Section 2.3(b), the principal amount outstanding under the Revolving Line shall accrue interest at a floating per annum rate equal to one-quarter of one percentage point (0.25%) above the Prime Rate, which interest shall be payable monthly in accordance with Section 2.3(f) below.

(b) Default Rate. Immediately upon the occurrence and during the continuance of an Event of Default, Obligations shall bear interest at a rate per annum which is five percentage points (5.00%) above the rate that is otherwise applicable thereto (the " **Default Rate**") unless Bank otherwise elects from time to time in its sole discretion to impose a smaller increase. Fees and expenses which are required to be paid by Borrower pursuant to the Loan Documents (including, without limitation, Bank Expenses) but are not paid when due shall bear interest until paid at a rate equal to the highest rate applicable to the Obligations. Payment or acceptance of the increased interest rate provided in this Section 2.3(b) is not a permitted alternative to timely payment and shall not constitute a waiver of any Event of Default or otherwise prejudice or limit any rights or remedies of Bank.

(c) Adjustment to Interest Rate. Changes to the interest rate of any Credit Extension based on changes to the Prime Rate shall be effective on the effective date of any change to the Prime Rate and to the extent of any such change.

(d) Computation; 360-Day Year. In computing interest, the date of the making of any Credit Extension shall be included and the date of payment shall be excluded; *provided, however,* that if any Credit Extension is repaid on the same day on which it is made, such day shall be included in computing interest on such Credit Extension. Interest shall be computed on the basis of a 360-day year for the actual number of days elapsed.

(e) Debit of Accounts. Bank may debit any of Borrower's deposit accounts, including the Designated Deposit Account, for principal and interest payments or any other amounts Borrower owes Bank when due. These debits shall not constitute a set-off.

(f) Interest Payment Date. Unless otherwise provided, interest is payable monthly on the last calendar day of each month.

2.4 Fees. Borrower shall pay to Bank:

(a) Commitment Fee. A fully earned, non-refundable commitment fee of $25,000.00, on the Effective Date;

(b) Letter of Credit Fee. Bank's customary fees and expenses for the issuance or renewal of Letters of Credit, including, without limitation, a letter of credit fee of one and one-quarter percent (1.25%) per annum of the Dollar Equivalent of the face amount of each Letter of Credit issued, upon the issuance of such Letter of Credit, each anniversary of the issuance during the term of such Letter of Credit, and upon the renewal of such Letter of Credit by Bank; and

(c) Unused Revolving Line Facility Fee. A fee (the "**Unused Revolving Line Facility Fee**"), payable monthly, in arrears, on a calendar year basis, in an amount equal to one-quarter of one percent (0.25%) per annum of the average unused portion of the Revolving Line. The unused portion of the Revolving Line, for purposes of this calculation, shall equal the difference between (x) $10,000,000.00 and (y) the average for the period of the daily closing balance of the Revolving Line outstanding plus the sum of the aggregate amount of outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit). Borrower shall not be entitled to any credit, rebate or repayment of any Unused Revolving Line Facility Fee previously earned by Bank pursuant to this Section notwithstanding any termination of the Agreement or the suspension or termination of Bank's obligation to make loans and advances hereunder; and

(d) Bank Expenses. All Bank Expenses (including reasonable attorneys' fees and expenses for documentation and negotiation of this Agreement) incurred through and after the Effective Date, when due.

2.5 Payments; Application of Payments.

(a) All payments (including prepayments) to be made by Borrower under any Loan Document shall be made in immediately available funds in U.S. Dollars, without setoff or counterclaim, before 12:00 p.m. Pacific time on the date when due. Payments of principal and/or interest received after 12:00 p.m. Pacific time are considered received at the opening of business on the next Business Day. When a payment is due on a day that is not a Business Day, the payment shall be due the next Business Day, and additional fees or interest, as applicable, shall continue to accrue until paid.

(b) Bank shall apply the whole or any part of collected funds against the Revolving Line or credit such collected funds to a depository account of Borrower with Bank (or an account maintained by an Affiliate of Bank), the order and method of such application to be in the sole discretion of Bank. Borrower shall have no right to specify the order or the accounts to which Bank shall allocate or apply any payments required to be made by Borrower to Bank or otherwise received by Bank under this Agreement when any such allocation or application is not specified elsewhere in this Agreement.

3 CONDITIONS OF LOANS

3.1 Conditions Precedent to Initial Credit Extension. Bank's obligation to make the initial Credit Extension is subject to the condition precedent that Bank shall have received, in form and substance satisfactory to Bank, such documents, and completion of such other matters, as Bank may reasonably deem necessary or appropriate, including, without limitation:

(a) duly executed original signatures to the Loan Documents;

(b) duly executed original signatures to the Control Agreements of (i) Wells Fargo Bank, National Association and (ii) SVB Asset Management;

(c) (i) Borrower's Operating Documents, (ii) a good standing certificate of Borrower certified by the Secretary of State of the State of Oregon and (iii) a good standing certificate of the Borrower in any applicable jurisdiction of the United States in which it is qualified to transact business, in each case, as of a date no earlier than thirty (30) days prior to the Effective Date;

(d) duly executed original signatures to the completed Borrowing Resolutions for Borrower;

(e) certified copies, dated as of a recent date, of financing statement searches, as Bank shall request, accompanied by written evidence (including any UCC termination statements) that the Liens indicated in any such financing statements either constitute Permitted Liens or have been or, in connection with the initial Credit Extension, will be terminated or released;

(f) the Perfection Certificate of Borrower, together with the duly executed original signature thereto;

(g) evidence satisfactory to Bank that the insurance policies required by Section 6.5 hereof are in full force and effect, together with appropriate evidence showing lender loss payable and/or additional insured clauses and cancellation notice to Bank (or endorsements reflecting the same) in favor of Bank; and

(h) payment of the fees and Bank Expenses then due as specified in Section 2.4 hereof.

3.2 Conditions Precedent to all Credit Extensions. Bank's obligations to make each Credit Extension, including the initial Credit Extension, is subject to the following conditions precedent:

(a) except as otherwise provided in Section 3.5(a) and, with respect to Nonformula Advances, Section 2.1.1(a), timely receipt of an executed Payment/Advance Form;

(b) the representations and warranties in this Agreement shall be true, accurate, and complete in all material respects on the date of the Payment/Advance Form and on the Funding Date of each Credit Extension; *provided*, *however*, that such materiality qualifier shall not be applicable to any representations and warranties that already are qualified or modified by materiality in the text thereof; and *provided*, *further* that those representations and warranties expressly referring to a specific date shall be true, accurate and complete in all material respects as of such date, and no Event of Default shall have occurred and be continuing or result from the Credit Extension. Each Credit Extension is Borrower's representation and warranty on that date that the representations and warranties in this Agreement remain true, accurate, and complete in all material respects; *provided*, *however*, that such materiality qualifier shall not be applicable to any representations and warranties that already are qualified or modified by materiality in the text thereof; and *provided*, *further* that those representations and warranties expressly referring to a specific date shall be true, accurate and complete in all material respects as of such date; and

(c) as determined in Bank's reasonable discretion, there shall not have occurred a Material Adverse Change.

3.3 Post-Closing Condition. Unless otherwise provided in writing, not later than January 4, 2011 Bank shall have received, in form and substance satisfactory to Bank, the duly executed original signatures to the Control Agreement of RBC Wealth Management.

3.4 Covenant to Deliver. Borrower agrees to deliver to Bank each item required to be delivered to Bank under this Agreement as a condition precedent to any Credit Extension. Borrower expressly agrees that a Credit Extension made prior to the receipt by Bank of any such item shall not constitute a waiver by Bank of Borrower's obligation to deliver such item, and the making of any Credit Extension in the absence of a required item shall be in Bank's sole discretion.

3.5 Procedures for Borrowing.

(a) Advances. Subject to the prior satisfaction of all other applicable conditions to the making of an Advance set forth in this Agreement (including, without limitation, the conditions to the making of a Nonformula Advance set forth in Section 2.1.1(a)), to obtain an Advance (other than Advances under Sections 2.1.2 or 2.1.4), Borrower shall notify Bank (which notice shall be irrevocable) by electronic mail, facsimile, or telephone by 12:00 p.m. Pacific time on the Funding Date of the Advance. Together with any such electronic or facsimile notification, Borrower shall deliver to Bank by electronic mail or facsimile a completed Payment/Advance Form executed by a Responsible Officer or his or her designee. Bank may rely on any telephone notice given by a person whom Bank believes is a Responsible Officer or designee. Bank shall credit Advances to the Designated Deposit Account. Bank may make Advances under this Agreement based on instructions from a Responsible Officer or his or her designee or without instructions if the Advances are necessary to meet Obligations which have become due.

4 CREATION OF SECURITY INTEREST

4.1 Grant of Security Interest. Borrower hereby grants Bank, to secure the payment and performance in full of all of the Obligations, a continuing security interest in, and pledges to Bank, the Collateral, wherever located, whether now owned or hereafter acquired or arising, and all proceeds and products thereof.

4.2 Priority of Security Interest. Borrower represents, warrants, and covenants that the security interest granted herein is and shall at all times continue to be a first priority perfected security interest in the Collateral (subject only to Permitted Liens that may have superior priority to Bank's Lien under this Agreement). If Borrower shall acquire a commercial tort claim, Borrower shall promptly notify Bank in a writing signed by Borrower of the general details thereof and grant to Bank in such writing a security interest therein and in the proceeds thereof, all upon the terms of this Agreement, with such writing to be in form and substance reasonably satisfactory to Bank.

If this Agreement is terminated, Bank's Lien in the Collateral shall continue until the Obligations (other than inchoate indemnity obligations) are repaid in full in cash. Upon payment in full in cash of the Obligations and at such time as Bank's obligation to make Credit Extensions has terminated, Bank shall, at Borrower's sole cost and expense, release its Liens in the Collateral and all rights therein shall revert to Borrower.

4.3 Authorization to File Financing Statements . Borrower hereby authorizes Bank to file financing statements, without notice to Borrower, with all appropriate jurisdictions to perfect or protect Bank's interest or rights hereunder, including a notice that any disposition of the Collateral, by either Borrower or any other Person, shall be deemed to violate the rights of Bank under the Code. Such financing statements may indicate the Collateral as "all assets of the Debtor" or words of similar effect, or as being of an equal or lesser scope, or with greater detail, all in Bank's discretion.

5 REPRESENTATIONS AND WARRANTIES

Borrower represents and warrants as follows:

5.1 Due Organization, Authorization; Power and Authority . Borrower is duly existing and in good standing in its jurisdiction of formation and is qualified and licensed to do business and is in good standing in any jurisdiction in which the conduct of its business or its ownership of property requires that it be qualified except where the failure to do so could not reasonably be expected to have a material adverse effect on Borrower's business. In connection with this Agreement, Borrower has delivered to Bank a completed certificate signed by Borrower, entitled "Perfection Certificate". Borrower represents and warrants to Bank that (a) Borrower's exact legal name is that indicated on the Perfection Certificate and on the signature page hereof; (b) Borrower is an organization of the type and is organized in the jurisdiction set forth in the Perfection Certificate; (c) the Perfection Certificate accurately sets forth Borrower's organizational identification number or accurately states that Borrower has none; (d) the Perfection Certificate accurately sets forth Borrower's place of business, or, if more than one, its chief executive office as well as Borrower's mailing address (if different than its chief executive office); (e) Borrower (and each of its predecessors) has not, in the past five (5) years, changed its jurisdiction of formation, organizational structure or type, or any organizational number assigned by its jurisdiction; and (f) all other information set forth on the Perfection Certificate pertaining to Borrower and each of its Subsidiaries is accurate and complete (it being understood and agreed that Borrower may from time to time update certain information in the Perfection Certificate after the Effective Date to the extent permitted by one or more specific provisions in this Agreement).

The execution, delivery and performance by Borrower of the Loan Documents to which it is a party have been duly authorized, and do not (i) conflict with any of Borrower's organizational documents, (ii) contravene, conflict with, constitute a default under or violate any material Requirement of Law, (iii) contravene, conflict or violate any applicable order, writ, judgment, injunction, decree, determination or award of any Governmental Authority by which Borrower or any of its Subsidiaries or any of their property or assets may be bound or affected, (iv) require any action by, filing, registration, or qualification with, or Governmental Approval from, any Governmental Authority (except such Governmental Approvals which have already been obtained and are in full force and effect or except for filings necessary for the perfection of the Liens granted pursuant to this Agreement) or (v) constitute an event of default under any material agreement by which Borrower is bound. Borrower is not in default under any agreement to which it is a party or by which it is bound in which the default could reasonably be expected to have a material adverse effect on Borrower's business.

5.2 Collateral. Borrower has good title to, has rights in, and the power to transfer each item of the Collateral upon which it purports to grant a Lien hereunder, free and clear of any and all Liens except Permitted Liens. Except as permitted by Section 6.6(b), Borrower has no domestic deposit accounts other than the deposit accounts with Bank, the deposit accounts, if any, described in the Perfection Certificate delivered to Bank in connection herewith, or of which Borrower has given Bank notice and taken such actions as are necessary to give Bank a perfected security interest therein. The Accounts are bona fide, existing obligations of the Account Debtors.

The Collateral is not in the possession of any third party bailee (such as a warehouse) except as otherwise provided in the Perfection Certificate or except as permitted by Section 7.2. None of the components of the Collateral shall be maintained at locations other than as provided in the Perfection Certificate or as permitted pursuant to Section 7.2.

All Inventory is in all material respects of good and marketable quality, free from material defects, except for any Inventory for which reserves have been established in the ordinary course of business in accordance with GAAP.

Borrower is the sole owner of the Intellectual Property which it owns or purports to own except for (a) non-exclusive licenses granted to its customers in the ordinary course of business, (b) over-the-counter software that is commercially available to the public, and (c) material Intellectual Property licensed to Borrower and noted on the Perfection Certificate. Each Patent which it owns or purports to own and which is material to Borrower's business is valid and enforceable, and no part of the Intellectual Property which Borrower owns or purports to own and which is material to Borrower's business has been judged invalid or unenforceable, in whole or in part. To the best of Borrower's knowledge, no claim has been made that any part of the Intellectual Property violates the rights of any third party except to the extent such claim would not reasonably be expected to have a material adverse effect on Borrower's business.

5.3 Accounts Receivable. For any Eligible Account in any Borrowing Base Certificate, all statements made and all unpaid balances appearing in all invoices, instruments and other documents evidencing such Eligible Accounts are and shall be true and correct and all such invoices, instruments and other documents, and all of Borrower's Books are genuine and in all respects what they purport to be. Borrower has no knowledge of any actual or imminent Insolvency Proceeding of any Account Debtor whose accounts are Eligible Accounts in any Borrowing Base Certificate. To the best of Borrower's knowledge, all signatures and endorsements on all documents, instruments, and agreements relating to all Eligible Accounts are genuine, and all such documents, instruments and agreements are legally enforceable in accordance with their terms.

5.4 Litigation. There are no actions or proceedings pending or, to the knowledge of the Responsible Officers, threatened in writing by or against Borrower or any of its Subsidiaries involving more than, individually or in the aggregate, Seven Hundred Fifty Thousand Dollars ($750,000).

5.5 Financial Statements; Financial Condition. All consolidated financial statements for Borrower and any of its Subsidiaries delivered to Bank fairly present in all material respects Borrower's consolidated financial condition and Borrower's consolidated results of operations. There has not been any material deterioration in Borrower's consolidated financial condition since the date of the most recent financial statements submitted to Bank.

5.6 Solvency. The fair salable value of Borrower's assets (including goodwill minus disposition costs) exceeds the fair value of its liabilities; Borrower is not left with unreasonably small capital after the transactions in this Agreement; and Borrower is able to pay its debts (including trade debts) as they mature.

5.7 Regulatory Compliance. Borrower is not an "investment company" or a company "controlled" by an "investment company" under the Investment Company Act of 1940, as amended. Borrower is not engaged as one of its important activities in extending credit for margin stock (under Regulations X, T and U of the Federal Reserve Board of Governors). Borrower has complied in all material respects with the Federal Fair Labor Standards Act. Neither Borrower nor any of its Subsidiaries is a "holding company" or an "affiliate" of a "holding company" or a "subsidiary company" of a "holding company" as each term is defined and used in the Public Utility Holding Company Act of 2005. Borrower has not violated any laws, ordinances or rules, the violation of which could reasonably be expected to have a material adverse effect on its business. None of Borrower's or any of its Subsidiaries' properties or assets has been used by Borrower or any Subsidiary or, to the best of Borrower's knowledge, by previous Persons, in disposing, producing, storing, treating, or transporting any hazardous substance other than legally. Borrower and each of its Subsidiaries have obtained all consents, approvals and authorizations of, made all declarations or filings with, and given all notices to, all Government Authorities that are necessary to continue their respective businesses as currently conducted.

5.8 Subsidiaries; Investments. Borrower does not own any stock, partnership interest or other equity securities except for Permitted Investments. Borrower's membership interests in its current Subsidiaries are not represented by any certificate and are "general intangibles" as defined by the Uniform Commercial Code (the "**UCC**").

5.9 Tax Returns and Payments; Pension Contributions. Borrower has timely filed all required tax returns and reports, and Borrower has timely paid all foreign, federal and state income and payroll taxes and any other material assessments, deposits and contributions owed by Borrower. Borrower may defer payment of any contested taxes, provided that Borrower (a) in good faith contests its obligation to pay the taxes by appropriate proceedings promptly and diligently instituted and conducted, (b) notifies Bank in writing of the commencement of, and any material development in, the proceedings, (c) posts bonds or takes any other steps required to prevent the governmental authority levying such contested taxes from obtaining a Lien upon any of the Collateral that is other than a “Permitted Lien”. Borrower is unaware of any claims or adjustments proposed for any of Borrower’s prior tax years which could result in additional taxes becoming due and payable by Borrower. Borrower has paid all amounts necessary to fund all present pension, profit sharing and deferred compensation plans in accordance with their terms, and Borrower has not withdrawn from participation in, and has not permitted partial or complete termination of, or permitted the occurrence of any other event with respect to, any such plan which could reasonably be expected to result in any liability of Borrower, including any liability to the Pension Benefit Guaranty Corporation or its successors or any other governmental agency.

5.10 Use of Proceeds. Borrower shall use the proceeds of the Credit Extensions solely as working capital and to fund its general business requirements and not for personal, family, household or agricultural purposes.

5.11 Designation of Indebtedness under this Agreement as Senior Indebtedness. All principal of, interest (including all interest accruing after the commencement of any bankruptcy or similar proceeding, whether or not a claim for post-petition interest is allowable as a claim in any such proceeding), and all fees, costs, expenses and other amounts accrued or due under this Agreement shall constitute “Designated Senior Indebtedness” under the terms of the Indenture.

5.12 Full Disclosure. No written representation, warranty or other statement of Borrower in any certificate or written statement given to Bank, as of the date such representation, warranty, or other statement was made, taken together with all such written certificates and written statements given to Bank, contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements contained in the certificates or statements not misleading (it being recognized by Bank that the projections and forecasts provided by Borrower in good faith and based upon reasonable assumptions are not viewed as facts and that actual results during the period or periods covered by such projections and forecasts may differ from the projected or forecasted results).

5.13 Definition of “Knowledge.” For purposes of the Loan Documents, whenever a representation or warranty is made to Borrower’s knowledge or awareness, to the “best of” Borrower’s knowledge, or with a similar qualification, knowledge or awareness means the actual knowledge, after reasonable investigation, of the Responsible Officers.

6 AFFIRMATIVE COVENANTS

Borrower shall do all of the following:

6.1 Government Compliance. Maintain its and all its Subsidiaries’ legal existence and good standing in their respective jurisdictions of formation and maintain qualification in each jurisdiction in which the failure to so qualify would reasonably be expected to have a material adverse effect on Borrower’s business or operations. Borrower shall comply, and have each Subsidiary comply, with all laws, ordinances and regulations to which it is subject, noncompliance with which could have a material adverse effect on Borrower’s business. All sales and other transactions underlying or giving rise to each Eligible Account shall comply in all material respects with all applicable laws and governmental rules and regulations.

6.2 Financial Statements, Reports, Certificates. Deliver to Bank:

(a) Advances other than Nonformula Advances. Written notice of the Borrower’s intention to request (the “**Initial Regular Advance Request**”) an initial Advance that is not a Nonformula Advance (the “**Initial Regular Advance**”) no later than thirty (30) days prior to such request;

(b) Borrowing Base Reports. To the extent Borrower has received an Initial Regular Advance pursuant to the terms of this Agreement, within thirty (30) days after the last day of each month, aged listings of accounts receivable and accounts payable (by invoice date) (the “**Borrowing Base Reports**”);

(c) Deferred Revenue Reports. To the extent Borrower has received an Initial Regular Advance pursuant to the terms of this Agreement, within thirty (30) days after the last day of each month and together with the Borrowing Base Reports, a duly completed deferred revenue report (the “**Deferred Revenue Report**”);

(d) Borrowing Base Certificate. To the extent Borrower has received an Initial Regular Advance pursuant to the terms of this Agreement, within thirty (30) days after the last day of each month and together with the Borrowing Base Reports, a duly completed Borrowing Base Certificate signed by a Responsible Officer;

(e) Monthly Financial Statements. As soon as available, but no later than thirty (30) days after the last day of each month, company prepared consolidated and consolidating balance sheets and income statements covering Borrower's consolidated and Borrower's and each of its Subsidiary's operations for such month certified by a Responsible Officer and in a form acceptable to Bank (the " **Monthly Financial Statements**");

(f) Monthly Compliance Certificate. Within thirty (30) days after the last day of each month and together with the Monthly Financial Statements, a duly completed Compliance Certificate signed by a Responsible Officer, certifying that as of the end of such month, Borrower was in full compliance with all of the terms and conditions of this Agreement, and setting forth calculations showing compliance with the financial covenants set forth in this Agreement and such other information as Bank shall reasonably request;

(g) Annual Audited Financial Statements. As soon as available, but no later than ninety (90) days after the last day of Borrower's fiscal year, audited consolidated financial statements prepared under GAAP, consistently applied, together with an unqualified opinion on the financial statements from an independent certified public accounting firm acceptable to Bank in its reasonable discretion;

(h) Budgets and Projections. As soon as available, but no later than forty-five (45) days after the last day of Borrower's fiscal year, annual operating budgets (including quarterly income statements, balance sheets and cash flow statements) for the upcoming fiscal year of Borrower;

(i) Other Statements. Within five (5) days of delivery, copies of all statements, reports and notices made available to Borrower's security holders or to any holders of Subordinated Debt;

(j) SEC Filings. In the event that Borrower becomes subject to the reporting requirements under the Exchange Act within five (5) days of filing (and, in no event, later than (i) fifty (50) days of the end of each fiscal quarter with respect to each Form 10Q filed by the Borrower and (ii) ninety (90) days of the end of each fiscal year with respect to each Form 10K filed by the Borrower), copies of all periodic and other reports, proxy statements and other materials filed by Borrower with the SEC, any Governmental Authority succeeding to any or all of the functions of the SEC or with any national securities exchange, or distributed to its shareholders, as the case may be. Documents required to be delivered pursuant to the terms hereof (to the extent any such documents are included in materials otherwise filed with the SEC) may be delivered electronically and if so delivered, shall be deemed to have been delivered on the date on which Borrower posts such documents, or provides a link thereto, on Borrower's website on the Internet at Borrower's website address;

(k) Legal Action Notice. A prompt report of any legal actions pending or threatened in writing against Borrower or any of its Subsidiaries that could result in damages or costs to Borrower or any of its Subsidiaries of, individually or in the aggregate, Seven Hundred Fifty Thousand Dollars ($750,000) or more;

(l) Intellectual Property Notice. Together with delivery of the Compliance Certificate delivered at the end of each fiscal quarter, written notice of (i) any material change in the composition of the Intellectual Property, (ii) the registration of any copyright, patent or trademark, including any subsequent ownership right of Borrower in or to any copyright, patent or trademark not previously disclosed in writing to Bank, and (iii) Borrower's knowledge of an event that could reasonably be expected to materially and adversely affect the value of the Intellectual Property; and

(m) Other Financial Information. Budgets, sales projections, operating plans and other financial information reasonably requested by Bank.

6.3 Inventory; Returns. Keep all Inventory in good and marketable condition, free from material defects, except for any Inventory for which reserves have been established in the ordinary course of business in accordance with GAAP. Returns and allowances between Borrower and its Account Debtors shall follow Borrower's customary practices as they exist at the Effective Date. Borrower must promptly notify Bank of all returns, recoveries, disputes and claims that involve more than Five Hundred Thousand Dollars ($500,000).

6.4 Taxes; Pensions. Timely file, and require each of its Subsidiaries to timely file, all required tax returns and reports and timely pay, and require each of its Subsidiaries to timely pay, all foreign, federal and state income and payroll taxes and any other material assessments, deposits and contributions owed by Borrower and each of its Subsidiaries, except for deferred payment of any taxes contested pursuant to the terms of Section 5.9 hereof, and except for any failure to file or pay that does not result in any Lien attaching to the Collateral, and shall deliver to Bank, on demand, appropriate certificates attesting to such payments, and pay all amounts necessary to fund all present pension, profit sharing and deferred compensation plans in accordance with their terms.

6.5 Insurance. Keep its business and the Collateral insured for risks and in amounts standard for companies in Borrower's industry and location and as Bank may reasonably request. Insurance policies shall be in a form, with companies, and in amounts that are satisfactory to Bank. All property policies shall have a lender's loss payable endorsement showing Bank as a lender loss payee and waive subrogation against Bank. All liability policies shall show, or have endorsements showing, Bank as an additional insured. All policies (or their respective endorsements) shall provide that the insurer shall give Bank at least twenty (20) days notice before canceling, amending, or declining to renew its policy. At Bank's request, Borrower shall deliver certified copies of policies and evidence of all premium payments. Proceeds payable under any policy shall, at Bank's option, be payable to Bank on account of the Obligations. Notwithstanding the foregoing, (a) so long as no Event of Default has occurred and is continuing, Borrower shall have the option of applying the proceeds of any casualty policy up to Fifty Thousand Dollars ($50,000) with respect to any loss, but not exceeding One Hundred Thousand Dollars ($100,000) in the aggregate for all losses under all casualty policies in any one year, toward the replacement or repair of destroyed or damaged property; *provided* that any such replaced or repaired property (i) shall be of equal or like value as the replaced or repaired Collateral and (ii) shall be deemed Collateral in which Bank has been granted a first priority security interest, and (b) after the occurrence and during the continuance of an Event of Default, all proceeds payable under such casualty policy shall, at the option of Bank, be payable to Bank on account of the Obligations. If Borrower fails to obtain insurance as required under this Section 6.5 or to pay any amount or furnish any required proof of payment to third persons and Bank, Bank may make all or part of such payment or obtain such insurance policies required in this Section 6.5, and take any action under the policies Bank deems prudent.

6.6 Operating Accounts.

(a) With ninety (90) days of the Effective Date, maintain its primary domestic operating and other deposit accounts with Bank and Bank's Affiliates.

(b) Provide Bank five (5) days prior written notice before establishing any Collateral Account at or with any bank or financial institution other than Bank or Bank's Affiliates. For each Collateral Account that Borrower at any time maintains, Borrower shall cause the applicable bank or financial institution (other than Bank) at or with which any Collateral Account is maintained to execute and deliver a Control Agreement or other appropriate instrument with respect to such Collateral Account to perfect Bank's Lien in such Collateral Account in accordance with the terms hereunder which Control Agreement may not be terminated without the prior written consent of Bank. The provisions of the previous sentence shall not apply to deposit accounts exclusively used for payroll, payroll taxes and other employee wage and benefit payments to or for the benefit of Borrower's employees and identified to Bank by Borrower as such or to deposit accounts located outside of the United States.

6.7 Financial Covenants. Maintain as of the last day of each month, unless otherwise noted, on a consolidated basis with respect to Borrower and its Subsidiaries:

(a) Liquidity Coverage. A ratio of unrestricted cash and Cash Equivalents held at Bank and its Affiliates plus net Accounts *to* all Obligations of Borrower to Bank plus the principal amount of the Borrower Debenture of not less than (i) for each month ending on or prior to April 30, 2011, 1.25:1.00, and (ii) for each month ending on May 31, 2011 and thereafter, 1.50:1.00.

6.8 Protection of Intellectual Property Rights. (a) Protect, defend and maintain the validity and enforceability of its Intellectual Property; (b) promptly advise Bank in writing of material infringements of its Intellectual Property; and (c) not allow any Intellectual Property material to Borrower's business to be abandoned, forfeited or dedicated to the public without Bank's written consent.

6.9 Litigation Cooperation. From the date hereof and continuing through the termination of this Agreement, make available to Bank, without expense to Bank, Borrower and its officers, employees and agents and Borrower's books and records, to the extent that Bank may deem them reasonably necessary to prosecute or defend any third-party suit or proceeding instituted by or against Bank with respect to any Collateral or relating to Borrower.

6.10 [reserved.]

6.11 Designated Senior Indebtedness. Borrower shall designate all principal of, interest (including all interest accruing after the commencement of any bankruptcy or similar proceeding, whether or not a claim for post-petition interest is allowable as a claim in any such proceeding), and all fees, costs, expenses and other amounts accrued or due under this Agreement as "Designated Senior Indebtedness", or such similar term, in any future Subordinated Debt incurred by Borrower after the date hereof, if such Subordinated Debt contains such term or similar term and if the effect of such designation is to grant to Bank the same or similar rights as granted to Bank as a holder of "Designated Senior Indebtedness" under the Indenture.

6.12 Access to Collateral; Books and Records . Allow Bank, or its agents, at reasonable times, on five (5) Business Days' notice (provided no notice is required if an Event of Default has occurred and is continuing), to inspect the Collateral and audit and copy Borrower's Books. Such inspections or audits outlined in this Section 6.12 shall be conducted at the expense of the Borrower no more often than once every twelve (12) months unless an Event of Default has occurred and is continuing. The foregoing inspections and audits shall be at Borrower's expense, and the charge therefor shall be $850 per person per day (or such higher amount as shall represent Bank's then-current standard charge for the same), plus reasonable out-of-pocket expenses. In the event Borrower and Bank schedule an audit more than ten (10) days in advance, and Borrower cancels or seeks to reschedule the audit with less than ten (10) days written notice to Bank, then (without limiting any of Bank's rights or remedies), Borrower shall pay Bank a fee of $1,000 plus any out-of-pocket expenses incurred by Bank to compensate Bank for the anticipated costs and expenses of the cancellation or rescheduling. Whether or not an Event of Default has occurred and is continuing, Bank may contact any Account Debtor owing Borrower money to verify the amount of such Eligible Account and, if an Event of Default has occurred and is continuing, notify such Account Debtor of Bank's security interest in such funds. In the event that Borrower submits an Initial Regular Advance Request to Bank, Borrower hereby acknowledges that Bank shall conduct an audit of the Borrower's Eligible Accounts pursuant to the terms of this Section 6.12 prior to the Borrower's receipt of the Initial Regular Advance and the results of such audit shall be in form and substance satisfactory to Bank in its discretion. Borrower hereby acknowledges and agrees that, once Borrower requests the Initial Regular Advance, Bank shall conduct an annual audit of the Borrower's Eligible Accounts for purposes of all future Advances that are not Nonformula Advances.

6.13 Formation or Acquisition of Subsidiaries . At the time that Borrower forms any direct or indirect Subsidiary or acquires any direct or indirect Subsidiary after the Effective Date, Borrower shall provide to Bank appropriate certificates and powers and financing statements, pledging (i) all of the direct or beneficial ownership interest in such new Subsidiary if such Subsidiary is a Domestic Subsidiary and (ii) not greater than 65% of all voting equity interests and all nonvoting equity interests in such new Subsidiary if such Subsidiary is a Foreign Subsidiary, in each case in form and substance reasonably satisfactory to Bank. Upon the reasonable request of Bank, Borrower shall cause such new Subsidiary to provide to Bank a joinder to the Loan Agreement to cause such Subsidiary to become a co-borrower hereunder or execute a guaranty, together with such appropriate financing statements and/or Control Agreements, all in form and substance satisfactory to Bank (including being sufficient to grant Bank a first priority Lien (subject to Permitted Liens) in and to the assets of such newly formed or acquired Subsidiary). Borrower shall provide to Bank all other documentation in form and substance satisfactory to Bank, including one or more opinions of counsel satisfactory to Bank, which in its opinion is appropriate with respect to the execution and delivery of the applicable documentation referred to above. Any document, agreement, or instrument executed or issued pursuant to this Section 6.13 shall be a Loan Document.

6.14 Further Assurances. Execute any further instruments and take further action as Bank reasonably requests to perfect or continue Bank's Lien in the Collateral or to effect the purposes of this Agreement. Deliver to Bank, within five (5) days after the same are sent or received, copies of all correspondence, reports, documents and other filings with any Governmental Authority regarding compliance with or maintenance of Governmental Approvals or Requirements of Law or that could reasonably be expected to have a material effect on any of the Governmental Approvals or otherwise on the operations of Borrower or any of its Subsidiaries.

7 NEGATIVE COVENANTS

Borrower shall not do any of the following without Bank's prior written consent:

7.1 Dispositions. Convey, sell, lease, transfer, assign, or otherwise dispose of (collectively, "**Transfer**"), or permit any of its Subsidiaries to Transfer, all or any part of its business or property, except for Transfers (a) of Inventory in the ordinary course of business; (b) of worn-out or obsolete Equipment; (c) in connection with Permitted Liens and Permitted Investments; (d) of non-exclusive licenses for the use of the property of Borrower or its Subsidiaries in the ordinary course of business and licenses that could not result in a legal transfer of title of the licensed property but that may be exclusive in respects other than territory and that may be exclusive as to territory only as to discreet geographical areas outside of the United States; (e) by the Borrower of all of its Investments in SMIC, provided that such Transfer is completed on or before December 31, 2011 and (f) by the Borrower and its Subsidiary, Equator Technologies, Inc., of the Saleable Patents to [***].

7.2 Changes in Business, Ownership, or Business Locations. (a) Engage in or permit any of its Subsidiaries to engage in any business other than the businesses currently engaged in by Borrower and such Subsidiary, as applicable, or reasonably related thereto; (b) except for the dissolution of its Subsidiary, Jaldi Semiconductor, liquidate or dissolve; or (c) enter into any transaction or series of related transactions in which the stockholders of Borrower who were not stockholders immediately prior to the first such transaction own more than 40% of the voting stock of Borrower immediately after giving effect to such transaction or related series of such transactions (other than by the sale of Borrower's equity securities in a public offering or to venture capital investors so long as Borrower identifies to Bank the venture capital investors prior to the closing of the transaction and provides to Bank a description of the material terms of the transaction).

Borrower shall not, without at least thirty (30) days prior written notice to Bank: (1) add any new offices or business locations, including warehouses (unless such new offices or business locations contain less than One Hundred Thousand Dollars ($100,000) in Borrower's assets or property) or deliver any portion of the Collateral valued, individually or in the aggregate, in excess of One Hundred Thousand Dollars ($100,000) to a bailee at a location other than to a bailee and at a location already disclosed in the Perfection Certificate, (2) change its jurisdiction of organization, (3) change its organizational structure or type, (4) change its legal name, or (5) change any organizational number (if any) assigned by its jurisdiction of organization. If Borrower intends to deliver any portion of the Collateral valued, individually or in the aggregate, in excess of One Hundred Thousand Dollars ($100,000) to a bailee, and Bank and such bailee is not already party to a bailee agreement governing both the Collateral and the location to which Borrower intends to deliver the Collateral, then Borrower will first receive the written consent of Bank, and such bailee shall execute and deliver a bailee agreement in form and substance satisfactory to Bank in its sole discretion.

7.3 Mergers or Acquisitions. Merge or consolidate, or permit any of its Subsidiaries to merge or consolidate, with any other Person, or acquire, or permit any of its Subsidiaries to acquire, all or substantially all of the capital stock or property of another Person. A Subsidiary may merge or consolidate into another Subsidiary or into Borrower.

7.4 Subsidiaries. Permit its membership interests in any Subsidiary, without the prior written consent of Bank, (i) to be represented by any certificate, or (ii) cease to be "general intangibles" as defined by the UCC.

7.5 Indebtedness. Create, incur, assume, or be liable for any Indebtedness, or permit any Subsidiary to do so, other than Permitted Indebtedness.

7.6 Encumbrance. Create, incur, allow, or suffer any Lien on any of its property, or assign or convey any right to receive income, including the sale of any Accounts, or permit any of its Subsidiaries to do so, except for Permitted Liens, permit any Collateral not to be subject to the first priority security interest granted herein, or enter into any agreement, document, instrument or other arrangement (except with or in favor of Bank) with any Person which directly or indirectly prohibits or has the effect of prohibiting Borrower or any Subsidiary from assigning, mortgaging, pledging, granting a security interest in or upon, or encumbering any of Borrower's or any Subsidiary's Intellectual Property, except as is otherwise permitted in Section 7.1 hereof and the definition of "Permitted Liens" herein.

7.7 Maintenance of Collateral Accounts. Maintain any Collateral Account except pursuant to the terms of Section 6.6(b) hereof.

7.8 Distributions; Investments. (a) Pay any dividends or make any distribution or payment or redeem, retire or purchase any capital stock provided that (i) Borrower may convert any of its convertible securities into other securities pursuant to the terms of such convertible securities or otherwise in exchange thereof, (ii) Borrower may pay dividends solely in common stock; and (iii) Borrower may repurchase the stock of former employees or consultants pursuant to stock repurchase agreements so long as an Event of Default does not exist at the time of such repurchase and would not exist after giving effect to such repurchase, provided such repurchase does not exceed in the aggregate of Five Hundred Thousand Dollars ($500,000) per fiscal year; or (b) directly or indirectly make any Investment other than Permitted Investments, or permit any of its Subsidiaries to do so.

7.9 Transactions with Affiliates. Directly or indirectly enter into or permit to exist any material transaction with any Affiliate of Borrower, except for transactions that are in the ordinary course of Borrower's business, upon fair and reasonable terms that are no less favorable to Borrower than would be obtained in an arm's length transaction with a non-affiliated Person, other than the transfer of certain of the Saleable Patents to its Subsidiary, Equator Technologies, Inc., pursuant to the subsequent sale of the Saleable Patents to [***].

7.10 Subordinated Debt. (a) Make or permit any payment on any Subordinated Debt, except under the terms of the subordination, intercreditor, or other similar agreement to which such Subordinated Debt is subject, or (b) amend any provision in any document relating to the Subordinated Debt which would increase the amount thereof or adversely affect the subordination thereof to Obligations owed to Bank.

7.11 Compliance. Become an "investment company" or a company controlled by an "investment company", under the Investment Company Act of 1940, as amended, or undertake as one of its important activities extending credit to purchase or carry margin stock (as defined in Regulation U of the Board of Governors of the Federal Reserve System), or use the proceeds of any Credit Extension for that purpose; fail to meet the minimum funding requirements of ERISA, permit a Reportable Event or Prohibited Transaction, as defined in ERISA, to occur; fail to comply with the Federal Fair Labor Standards Act or violate any other law or regulation, if the violation could reasonably be expected to have a material adverse effect on Borrower's business, or permit any of its Subsidiaries to do so; withdraw or permit any Subsidiary to withdraw from participation in, permit partial or complete termination of, or permit the occurrence of any other event with respect to, any present pension, profit sharing and deferred compensation plan which could reasonably be expected to result in any liability of Borrower, including any liability to the Pension Benefit Guaranty Corporation or its successors or any other governmental agency.

8 EVENTS OF DEFAULT

Any one of the following shall constitute an event of default (an " **Event of Default**") under this Agreement:

8.1 Payment Default. Borrower fails to (a) make any payment of principal or interest on any Credit Extension on its due date, or (b) pay any other Obligations within three (3) Business Days after such Obligations are due and payable (which three (3) Business Day cure period shall not apply to payments due on the Revolving Line Maturity Date). During the cure period, the failure to make or pay any payment specified under clause (a) or (b) hereunder is not an Event of Default (but no Credit Extension will be made during the cure period);

8.2 Covenant Default.

(a) Borrower fails or neglects to perform any obligation in Sections 3.3, 6.2, 6.4, 6.5, 6.6, 6.7, 6.12 or violates any covenant in Section 7; or

(b) Borrower fails or neglects to perform, keep, or observe any other term, provision, condition, covenant or agreement contained in this Agreement or any Loan Documents, and as to any default (other than those specified in this Section 8) under such other term, provision, condition, covenant or agreement that can be cured, has failed to cure the default within ten (10) days after a Responsible Officer knew or should have known, in the exercise of reasonable diligence required by applicable law, of the occurrence thereof; provided, however, that if the default cannot by its nature be cured within the ten (10) day period or cannot after diligent attempts by Borrower be cured within such ten (10) day period, and such default is likely to be cured within a reasonable time, then Borrower shall have an additional period (which shall not in any case exceed thirty (30) days) to attempt to cure such default, and within such reasonable time period the failure to cure the default shall not be deemed an Event of Default (but no Credit Extensions shall be made during such cure period). Cure periods provided under this section shall not apply, among other things, to financial covenants or any other covenants set forth in clause (a) above;

8.3 Material Adverse Change. A Material Adverse Change occurs;

8.4 Attachment; Levy; Restraint on Business.

(a) (i) The service of process seeking to attach, by trustee or similar process, any funds of Borrower or of any entity under the control of Borrower (including a Subsidiary) on deposit or otherwise maintained with Bank or any Bank Affiliate, or (ii) a notice of lien or levy is filed against any of Borrower's assets by any government agency, and the same under subclauses (i) and (ii) hereof are not, within ten (10) days after the occurrence thereof, discharged or stayed (whether through the posting of a bond or otherwise); provided, however, no Credit Extensions shall be made during any ten (10) day cure period; or

(b) (i) any material portion of Borrower's assets is attached, seized, levied on, or comes into possession of a trustee or receiver, or (ii) any court order enjoins, restrains, or prevents Borrower from conducting any material part of its business;

8.5 Insolvency. (a) Borrower is unable to pay its debts (including trade debts) as they become due or otherwise becomes insolvent; (b) Borrower begins an Insolvency Proceeding; or (c) an Insolvency Proceeding is begun against Borrower and not dismissed or stayed within thirty (30) days (but no Credit Extensions shall be made while of any of the conditions described in clause (a) exist and/or until any Insolvency Proceeding is dismissed);

8.6 Other Agreements. There is, under any agreement to which Borrower is a party with a third party or parties, (a) any default resulting in a right by such third party or parties, whether or not exercised, to accelerate the maturity of any Indebtedness in an amount individually or in the aggregate in excess of Two Hundred Thousand Dollars ($200,000); or (b) any default by Borrower, the result of which could be reasonably expected to have a material adverse effect on Borrower's business; *provided*, *however*, that the Event of Default under this Section 8.6 caused by the occurrence of a default under such other agreement shall be cured or waived for purposes of this Agreement upon Bank receiving written notice from the party asserting such default of such cure or waiver of the default under such other agreement, if at the time of such cure or waiver under such other agreement (x) Bank has not declared an Event of Default under this Agreement and/or exercised any rights with respect thereto; (y) any such cure or waiver does not result in an Event of Default under any other provision of this Agreement or any Loan Document; and (z) in connection with any such cure or waiver under such other agreement, the terms of any agreement with such third party are not modified or amended in any manner which could adversely affect Bank;

8.7 Judgments. One or more final judgments, orders, or decrees for the payment of money in an amount, individually or in the aggregate, of at least Two Hundred Fifty Thousand Dollars ($250,000) (not covered by independent third-party insurance as to which liability has been accepted by such insurance carrier) shall be rendered against Borrower and the same are not, within ten (10) days after the entry thereof, discharged or execution thereof stayed or bonded pending appeal, or such judgments are not discharged prior to the expiration of any such stay (provided that no Credit Extensions will be made prior to the discharge, stay, or bonding of such judgment, order, or decree); and

8.8 Misrepresentations. Borrower or any Person acting for Borrower makes any representation, warranty, or other statement now or later in this Agreement, any Loan Document or in any writing delivered to Bank or to induce Bank to enter this Agreement or any Loan Document, and such representation, warranty, or other statement is incorrect in any material respect when made.

9 BANK'S RIGHTS AND REMEDIES

9.1 Rights and Remedies. While an Event of Default occurs and continues Bank may, without notice or demand, do any or all of the following:

(a) declare all Obligations immediately due and payable (but if an Event of Default described in Section 8.5 occurs all Obligations are immediately due and payable without any action by Bank);

(b) stop advancing money or extending credit for Borrower's benefit under this Agreement or under any other agreement between Borrower and Bank;

(c) demand that Borrower (i) deposit cash with Bank in an amount equal to 105% of the Dollar Equivalent of the aggregate face amount of all Letters of Credit remaining undrawn (plus all interest, fees, and costs due or to become due in connection therewith (as estimated by Bank in its good faith business judgment)), to secure all of the Obligations relating to such Letters of Credit, as collateral security for the repayment of any future drawings under such Letters of Credit, and Borrower shall forthwith deposit and pay such amounts, and (ii) pay in advance all letter of credit fees scheduled to be paid or payable over the remaining term of any Letters of Credit;

(d) terminate any FX Forward Contracts;

(e) settle or adjust disputes and claims directly with Account Debtors for amounts on terms and in any order that Bank considers advisable, notify any Person owing Borrower money of Bank's security interest in such funds, and verify the amount of such account;

(f) make any payments and do any acts it considers necessary or reasonable to protect the Collateral and/or its security interest in the Collateral. Borrower shall assemble the Collateral if Bank requests and make it available as Bank designates. Bank may enter premises where the Collateral is located, take and maintain possession of any part of the Collateral, and pay, purchase, contest, or compromise any Lien which appears to be prior or superior to its security interest and pay all expenses incurred. Borrower grants Bank a license to enter and occupy any of its premises, without charge, to exercise any of Bank's rights or remedies;

(g) apply to the Obligations any (i) balances and deposits of Borrower it holds, or (ii) any amount held by Bank owing to or for the credit or the account of Borrower;

(h) ship, reclaim, recover, store, finish, maintain, repair, prepare for sale, advertise for sale, and sell the Collateral. Bank is hereby granted a non-exclusive, royalty-free license or other right to use, without charge, Borrower's labels, Patents, Copyrights, mask works, rights of use of any name, trade secrets, trade names, Trademarks, and advertising matter, or any similar property as it pertains to the Collateral, in completing production of, advertising for sale, and selling any Collateral and, in connection with Bank's exercise of its rights under this Section, Borrower's rights under all licenses and all franchise agreements inure to Bank's benefit;

(i) place a "hold" on any account maintained with Bank and/or deliver a notice of exclusive control, any entitlement order, or other directions or instructions pursuant to any Control Agreement or similar agreements providing control of any Collateral;

(j) demand and receive possession of Borrower's Books; and

(k) exercise all rights and remedies available to Bank under the Loan Documents or at law or equity, including all remedies provided under the Code (including disposal of the Collateral pursuant to the terms thereof).

9.2 Power of Attorney. Borrower hereby irrevocably appoints Bank as its lawful attorney-in-fact, exercisable upon the occurrence and during the continuance of an Event of Default, to: (a) endorse Borrower's name on any checks or other forms of payment or security; (b) sign Borrower's name on any invoice or bill of lading for any Account or drafts against Account Debtors; (c) settle and adjust disputes and claims about the Accounts directly with Account Debtors, for amounts and on terms Bank determines reasonable; (d) make, settle, and adjust all claims under Borrower's insurance policies; (e) pay, contest or settle any Lien, charge, encumbrance, security interest, and adverse claim in or to the Collateral, or any judgment based thereon, or otherwise take any action to terminate or discharge the same; and (f) transfer the Collateral into the name of Bank or a third party as the Code permits. Borrower hereby appoints Bank as its lawful attorney-in-fact to sign Borrower's name on any documents necessary to perfect or continue the perfection of Bank's security interest in the Collateral regardless of whether an Event of Default has occurred until all Obligations have been satisfied in full and Bank is under no further obligation to make Credit Extensions hereunder. Bank's foregoing appointment as Borrower's attorney in fact, and all of Bank's rights and powers, coupled with an interest, are irrevocable until all Obligations have been fully repaid and performed and Bank's obligation to provide Credit Extensions terminates.

9.3 Protective Payments. If Borrower fails to obtain the insurance called for by Section 6.5 or fails to pay any premium thereon or fails to pay any other amount which Borrower is obligated to pay under this Agreement or any other Loan Document, Bank may obtain such insurance or make such payment, and all amounts so paid by Bank are Bank Expenses and immediately due and payable, bearing interest at the then highest rate applicable to the Obligations, and secured by the Collateral. Bank will make reasonable efforts to provide Borrower with notice of Bank obtaining such insurance at the time it is obtained or within a reasonable time thereafter. No payments by Bank are deemed an agreement to make similar payments in the future or Bank's waiver of any Event of Default.

9.4 Application of Payments and Proceeds Upon Default . If an Event of Default has occurred and is continuing, Bank may apply any funds in its possession, whether from Borrower account balances, payments, proceeds realized as the result of any collection of Accounts or other disposition of the Collateral, or otherwise, to the Obligations in such order as Bank shall determine in its sole discretion. Any surplus shall be paid to Borrower or other Persons legally entitled thereto; Borrower shall remain liable to Bank for any deficiency. If Bank, in its good faith business judgment, directly or indirectly enters into a deferred payment or other credit transaction with any purchaser at any sale of Collateral, Bank shall have the option, exercisable at any time, of either reducing the Obligations by the principal amount of the purchase price or deferring the reduction of the Obligations until the actual receipt by Bank of cash therefor.

9.5 Bank's Liability for Collateral. So long as Bank complies with reasonable banking practices regarding the safekeeping of the Collateral in the possession or under the control of Bank, Bank shall not be liable or responsible for: (a) the safekeeping of the Collateral; (b) any loss or damage to the Collateral; (c) any diminution in the value of the Collateral; or (d) any act or default of any carrier, warehouseman, bailee, or other Person. Borrower bears all risk of loss, damage or destruction of the Collateral.

9.6 No Waiver; Remedies Cumulative. Bank's failure, at any time or times, to require strict performance by Borrower of any provision of this Agreement or any other Loan Document shall not waive, affect, or diminish any right of Bank thereafter to demand strict performance and compliance herewith or therewith. No waiver hereunder shall be effective unless signed by the party granting the waiver and then is only effective for the specific instance and purpose for which it is given. Bank's rights and remedies under this Agreement and the other Loan Documents are cumulative. Bank has all rights and remedies provided under the Code, by law, or in equity. Bank's exercise of one right or remedy is not an election and shall not preclude Bank from exercising any other remedy under this Agreement or other remedy available at law or in equity, and Bank's waiver of any Event of Default is not a continuing waiver. Bank's delay in exercising any remedy is not a waiver, election, or acquiescence.

9.7 Demand Waiver. Borrower waives demand, notice of default or dishonor, notice of payment and nonpayment, notice of any default, nonpayment at maturity, release, compromise, settlement, extension, or renewal of accounts, documents, instruments, chattel paper, and guarantees held by Bank on which Borrower is liable.

10 NOTICES

All notices, consents, requests, approvals, demands, or other communication by any party to this Agreement or any other Loan Document must be in writing and shall be deemed to have been validly served, given, or delivered: (a) upon the earlier of actual receipt and three (3) Business Days after deposit in the U.S. mail, first class, registered or certified mail return receipt requested, with proper postage prepaid; (b) upon transmission, when sent by electronic mail or facsimile transmission; (c) one (1) Business Day after deposit with a reputable overnight courier with all charges prepaid; or (d) when delivered, if hand-delivered by messenger, all of which shall be addressed to the party to be notified and sent to the address, facsimile number, or email address indicated below. Bank or Borrower may change its mailing or electronic mail address or facsimile number by giving the other party written notice thereof in accordance with the terms of this Section 10.

If to Borrower: Pixelworks, Inc.
224 Airport Parkway, Suite 400
San Jose, California 95110
Attn: Steven Moore, CFO
Fax: 408 200 9299
Email: smoore@pixelworks.com

If to Bank: Silicon Valley Bank
2400 Hanover St.
Palo Alto, California 94304
Attn: Justin Mauch, Relationship Manager
Fax: 650 320 0016
Email: jmauch@svb.com

11 CHOICE OF LAW, VENUE, JURY TRIAL WAIVER, AND JUDICIAL REFERENCE

California law governs the Loan Documents without regard to principles of conflicts of law. Borrower and Bank each submit to the exclusive jurisdiction of the State and Federal courts in Santa Clara County, California; provided, however, that nothing in this Agreement shall be deemed to operate to preclude Bank from bringing suit or taking other legal action in any other jurisdiction to realize on the Collateral or any other security for the Obligations, or to enforce a judgment or other court order in favor of Bank. Borrower expressly submits and consents in advance to such jurisdiction in any action or suit commenced in any such court, and Borrower hereby waives any objection that it may have based upon lack of personal jurisdiction, improper venue, or forum non conveniens and hereby consents to the granting of such legal or equitable relief as is deemed appropriate by such court. Borrower hereby waives personal service of the summons, complaints, and other process issued in such action or suit and agrees that service of such summons, complaints, and other process may be made by registered or certified mail addressed to Borrower at the address set forth in, or subsequently provided by Borrower in accordance with, Section 10 of this Agreement and that service so made shall be deemed completed upon the earlier to occur of Borrower's actual receipt thereof or three (3) days after deposit in the U.S. mails, proper postage prepaid.

TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, BORROWER AND BANK EACH WAIVE THEIR RIGHT TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION ARISING OUT OF OR BASED UPON THIS AGREEMENT, THE LOAN DOCUMENTS OR ANY CONTEMPLATED TRANSACTION, INCLUDING CONTRACT, TORT, BREACH OF DUTY AND ALL OTHER CLAIMS. THIS WAIVER IS A MATERIAL INDUCEMENT FOR BOTH PARTIES TO ENTER INTO THIS AGREEMENT. EACH PARTY HAS REVIEWED THIS WAIVER WITH ITS COUNSEL.

WITHOUT INTENDING IN ANY WAY TO LIMIT THE PARTIES' AGREEMENT TO WAIVE THEIR RESPECTIVE RIGHT TO A TRIAL BY JURY, if the above waiver of the right to a trial by jury is not enforceable, the parties hereto agree that any and all disputes or controversies of any nature between them arising at any time shall be decided by a reference to a private judge, mutually selected by the parties (or, if they cannot agree, by the Presiding Judge of the Santa Clara County, California Superior Court) appointed in accordance with California Code of Civil Procedure Section 638 (or pursuant to comparable provisions of federal law if the dispute falls within the exclusive jurisdiction of the federal courts), sitting without a jury, in Santa Clara County, California; and the parties hereby submit to the jurisdiction of such court. The reference proceedings shall be conducted pursuant to and in accordance with the provisions of California Code of Civil Procedure §§ 638 through 645.1, inclusive. The private judge shall have the power, among others, to grant provisional relief, including without limitation, entering temporary restraining orders, issuing preliminary and permanent injunctions and appointing receivers. All such proceedings shall be closed to the public and confidential and all records relating thereto shall be permanently sealed. If during the course of any dispute, a party desires to seek provisional relief, but a judge has not been appointed at that point pursuant to the judicial reference procedures, then such party may apply to the Santa Clara County, California Superior Court for such relief. The proceeding before the private judge shall be conducted in the same manner as it would be before a court under the rules of evidence applicable to judicial proceedings. The parties shall be entitled to discovery which shall be conducted in the same manner as it would be before a court under the rules of discovery applicable to judicial proceedings. The private judge shall oversee discovery and may enforce all discovery rules and orders applicable to judicial proceedings in the same manner as a trial court judge. The parties agree that the selected or appointed private judge shall have the power to decide all issues in the action or proceeding, whether of fact or of law, and shall report a statement of decision thereon pursuant to California Code of Civil Procedure § 644(a). Nothing in this paragraph shall limit the right of any party at any time to exercise self-help remedies, foreclose against collateral, or obtain provisional remedies. The private judge shall also determine all issues relating to the applicability, interpretation, and enforceability of this paragraph.

12 GENERAL PROVISIONS

12.1 Successors and Assigns. This Agreement binds and is for the benefit of the successors and permitted assigns of each party. Borrower may not assign this Agreement or any rights or obligations under it without Bank's prior written consent (which may be granted or withheld in Bank's discretion). Bank has the right, without the consent of or notice to Borrower, to sell, transfer, assign, negotiate, or grant participation in all or any part of, or any interest in, Bank's obligations, rights, and benefits under this Agreement and the other Loan Documents.

12.2 Indemnification. Borrower agrees to indemnify, defend and hold Bank and its directors, officers, employees, agents, attorneys, or any other Person affiliated with or representing Bank (each, an "Indemnified Person") harmless against: (a) all obligations, demands, claims, and liabilities (collectively, "Claims") claimed or asserted by any other party in connection with the transactions contemplated by the Loan Documents; and (b) all losses or expenses (including Bank Expenses) in any way suffered, incurred, or paid by such Indemnified Person as a result of, following from, consequential to, or arising from transactions between Bank and Borrower contemplated by the Loan Documents (including reasonable attorneys' fees and expenses), except for Claims and/or losses directly caused by such Indemnified Person's gross negligence or willful misconduct.

12.3 Time of Essence. Time is of the essence for the performance of all Obligations in this Agreement.

12.4 Severability of Provisions. Each provision of this Agreement is severable from every other provision in determining the enforceability of any provision.

12.5 Correction of Loan Documents. Bank may correct patent errors and fill in any blanks in the Loan Documents consistent with the agreement of the parties.

12.6 Amendments in Writing; Waiver; Integration. No purported amendment or modification of any Loan Document, or waiver, discharge or termination of any obligation under any Loan Document, shall be enforceable or admissible unless, and only to the extent, expressly set forth in a writing signed by the party against which enforcement or admission is sought. Without limiting the generality of the foregoing, no oral promise or statement, nor any action, inaction, delay, failure to require performance or course of conduct shall operate as, or evidence, an amendment, supplement or waiver or have any other effect on any Loan Document. Any waiver granted shall be limited to the specific circumstance expressly described in it, and shall not apply to any subsequent or other circumstance, whether similar or dissimilar, or give rise to, or evidence, any obligation or commitment to grant any further waiver. The Loan Documents represent the entire agreement about this subject matter and supersede prior negotiations or agreements. All prior agreements, understandings, representations, warranties, and negotiations between the parties about the subject matter of the Loan Documents merge into the Loan Documents.

12.7 Counterparts. This Agreement may be executed in any number of counterparts and by different parties on separate counterparts, each of which, when executed and delivered, is an original, and all taken together, constitute one Agreement.

12.8 Survival. All covenants, representations and warranties made in this Agreement continue in full force until this Agreement has terminated pursuant to its terms and all Obligations (other than inchoate indemnity obligations and any other obligations which, by their terms, are to survive the termination of this Agreement) have been paid in full and satisfied. The obligation of Borrower in Section 12.2 to indemnify Bank shall survive until the statute of limitations with respect to such claim or cause of action shall have run.

12.9 Confidentiality. In handling any confidential information, Bank shall exercise the same degree of care that it exercises for its own proprietary information, but disclosure of information may be made: (a) to Bank's Subsidiaries or Affiliates (such Subsidiaries and Affiliates, together with Bank, collectively, "Bank Entities"); (b) to prospective transferees or purchasers of any interest in the Credit Extensions; (c) as required by law, regulation, subpoena, or other order; (d) to Bank's regulators or as otherwise required in connection with Bank's examination or audit; (e) as Bank considers appropriate in exercising remedies under the Loan Documents; and (f) to third-party service providers of Bank so long as such service providers have executed a confidentiality agreement with Bank with terms no less restrictive than those contained herein. Confidential information does not include information that is either: (i) in the public domain or in Bank's possession when disclosed to Bank, or becomes part of the public domain after disclosure to Bank; or (ii) disclosed to Bank by a third party if Bank does not know that the third party is prohibited from disclosing the information.

Bank Entities may use the confidential information for reporting purposes and the development and distribution of databases and market analyses so long as such confidential information is aggregated and anonymized prior to distribution unless otherwise expressly prohibited by Borrower. The provisions of the immediately preceding sentence shall survive the termination of this Agreement.

12.10 Attorneys' Fees, Costs and Expenses . In any action or proceeding between Borrower and Bank arising out of or relating to the Loan Documents, the prevailing party shall be entitled to recover its reasonable attorneys' fees and other costs and expenses incurred, in addition to any other relief to which it may be entitled.

12.11 Electronic Execution of Documents. The words "execution," "signed," "signature" and words of like import in any Loan Document shall be deemed to include electronic signatures or the keeping of records in electronic form, each of which shall be of the same legal effect, validity and enforceability as a manually executed signature or the use of a paper-based recordkeeping systems, as the case may be, to the extent and as provided for in any applicable law, including, without limitation, any state law based on the Uniform Electronic Transactions Act.

12.12 Captions. The headings used in this Agreement are for convenience only and shall not affect the interpretation of this Agreement.

12.13 Construction of Agreement . The parties mutually acknowledge that they and their attorneys have participated in the preparation and negotiation of this Agreement. In cases of uncertainty this Agreement shall be construed without regard to which of the parties caused the uncertainty to exist.

12.14 Relationship. The relationship of the parties to this Agreement is determined solely by the provisions of this Agreement. The parties do not intend to create any agency, partnership, joint venture, trust, fiduciary or other relationship with duties or incidents different from those of parties to an arm's-length contract.

12.15 Third Parties. Nothing in this Agreement, whether express or implied, is intended to: (a) confer any benefits, rights or remedies under or by reason of this Agreement on any persons other than the express parties to it and their respective permitted successors and assigns; (b) relieve or discharge the obligation or liability of any person not an express party to this Agreement; or (c) give any person not an express party to this Agreement any right of subrogation or action against any party to this Agreement.

13 DEFINITIONS

13.1 Definitions. As used in the Loan Documents, the word "shall" is mandatory, the word "may" is permissive, the word "or" is not exclusive, the words "includes" and "including" are not limiting, the singular includes the plural, and numbers denoting amounts that are set off in brackets are negative. As used in this Agreement, the following capitalized terms have the following meanings:

"**Account**" is any "account" as defined in the Code with such additions to such term as may hereafter be made, and includes, without limitation, all accounts receivable and other sums owing to Borrower.

"**Account Debtor**" is any "account debtor" as defined in the Code with such additions to such term as may hereafter be made.

"**Advance**" or "**Advances**" means an advance (or advances) under the Revolving Line, including, without limitation, the Initial Regular Advance and any Nonformula Advance.

"**Affiliate**" is, with respect to any Person, each other Person that owns or controls directly or indirectly the Person, any Person that controls or is controlled by or is under common control with the Person, and each of that Person's senior executive officers, directors, partners and, for any Person that is a limited liability company, that Person's managers and members.

"**Agreement**" is defined in the preamble hereof.

"**Availability Amount**" is (a) the lesser of (i) the Revolving Line or (ii) the amount available under the Borrowing Base minus (b) the Dollar Equivalent amount of all outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit) plus an amount equal to the Letter of Credit Reserve, minus (c) the FX Reduction Amount, minus (d) any amounts used for Cash Management Services, and minus (e) the outstanding principal balance of any Advances.

“**Bank**” is defined in the preamble hereof.

“**Bank Expenses**” are all audit fees and expenses, costs, and expenses (including reasonable attorneys’ fees and expenses) for preparing, amending, negotiating, administering, defending and enforcing the Loan Documents (including, without limitation, those incurred in connection with appeals or Insolvency Proceedings) or otherwise incurred with respect to Borrower.

“**Borrower**” is defined in the preamble hereof.

“Borrower Debenture” means that certain 1.75% Convertible Subordinated Debenture due 2024 in an aggregate principal amount of $125,000,000, dated as of May 18, 2004, as increased to an aggregate principal amount of $150,000,000, executed by the Borrower, as issuer, and authenticated by Wells Fargo Bank, National Association, as trustee.

“**Borrower’s Books**” are all Borrower’s books and records including ledgers, federal and state tax returns, records regarding Borrower’s assets or liabilities, the Collateral, business operations or financial condition, and all computer programs or storage or any equipment containing such information.

“**Borrowing Base**” is 80% of Eligible Accounts, as determined by Bank from Borrower’s most recent Borrowing Base Certificate; *provided*, *however*, that Bank may decrease the foregoing percentages in its good faith business judgment based on events, conditions, contingencies, or risks which, as determined by Bank, may adversely affect Collateral.

“**Borrowing Base Certificate**” is that certain certificate in the form attached hereto as Exhibit C.

“**Borrowing Base Report**” is defined in Section 6.2(a).

“**Borrowing Resolutions**” are, with respect to any Person, those resolutions substantially in the form attached hereto as Exhibit F.

“**Business Day**” is any day that is not a Saturday, Sunday or a day on which Bank is closed.

“Cash Equivalents” means (a) marketable direct obligations issued or unconditionally guaranteed by the United States or any agency or any State thereof having maturities of not more than one (1) year from the date of acquisition; (b) commercial paper maturing no more than one (1) year after its creation and having the highest rating from either Standard & Poor’s Ratings Group or Moody’s Investors Service, Inc.; (c) Bank’s certificates of deposit issued maturing no more than one (1) year after issue; and (d) money market funds at least ninety-five percent (95%) of the assets of which constitute Cash Equivalents of the kinds described in clauses (a) through (c) of this definition.

“Cash Management Services” is defined in Section 2.1.4.

“**Code**” is the Uniform Commercial Code, as the same may, from time to time, be enacted and in effect in the State of California; provided, that, to the extent that the Code is used to define any term herein or in any Loan Document and such term is defined differently in different Articles or Divisions of the Code, the definition of such term contained in Article or Division 9 shall govern; provided further, that in the event that, by reason of mandatory provisions of law, any or all of the attachment, perfection, or priority of, or remedies with respect to, Bank’s Lien on any Collateral is governed by the Uniform Commercial Code in effect in a jurisdiction other than the State of California, the term “ **Code**” shall mean the Uniform Commercial Code as enacted and in effect in such other jurisdiction solely for purposes of the provisions thereof relating to such attachment, perfection, priority, or remedies and for purposes of definitions relating to such provisions.

“**Collateral**” is any and all properties, rights and assets of Borrower described on Exhibit A.

“**Collateral Account**” is any domestic Deposit Account, Securities Account, or Commodity Account.

"**Commodity Account**" is any "commodity account" as defined in the Code with such additions to such term as may hereafter be made.

"**Compliance Certificate**" is that certain certificate in the form attached hereto as Exhibit D.

"**Contingent Obligation**" is, for any Person, any direct or indirect liability, contingent or not, of that Person for (a) any indebtedness, lease, dividend, letter of credit or other obligation of another such as an obligation, in each case, directly or indirectly guaranteed, endorsed, co-made, discounted or sold with recourse by that Person, or for which that Person is directly or indirectly liable; (b) any obligations for undrawn letters of credit for the account of that Person; and (c) all obligations from any interest rate, currency or commodity swap agreement, interest rate cap or collar agreement, or other agreement or arrangement designated to protect a Person against fluctuation in interest rates, currency exchange rates or commodity prices; but "Contingent Obligation" does not include endorsements in the ordinary course of business. The amount of a Contingent Obligation is the stated or determined amount of the primary obligation for which the Contingent Obligation is made or, if not determinable, the maximum reasonably anticipated liability for it determined by the Person in good faith; but the amount may not exceed the maximum of the obligations under any guarantee or other support arrangement.

"**Control Agreement**" is any control agreement entered into among the depository institution at which Borrower maintains a Deposit Account or the securities intermediary or commodity intermediary at which Borrower maintains a Securities Account or a Commodity Account, Borrower, and Bank pursuant to which Bank obtains control (within the meaning of the Code) over such Deposit Account, Securities Account, or Commodity Account.

"**Copyrights**" are any and all copyright rights, copyright applications, copyright registrations and like protections in each work or authorship and derivative work thereof, whether published or unpublished and whether or not the same also constitutes a trade secret.

"**Credit Extension**" is any Advance, Letter of Credit, FX Forward Contract, amount utilized for Cash Management Services, or any other extension of credit by Bank for Borrower's benefit.

"**Default Rate**" is defined in Section 2.3(b).

"**Deferred Revenue**" is all amounts received or invoiced in advance of performance under contracts and not yet recognized as revenue.

"**Deferred Revenue Report**" is defined in Section 6.2(c).

"**Deposit Account**" is any "deposit account" as defined in the Code with such additions to such term as may hereafter be made.

"**Designated Deposit Account**" is Borrower's deposit account, account number 3300717221, maintained with Bank.

"**Dollars**," "**dollars**" or use of the sign "**$**" means only lawful money of the United States and not any other currency, regardless of whether that currency uses the "$" sign to denote its currency or may be readily converted into lawful money of the United States.

"**Dollar Equivalent**" is, at any time, (a) with respect to any amount denominated in Dollars, such amount, and (b) with respect to any amount denominated in a Foreign Currency, the equivalent amount therefor in Dollars as determined by Bank at such time on the basis of the then-prevailing rate of exchange in San Francisco, California, for sales of the Foreign Currency for transfer to the country issuing such Foreign Currency.

"**Domestic Subsidiary**" means a Subsidiary organized under the laws of the United States or any state or territory thereof or the District of Columbia.

"Early Termination Date" is defined in Section 2.1.1(b).

"**Effective Date**" is defined in the preamble hereof.

“**Eligible Accounts**” means Accounts which arise in the ordinary course of Borrower’s business that meet all Borrower’s representations and warranties in Section 5.3. Bank reserves the right at any time after the Effective Date to adjust any of the criteria set forth below and to establish new criteria in its sole discretion. Unless Bank otherwise agrees in writing, Eligible Accounts shall not include:

(a) Accounts for which the Account Debtor is Borrower’s Affiliate, officer, employee, or agent;

(b) Accounts that the Account Debtor has not paid within ninety (90) days of invoice date regardless of invoice payment period terms;

(c) Accounts with credit balances over ninety (90) days from invoice date;

(d) Accounts owing from an Account Debtor, in which thirty-five percent (35%) or more of the Accounts have not been paid within ninety (90) days of invoice date;

(e) Accounts owing from an Account Debtor which does not have its principal place of business in the United States (except for Tokyo Electron Device Ltd., Epson Precision (H.K.) Ltd., AECO Technology Co., Ltd. and Qisda Optronics (Suzhou) Corporation) unless such Accounts are otherwise Eligible Accounts and (i) covered in full by credit insurance satisfactory to Bank, less any deductible, (ii) supported by letter(s) of credit acceptable to Bank, (iii) supported by a guaranty from the Export-Import Bank of the United States, or (iv) that Bank otherwise approves of in writing;

(f) Accounts billed and/or payable outside of the United States (sometimes called foreign invoiced accounts);

(g) Accounts owing from an Account Debtor to the extent that Borrower is indebted or obligated in any manner to the Account Debtor (as creditor, lessor, supplier or otherwise - sometimes called “contra” accounts, accounts payable, customer deposits or credit accounts);

(h) Accounts owing from an Account Debtor, whose total obligations to Borrower exceed twenty-five percent (25%) of all Accounts, except for Tokyo Electron Device Ltd, for which such percentage is forty-five percent (45%) for the amounts that exceed that percentage, unless Bank approves in writing;

(i) Accounts owing from an Account Debtor which is a United States government entity or any department, agency, or instrumentality thereof unless Borrower has assigned its payment rights to Bank and the assignment has been acknowledged under the Federal Assignment of Claims Act of 1940, as amended;

(j) Accounts for demonstration or promotional equipment, or in which goods are consigned, or sold on a “sale guaranteed”, “sale or return”, “sale on approval”, or other terms if Account Debtor’s payment may be conditional;

(k) Accounts owing from an Account Debtor that has not been invoiced or where goods or services have not yet been rendered to the Account Debtor (sometimes called memo billings or pre-billings);

(l) Accounts subject to contractual arrangements between Borrower and an Account Debtor where payments shall be scheduled or due according to completion or fulfillment requirements where the Account Debtor has a right of offset for damages suffered as a result of Borrower’s failure to perform in accordance with the contract (sometimes called contracts accounts receivable, progress billings, milestone billings, or fulfillment contracts);

(m) Accounts owing from an Account Debtor the amount of which may be subject to withholding based on the Account Debtor’s satisfaction of Borrower’s complete performance (but only to the extent of the amount withheld; sometimes called retainage billings);

(n) Accounts subject to trust provisions, subrogation rights of a bonding company, or a statutory trust;

(o) Accounts owing from an Account Debtor that has been invoiced for goods that have not been shipped to the Account Debtor unless Bank, Borrower, and the Account Debtor have entered into an agreement acceptable to Bank in its sole discretion wherein the Account Debtor acknowledges that (i) it has title to and has ownership of the goods wherever located, (ii) a bona fide sale of the goods has occurred, and (iii) it owes payment for such goods in accordance with invoices from Borrower (sometimes called “bill and hold” accounts);

(p) Accounts for which the Account Debtor has not been invoiced;

(q) Accounts that represent non-trade receivables or that are derived by means other than in the ordinary course of Borrower's business;

(r) Accounts for which Borrower has permitted Account Debtor's payment to extend beyond 90 days;

(s) Accounts arising from chargebacks, debit memos or others payment deductions taken by an Account Debtor (but only to the extent the chargeback is determined invalid and subsequently collected by Borrower);

(t) Accounts arising from product returns and/or exchanges (sometimes called "warranty" or "RMA" accounts);

(u) Accounts owing from an Account Debtor with respect to which Borrower has received Deferred Revenue (but only to the extent of such Deferred Revenue);

(v) Accounts in which the Account Debtor disputes liability or makes any claim (but only up to the disputed or claimed amount), or if the Account Debtor is subject to an Insolvency Proceeding, or becomes insolvent, or goes out of business; and

(w) Accounts for which Bank in its good faith business judgment determines collection to be doubtful, including, without limitation, accounts represented by "refreshed" or "recycled" invoices.

"**Equipment**" is all "equipment" as defined in the Code with such additions to such term as may hereafter be made, and includes without limitation all machinery, fixtures, goods, vehicles (including motor vehicles and trailers), and any interest in any of the foregoing.

"**ERISA**" is the Employee Retirement Income Security Act of 1974, and its regulations.

"**Event of Default**" is defined in Section 8.

"**Exchange Act**" is the Securities Exchange Act of 1934, as amended.

"**Foreign Currency**" means lawful money of a country other than the United States.

"**Foreign Subsidiary**" means any Subsidiary which is not a Domestic Subsidiary.

"**Funding Date**" is any date on which a Credit Extension is made to or for the account of Borrower which shall be a Business Day.

"**FX Business Day**" is any day when (a) Bank's Foreign Exchange Department is conducting its normal business and (b) the Foreign Currency being purchased or sold by Borrower is available to Bank from the entity from which Bank shall buy or sell such Foreign Currency.

"**FX Forward Contract**" is defined in Section 2.1.3.

"**FX Reduction Amount**" is defined in Section 2.1.3.

"**FX Reserve**" is defined in Section 2.1.3.

"**GAAP**" is generally accepted accounting principles set forth in the opinions and pronouncements of the Accounting Principles Board of the American Institute of Certified Public Accountants and statements and pronouncements of the Financial Accounting Standards Board or in such other statements by such other Person as may be approved by a significant segment of the accounting profession, which are applicable to the circumstances as of the date of determination.

“**General Intangibles**” is all “general intangibles” as defined in the Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation, all Intellectual Property, claims, income and other tax refunds, security and other deposits, payment intangibles, contract rights, options to purchase or sell real or personal property, rights in all litigation presently or hereafter pending (whether in contract, tort or otherwise), insurance policies (including without limitation key man, property damage, and business interruption insurance), payments of insurance and rights to payment of any kind.

“**Governmental Approval**” is any consent, authorization, approval, order, license, franchise, permit, certificate, accreditation, registration, filing or notice, of, issued by, from or to, or other act by or in respect of, any Governmental Authority.

“**Governmental Authority**” is any nation or government, any state or other political subdivision thereof, any agency, authority, instrumentality, regulatory body, court, central bank or other entity exercising executive, legislative, judicial, taxing, regulatory or administrative functions of or pertaining to government, any securities exchange and any self-regulatory organization.

“**Indebtedness**” is (a) indebtedness for borrowed money or the deferred price of property or services, such as reimbursement and other obligations for surety bonds and letters of credit, (b) obligations evidenced by notes, bonds, debentures or similar instruments, (c) capital lease obligations, and (d) Contingent Obligations.

“**Indenture**” is that certain Indenture dated as of May 18, 2004, executed by and between Borrower, as issuer, and Wells Fargo Bank, National Association, as trustee, relating to 1.75% Convertible Subordinated Debentures due 2024, as supplemented from time to time.

“**Indemnified Person**” is defined in Section 12.2.

“**Initial Regular Advance**” is defined in Section 6.2(a).

“**Initial Regular Advance Request**” is defined in Section 6.2(a).

“**Insolvency Proceeding**” is any proceeding by or against any Person under the United States Bankruptcy Code, or any other bankruptcy or insolvency law, including assignments for the benefit of creditors, compositions, extensions generally with its creditors, or proceedings seeking reorganization, arrangement, or other relief.

“**Intellectual Property**” means all of Borrower’s right, title, and interest in and to the following:

(a) its Copyrights, Trademarks and Patents;

(b) any and all trade secrets and trade secret rights, including, without limitation, any rights to unpatented inventions, know-how, operating manuals;

(c) any and all source code;

(d) any and all design rights which may be available to a Borrower;

(e) any and all claims for damages by way of past, present and future infringement of any of the foregoing, with the right, but not the obligation, to sue for and collect such damages for said use or infringement of the Intellectual Property rights identified above; and

(f) all amendments, renewals and extensions of any of the Copyrights, Trademarks or Patents.

“**Inventory**” is all “inventory” as defined in the Code in effect on the date hereof with such additions to such term as may hereafter be made, and includes without limitation all merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products, including without limitation such inventory as is temporarily out of Borrower’s custody or possession or in transit and including any returned goods and any documents of title representing any of the above.

"**Investment**" is any beneficial ownership interest in any Person (including stock, partnership interest or other securities), and any loan, advance or capital contribution to any Person.

"**Letter of Credit"** means a standby letter of credit issued by Bank or another institution based upon an application, guarantee, indemnity or similar agreement on the part of Bank as set forth in Section 2.1.2.

"**Letter of Credit Application**" is defined in Section 2.1.2(b).

"**Letter of Credit Reserve**" has the meaning set forth in Section 2.1.2(e).

"**Lien**" is a claim, mortgage, deed of trust, levy, charge, pledge, security interest or other encumbrance of any kind, whether voluntarily incurred or arising by operation of law or otherwise against any property.

"**Loan Documents**" are, collectively, this Agreement, the Perfection Certificate, any note, or notes or guaranties executed by Borrower, and any other present or future agreement between Borrower and/or for the benefit of Bank in connection with this Agreement, all as amended, restated, or otherwise modified.

"**Material Adverse Change**" is (a) a material impairment in the perfection or priority of Bank's Lien in the Collateral or in the value of such Collateral; (b) a material adverse change in the business, operations, or condition (financial or otherwise) of Borrower; (c) a material impairment of the prospect of repayment of any portion of the Obligations or (d) Bank determines, based upon information available to it and in its reasonable judgment, that there is a reasonable likelihood that Borrower shall fail to comply with one or more of the financial covenants in Section 6 during the next succeeding financial reporting period.

"**Monthly Financial Statements**" is defined in Section 6.2(e).

"Nonformula Advances" is defined in Section 2.1.1(a).

"**Obligations**" are Borrower's obligations to pay when due any debts, principal, interest, Bank Expenses and other amounts Borrower owes Bank now or later, whether under this Agreement, the Loan Documents, or otherwise, including, without limitation, all obligations relating to letters of credit (including reimbursement obligations for drawn and undrawn letters of credit), cash management services, and foreign exchange contracts, if any, and including interest accruing after Insolvency Proceedings begin and debts, liabilities, or obligations of Borrower assigned to Bank, and to perform Borrower's duties under the Loan Documents.

"Operating Documents" are, for any Person, such Person's formation documents, as certified with the Secretary of State of such Person's state of formation on a date that is no earlier than 30 days prior to the Effective Date, and, (a) if such Person is a corporation, its bylaws in current form, (b) if such Person is a limited liability company, its limited liability company agreement (or similar agreement), and (c) if such Person is a partnership, its partnership agreement (or similar agreement), each of the foregoing with all current amendments or modifications thereto.

"**Patents**" means all patents, patent applications and like protections including without limitation improvements, divisions, continuations, renewals, reissues, extensions and continuations-in-part of the same.

"**Payment/Advance Form**" is that certain form attached hereto as Exhibit B.

"**Perfection Certificate**" is defined in Section 5.1.

"**Permitted Indebtedness**" is:

(a) Borrower's Indebtedness to Bank under this Agreement and the other Loan Documents;

(b) Indebtedness existing on the Effective Date and shown on the Perfection Certificate;

(c) Subordinated Debt;

(d) unsecured Indebtedness to trade creditors incurred in the ordinary course of business, including without limitation Indebtedness between or among the Borrower and its Subsidiaries consisting of payables for goods or services extended in the ordinary course of business consistent with past practice;

(e) Indebtedness incurred as a result of endorsing negotiable instruments received in the ordinary course of business;

(f) Indebtedness secured by Liens permitted under clauses (a) and (c) of the definition of "Permitted Liens" hereunder;

(g) other Indebtedness not otherwise permitted by Section 7.5 not exceeding $50,000.00 in the aggregate outstanding at any time; and

(h) extensions, refinancings, modifications, amendments and restatements of any items of Permitted Indebtedness (a) through (g) above, provided that the principal amount thereof is not increased or the terms thereof are not modified to impose more burdensome terms upon Borrower or its Subsidiary, as the case may be.

"**Permitted Investments**" are:

(a) Investments (including, without limitation, Subsidiaries) existing on the Effective Date and shown on the Perfection Certificate;

(b) Investments consisting of Cash Equivalents;

(c) Investments consisting of the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of Borrower;

(d) Investments consisting of deposit accounts in which Bank has a perfected security interest;

(e) Investments accepted in connection with Transfers permitted by Section 7.1;

(f) Investments (i) by Borrower in Subsidiaries not to exceed Seven Hundred Fifty Thousand Dollars ($750,000) in the aggregate in any fiscal year, (ii) by Subsidiaries in other Subsidiaries not to exceed Seven Hundred Fifty Thousand Dollars ($750,000) in the aggregate in any fiscal year or in Borrower and (iii) Investments between or among the Borrower and its Subsidiaries consisting of payables for goods or services extended in the ordinary course of business consistent with past practice;

(g) Investments consisting of (i) travel advances and employee relocation loans and other employee loans and advances in the ordinary course of business, and (ii) loans to employees, officers or directors relating to the purchase of equity securities of Borrower or its Subsidiaries pursuant to employee stock purchase plans or agreements approved by Borrower's Board of Directors;

(h) Investments (including debt obligations) received in connection with the bankruptcy or reorganization of customers or suppliers and in settlement of delinquent obligations of, and other disputes with, customers or suppliers arising in the ordinary course of business;

(i) Investments consisting of notes receivable of, or prepaid royalties and other credit extensions, to customers and suppliers who are not Affiliates, in the ordinary course of business;

(j) joint ventures or strategic alliances in the ordinary course of Borrower's business consisting of the non-exclusive licensing of technology, the development of technology or the providing of technical support, provided that any cash investments by Borrower do not exceed Five Hundred Thousand Dollars ($500,000) in the aggregate in any fiscal year; and

(k) other Investments not otherwise permitted by Section 7.8 not exceeding Two Hundred Thousand Dollars ($200,000) in the aggregate outstanding at any time.

"**Permitted Liens**" are:

(a) Liens existing on the Effective Date and shown on the Perfection Certificate or arising under this Agreement and the other Loan Documents, including, so long as such lien is terminated in its entirety by March 31, 2011, the lien in favor of NetApp, Inc. dba NetApp Financial Solutions;

(b) Liens for taxes, fees, assessments or other government charges or levies, either (i) not due and payable or (ii) being contested in good faith and for which Borrower maintains adequate reserves on its Books, provided that no notice of any such Lien has been filed or recorded under the Internal Revenue Code of 1986, as amended, and the Treasury Regulations adopted thereunder;

(c) purchase money Liens (i) on Equipment acquired or held by Borrower incurred for financing the acquisition of the Equipment securing no more than Seven Hundred Fifty Thousand Dollars ($750,000) in the aggregate amount outstanding, or (ii) existing on Equipment when acquired, if the Lien is confined to the property and improvements and the proceeds of the Equipment;

(d) Liens of carriers, warehousemen, suppliers, or other Persons that are possessory in nature arising in the ordinary course of business so long as such Liens attach only to Inventory, securing liabilities in the aggregate amount not to exceed Five Hundred Thousand Dollars ($500,000) and which are not delinquent or remain payable without penalty or which are being contested in good faith and by appropriate proceedings which proceedings have the effect of preventing the forfeiture or sale of the property subject thereto;

(e) Liens to secure payment of workers' compensation, employment insurance, old-age pensions, social security and other like obligations incurred in the ordinary course of business (other than Liens imposed by ERISA);

(f) Liens incurred in the extension, renewal or refinancing of the indebtedness secured by Liens described in (a) through (c), but any extension, renewal or replacement Lien must be limited to the property encumbered by the existing Lien and the principal amount of the indebtedness may not increase;

(g) leases or subleases of real property granted in the ordinary course of Borrower's business (or, if referring to another Person, in the ordinary course of such Person's business), and leases, subleases, non-exclusive licenses or sublicenses of personal property (other than Intellectual Property) granted in the ordinary course of Borrower's business (or, if referring to another Person, in the ordinary course of such Person's business), if the leases, subleases, licenses and sublicenses do not prohibit granting Bank a security interest therein;

(h) non-exclusive license of Intellectual Property granted to third parties in the ordinary course of business;

(i) Liens arising from attachments or judgments, orders, or decrees in circumstances not constituting an Event of Default under Sections 8.4 and 8.7;

(j) Liens in favor of other financial institutions arising in connection with Borrower's securities accounts held at such institutions, provided that Bank has a perfected security interest in the amounts held in such deposit and/or securities accounts;

(k) deposits to secure the performance of bids, trade contracts and leases, statutory obligations, surety bonds (other than bonds related to judgments or litigation), performance bonds and other obligations of a like nature incurred in the ordinary course of business; and

(l) Liens in favor of customs and revenue authorities arising as a matter of law to secure payment of customs duties in connection with the importation of goods.

"**Person**" is any individual, sole proprietorship, partnership, limited liability company, joint venture, company, trust, unincorporated organization, association, corporation, institution, public benefit corporation, firm, joint stock company, estate, entity or government agency.

"**Prime Rate**" is, as of any date of determination, equal to the rate as of such date published in the "Money Rates" section of The Wall Street Journal as being the "Prime Rate" (or, if more than one rate is published as the Prime Rate, then the highest of such rates). The Prime Rate will change as of the date of publication in The Wall Street Journal of a Prime Rate that is different from that published on the preceding Business Day. In the event that The Wall Street Journal shall, for any reason, fail or cease to publish the Prime Rate, the Bank shall choose a reasonably comparable index or source to use as the basis for the Prime Rate.

"**Requirement of Law**" is as to any Person, the organizational or governing documents of such Person, and any law (statutory or common), treaty, rule or regulation or determination of an arbitrator or a court or other Governmental Authority, in each case applicable to or binding upon such Person or any of its property or to which such Person or any of its property is subject.

"**Responsible Officer**" is any of the Chief Executive Officer, President, Chief Financial Officer and Controller of Borrower.

"**Restricted License**" is any material license or other agreement with respect to which Borrower is the licensee (a) that prohibits or otherwise restricts Borrower from granting a security interest in Borrower's interest in such license or agreement or any other property, or (b) for which a default under or termination of could interfere with the Bank's right to sell any Collateral.

"**Revolving Line**" is an Advance or Advances in an amount equal to Ten Million Dollars ($10,000,000.00).

"Revolving Line Maturity Date" is December 21, 2012.

"**Saleable Patents**" are those patents and related materials to be sold by Borrower's Subsidiary, Equator Technologies, Inc., to [***] within ninety (90) days of the Effective Date and that are listed in Exhibit G.

"**SEC**" shall mean the Securities and Exchange Commission, any successor thereto, and any analogous Governmental Authority.

"**Securities Account**" is any "securities account" as defined in the Code with such additions to such term as may hereafter be made.

"SMIC" means Semiconductor Manufacturing International Corporation, a Cayman Islands corporation.

"**Settlement Date**" is defined in Section 2.1.3.

"**Subordinated Debt**" is (a) indebtedness incurred by Borrower subordinated to all of Borrower's now or hereafter indebtedness to Bank (pursuant to a subordination, intercreditor, or other similar agreement in form and substance satisfactory to Bank entered into between Bank and the other creditor), on terms acceptable to Bank, and (b) all Indebtedness under the Indenture and the Borrower Debenture.

"**Subsidiary**" is, as to any Person, a corporation, partnership, limited liability company or other entity of which shares of stock or other ownership interests having ordinary voting power (other than stock or such other ownership interests having such power only by reason of the happening of a contingency) to elect a majority of the board of directors or other managers of such corporation, partnership or other entity are at the time owned, or the management of which is otherwise controlled, directly or indirectly through one or more intermediaries, or both, by such Person. Unless the context otherwise requires, each reference to a Subsidiary herein shall be a reference to a Subsidiary of Borrower.

"**Total Liabilities**" is on any day, obligations that should, under GAAP, be classified as liabilities on Borrower's consolidated balance sheet, including all Indebtedness and current portion of Subordinated Debt permitted by Bank to be paid by Borrower, but excluding all other Subordinated Debt.

"**Trademarks**" means any trademark and servicemark rights, whether registered or not, applications to register and registrations of the same and like protections, and the entire goodwill of the business of Borrower connected with and symbolized by such trademarks.

"**Transfer**" is defined in Section 7.1.

"**Unused Revolving Line Facility Fee**" is defined in Section 2.4(c).

"[***]" means the entity formed by [***], pursuant to the transfer of the Saleable Patents, as noted on the Patent Purchase Agreement to be entered into by Borrower and the other parties thereto.

[Signature page follows.**]**

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the Effective Date.

BORROWER:

PIXELWORKS, INC., an Oregon corporation

By: /s/ Steven L. Moore
Name: Steven L. Moore
Title: VP & CFO

BANK:

SILICON VALLEY BANK

By: /s/ Tom Smith
Name: Tom Smith
Title: Managing Director

Exhibit 21

Subsidiaries of Pixelworks, Inc.

Equator Technologies, Inc. — a Delaware corporation
Jaldi Semiconductor — an Ontario corporation
Pixelworks Japan Inc. — a Japan company
Pixelworks Semiconductor Technology (Shanghai) Co. Ltd. — a China company
Pixelworks Semiconductor Technology (Taiwan) Inc. — a Taiwan company

Exhibit 23

Consent of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Pixelworks, Inc.:

We consent to the incorporation by reference in the registration statement on Form S-8 of (Nos.333-168175, 333-161125, 333-152945, 333-136553, 333-126017, 333-125945, 333-123526, 333-121274, 333-89394, 333-62000, 333-41720, and 333-41722) and Form S-3 (Nos. 333-170768, 333-118100, 333-100548, and 333-67838) of Pixelworks, Inc. of our reports dated March 9, 2011, with respect to the consolidated balance sheets of Pixelworks, Inc. as of December 31, 2010 and 2009, and the related consolidated statements of operations, shareholders' equity (deficit) and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2010, and the effectiveness of internal control over financial reporting as of December 31, 2010, which reports appear in the December 31, 2010 annual report on Form 10-K of Pixelworks, Inc.

/s/ KPMG LLP

Portland, Oregon
March 9, 2011

Exhibit 31.1

CERTIFICATION

I, Bruce A. Walicek, certify that:

1. I have reviewed this annual report on Form 10-K of Pixelworks, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 9, 2011

By: /s/ Bruce A. Walicek

Bruce A. Walicek
President and
Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Steven L. Moore, certify that:

1. I have reviewed this annual report on Form 10-K of Pixelworks, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 9, 2011

By: /s/ Steven L. Moore

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

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Pixelworks, Inc. (the “Company”) on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Bruce A. Walicek, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Bruce A. Walicek
Bruce A. Walicek
President and Chief Executive Officer

Date: March 9, 2011

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Pixelworks, Inc. (the "Company") on Form 10-K for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven L. Moore, Vice President, Chief Financial Officer, Secretary and Treasurer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Steven L. Moore
Steven L. Moore
Vice President, Chief Financial Officer
Secretary and Treasurer

Date: March 9, 2011