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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2008.

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

(State or other jurisdiction of incorporation)

91-1761992

(I.R.S. Employer Identification No.)

**8100 SW Nyberg Road
Tualatin, Oregon 97062
(503) 454-1750**

(Address of principal executive offices, including zip code,
and Registrant's telephone number, including area code)

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

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

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

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

Number of shares of Common Stock outstanding as of July 31, 2008: 14,526,127

PIXELWORKS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2008

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	June 30, 2008	December 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 59,394	\$ 74,572
Short-term marketable securities	14,804	34,581
Accounts receivable, net	6,738	6,223
Inventories, net	6,271	11,265
Prepaid expenses and other current assets	3,862	3,791
Total current assets	91,069	130,432
Long-term marketable securities	7,495	9,804
Property and equipment, net	5,747	6,148
Other assets, net	7,036	6,902
Debt issuance costs, net	1,237	2,260
Acquired intangible assets, net	4,796	6,370
Total assets	<u>\$ 117,380</u>	<u>\$ 161,916</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 3,658	\$ 3,992
Accrued liabilities and current portion of long-term liabilities	9,988	13,848
Current portion of income taxes payable	281	232
Total current liabilities	13,927	18,072
Long-term liabilities, net of current portion	1,719	1,236
Income taxes payable, net of current portion	10,524	10,635
Long-term debt	89,752	140,000
Total liabilities	115,922	169,943
Commitments and contingencies		
Shareholders' equity (deficit):		
Preferred stock	—	—
Common stock	334,386	333,934
Shares exchangeable into common stock	—	113
Accumulated other comprehensive loss	(515)	(4,778)
Accumulated deficit	(332,413)	(337,296)
Total shareholders' equity (deficit)	1,458	(8,027)
Total liabilities and shareholders' equity	<u>\$ 117,380</u>	<u>\$ 161,916</u>

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2008	2007	2008	2007
Revenue, net	\$ 20,793	\$ 26,896	\$ 44,769	\$ 50,877
Cost of revenue (1)	10,295	15,294	22,600	29,422
Gross profit	10,498	11,602	22,169	21,455
Operating expenses:				
Research and development (2)	7,193	9,675	13,915	21,650
Selling, general and administrative (3)	4,491	7,013	9,177	14,538
Restructuring	(158)	2,635	850	5,403
Amortization of acquired intangible assets	74	90	164	180
Total operating expenses	11,600	19,413	24,106	41,771
Loss from operations	(1,102)	(7,811)	(1,937)	(20,316)
Interest income	553	1,444	1,536	2,971
Other income	218	—	218	—
Interest expense	(419)	(688)	(992)	(1,345)
Amortization of debt issuance costs	(125)	(166)	(271)	(331)
Gain on repurchase of long-term debt, net	—	—	11,557	—
Other-than-temporary impairment of marketable security	—	—	(6,490)	—
Interest and other income, net	227	590	5,558	1,295
Income (loss) before income taxes	(875)	(7,221)	3,621	(19,021)
Provision (benefit) for income taxes	375	399	(1,262)	1,021
Net income (loss)	<u>\$ (1,250)</u>	<u>\$ (7,620)</u>	<u>\$ 4,883</u>	<u>\$ (20,042)</u>
Net income (loss) per share — basic and diluted	<u>\$ (0.09)</u>	<u>\$ (0.47)</u>	<u>\$ 0.33</u>	<u>\$ (1.23)</u>
Weighted averages shares outstanding:				
Basic	<u>14,577</u>	<u>16,286</u>	<u>14,753</u>	<u>16,273</u>
Diluted	<u>14,577</u>	<u>16,286</u>	<u>14,766</u>	<u>16,273</u>
(1) Includes:				
Amortization of acquired developed technology	\$ 705	\$ 705	\$ 1,410	\$ 1,410
Stock-based compensation	20	28	38	48
Restructuring	—	35	—	136
(2) Includes stock-based compensation	449	510	898	1,180
(3) Includes stock-based compensation	313	916	738	1,949

See accompanying notes to condensed consolidated financial statements.

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

	Six Months Ended	
	June 30,	
	2008	2007
Cash flows from operating activities:		
Net income (loss)	\$ 4,883	\$(20,042)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Gain on repurchase of long-term debt, net	(11,557)	—
Other-than-temporary impairment of marketable security	6,490	—
Depreciation and amortization	3,375	7,742
Stock-based compensation	1,674	3,177
Amortization of acquired intangible assets	1,574	1,590
Deferred income tax benefit	(473)	—
Accretion on short- and long-term marketable securities	(295)	(147)
Amortization of debt issuance costs	271	331
Loss on asset disposals	80	206
Write off of certain assets related to restructuring	—	572
Unrealized foreign currency gain on investments	—	(201)
Other	27	26
Changes in operating assets and liabilities:		
Accounts receivable, net	(515)	293
Inventories, net	4,994	(3,060)
Prepaid expenses and other current and long-term assets, net	(535)	974
Accounts payable	(334)	4,891
Accrued current and long-term liabilities	(1,667)	(1,202)
Income taxes payable	(62)	(463)
Net cash provided by (used in) operating activities	<u>7,930</u>	<u>(5,313)</u>
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	36,814	30,118
Purchases of marketable securities	(16,659)	(15,556)
Payments on asset financings	(2,764)	(3,609)
Purchases of property and equipment	(1,245)	(1,496)
Proceeds from sales of property and equipment	20	—
Net cash provided by investing activities	<u>16,166</u>	<u>9,457</u>
Cash flows from financing activities:		
Repurchase of long-term debt	(37,939)	—
Repurchase of common stock	(1,371)	—
Proceeds from issuances of common stock	36	250
Net cash provided by (used in) financing activities	<u>(39,274)</u>	<u>250</u>
Net change in cash and cash equivalents	(15,178)	4,394
Cash and cash equivalents, beginning of period	<u>74,572</u>	<u>63,095</u>
Cash and cash equivalents, end of period	<u>\$ 59,394</u>	<u>\$ 67,489</u>

See accompanying notes to condensed consolidated financial statements.

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

NOTE 1: BASIS OF PRESENTATION

Nature of Business

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications. Our solutions enable manufacturers of digital display and projection devices, such as multimedia projectors and large-screen liquid crystal display ("LCD") televisions to differentiate their products with a consistently high level of video quality.

Condensed Consolidated Financial Statements

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

The financial information included herein for the three and six month periods ended June 30, 2008 and 2007 is unaudited; however, such information reflects all adjustments, consisting only of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows of the Company for these interim periods. The financial information as of December 31, 2007 is derived from our audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2007, included in Item 8 of our Annual Report on Form 10-K, filed with the SEC on March 12, 2008, and should be read in conjunction with such consolidated financial statements.

The results of operations for the three and six month periods ended June 30, 2008 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2008.

Use of Estimates

The preparation of consolidated financial statements in conformity with 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 valuation of short- and long-term marketable securities, product returns, warranty obligations, bad debts, inventories, property and equipment, intangible assets, valuation of share-based payments, income taxes, litigation and other contingencies. The actual results experienced could differ materially from our estimates.

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Reclassifications

Certain reclassifications have been made to the 2007 condensed consolidated financial statements to conform with the 2008 presentation.

NOTE 2: BALANCE SHEET COMPONENTS

Marketable Securities

As of June 30, 2008 and December 31, 2007, all of our short- and long-term marketable securities are available-for-sale.

Unrealized holding gains (losses) on short- and long-term available-for-sale securities, net of tax, were \$25 and \$(497), respectively, as of June 30, 2008 and \$(22) and \$(4,713), respectively, as of December 31, 2007. These unrealized holding gains and losses are recorded in accumulated other comprehensive loss, a component of shareholders' equity (deficit), in the condensed consolidated balance sheets. We have determined that as of June 30, 2008, gross unrealized losses on our marketable securities were temporary based on our intent and ability to hold the investments until recovery.

Accounts Receivable, Net

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

	June 30, 2008	December 31, 2007
Accounts receivable, gross	\$ 7,280	\$ 6,765
Less: allowance for doubtful accounts	(542)	(542)
Accounts receivable, net	<u>\$ 6,738</u>	<u>\$ 6,223</u>

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

	Six Months Ended June 30,	
	2008	2007
Balance at beginning of period	\$ 542	\$ 200
Provision	—	483
Recoveries	—	(41)
Balance at end of period	<u>\$ 542</u>	<u>\$ 642</u>

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

Inventories, net consists of the following:

	June 30, 2008	December 31, 2007
Finished goods	\$ 6,559	\$ 12,733
Work-in-process	<u>5,238</u>	<u>4,482</u>
	11,797	17,215
Less: reserve for slow-moving and obsolete items	<u>(5,526)</u>	<u>(5,950)</u>
Inventory, net	<u>\$ 6,271</u>	<u>\$ 11,265</u>

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

	Six Months Ended June 30,	
	2008	2007
Balance at beginning of period	\$ 5,950	\$ 5,950
Provision	1,315	2,008
Usage:		
Sales	(655)	(586)
Scrap	<u>(1,084)</u>	<u>(1,545)</u>
Total usage	<u>(1,739)</u>	<u>(2,131)</u>
Balance at end of period	<u>\$ 5,526</u>	<u>\$ 5,827</u>

Based upon our forecast and backlog, we do not currently expect to be able to sell or otherwise use the reserved inventory we have on hand at June 30, 2008. However, it is possible that a customer will decide in the future to purchase a portion of the reserved inventory. It is not possible for us to predict if or when this may happen, or how much we may sell. If such sales occur, we do not expect that they will have a material effect on gross profit margin.

Property and Equipment, Net

Property and equipment, net consists of the following:

	June 30, 2008	December 31, 2007
Gross carrying amount	\$ 19,056	\$ 17,109
Less: accumulated depreciation and amortization	<u>(13,309)</u>	<u>(10,961)</u>
Property and equipment, net	<u>\$ 5,747</u>	<u>\$ 6,148</u>

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Acquired Intangible Assets, Net

Acquired intangible assets, net consists of the following:

	June 30, 2008	December 31, 2007
Gross carrying amount:		
Developed technology	\$ 19,170	\$ 19,170
Customer relationships	1,689	1,689
	20,859	20,859
Less accumulated amortization:		
Developed technology	(14,374)	(12,964)
Customer relationships	(1,689)	(1,525)
	(16,063)	(14,489)
Acquired intangible assets, net	<u>\$ 4,796</u>	<u>\$ 6,370</u>

Estimated future amortization of acquired developed technology is as follows:

Six Months Ending December 31:		
2008		\$ 1,410
Year Ending December 31:		
2009		2,336
2010		1,050
		<u>\$ 4,796</u>

Accrued Liabilities and Current Portion of Long-Term Liabilities

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

	June 30, 2008	December 31, 2007
Accrued payroll and related liabilities	\$ 3,416	\$ 3,366
Current portion of accrued liabilities for asset financings	2,290	4,150
Accrued costs related to restructuring	1,014	2,918
Reserve for warranty returns	726	932
Accrued interest payable	295	405
Accrued commissions and royalties	235	381
Reserve for sales returns and allowances	175	175
Other	1,837	1,521
	<u>\$ 9,988</u>	<u>\$ 13,848</u>

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

	Six Months Ended	
	June 30,	
	2008	2007
Reserve for warranty returns:		
Balance at beginning of period	\$ 932	\$ 662
Provision	(54)	682
Charge offs	(152)	(502)
Balance at end of period	<u>\$ 726</u>	<u>\$ 842</u>
Reserve for sales returns and allowances:		
Balance at beginning of period	\$ 175	\$ 479
Provision	14	18
Charge offs	(14)	(322)
Balance at end of period	<u>\$ 175</u>	<u>\$ 175</u>

Long-Term Debt

In 2004, we issued \$150,000 of 1.75% convertible subordinated debentures (the “debentures”) due 2024. In February 2006, we repurchased and retired \$10,000 of the debentures. In January 2008, we commenced a modified dutch auction tender offer under which we offered to purchase, for cash, up to \$50,000 aggregate principal amount of the debentures at a price not greater than \$0.75 nor less than \$0.68 per \$1 principal amount. The tender offer expired on February 28, 2008 and we repurchased \$50,248 principal amount of the debentures, which included \$248 that we purchased without extending the tender offer in accordance with applicable securities laws. The purchase price was \$0.74 per \$1. We recognized a net gain of \$11,557 on the repurchase, which included the \$13,064 discount, offset by legal and professional fees of \$755 and a write-off of debt issuance costs of \$752.

The remaining \$89,752 of 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 1,228,489 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.

We may redeem some or all of the debentures for cash on or after May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest. The holders of the debentures have the right to require us to purchase all or a portion of the \$89,752 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 our existing and future senior debt.

Shareholders' Equity (Deficit)

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 long-term debt 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.

Share Repurchase Program

On September 25, 2007, we announced a share repurchase program under which the Board of Directors authorized the repurchase of up to \$10,000 of our common stock over the next twelve months. The program does not obligate us to acquire any particular amount of common stock and may be modified or suspended at any time at our discretion. Share repurchases under the program may be made through open market and privately negotiated transactions at our discretion, subject to market conditions and other factors. During 2007, we repurchased 1,260,833 common shares at a cost of \$4,269. During the first half of 2008, we repurchased 607,737 shares for \$1,371. As of June 30, 2008, \$4,360 remained available for repurchase under the plan. The above numbers reflect the June 4, 2008 one-for-three reverse stock split of our common stock.

NOTE 3: FAIR VALUE MEASUREMENT

On January 1, 2008, we adopted FASB Statement of Financial Accounting Standard No. ("SFAS") 157, *Fair Value Measurement*" (SFAS 157) for our financial assets and liabilities. SFAS 157 defines fair value and describes three levels of inputs that may be used to measure fair value:

- Level 1: Valuations based on quoted prices in active markets for identical assets and liabilities.
- Level 2: Valuations based on observable inputs other than quoted prices in active markets for identical assets and liabilities.
- Level 3: Valuations based on unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions.

The table below presents information about our financial assets and liabilities measured at fair value at June 30, 2008:

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	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Cash equivalents	\$ 46,637	\$ —	—	\$ 46,637
Short-term marketable securities	—	14,804	—	14,804
Long-term marketable securities	2,910	4,585	—	7,495
Total	<u>\$ 49,547</u>	<u>\$ 19,389</u>	<u>—</u>	<u>\$ 68,936</u>

Level 1 financial assets include money market funds and a long term equity security. Level two financial assets include commercial paper, corporate debt securities and U.S. government agencies debt securities. We primarily use the market approach to determine the fair value of our financial assets.

The adoption of SFAS 157 for financial assets and financial liabilities did not have a material impact on our consolidated financial statements. FSP 157-2 *Partial Deferral of the Effective Date of Statement 157* (“FSP 157-2”) deferred the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008. We will adopt FSP 157-2 on January 1, 2009, and do not expect the adoption to have a material impact on our consolidated financial statements.

On January 1, 2008, we adopted SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (“SFAS 159”). SFAS 159 allows us to measure many financial instruments and certain other items at fair value. 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 4: RESTRUCTURING PLANS

In 2006, we initiated restructuring plans aimed at returning the Company to profitability. We continued to implement these plans throughout 2007 and during the first half of 2008. The following is a summary of restructuring expense incurred during the six months ended June 30, 2008 and the cumulative amount incurred through June 30, 2008:

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	Six Months Ended June 30, 2008	Cumulative Amount Incurred To June 30, 2008
Cost of revenue — restructuring:		
Termination and retention benefits	\$ —	\$ 219
Licensed technology and tooling write-offs	—	2,072
	<u>—</u>	<u>2,291</u>
Operating expenses — restructuring:		
Consolidation of leased space	494	3,054
Termination and retention benefits	356	8,338
Net write off of assets and reversal of related liabilities	—	13,451
Contract termination fee	—	1,693
Payments, non-cancelable contracts	—	827
Other	—	88
	<u>850</u>	<u>27,451</u>
Total restructuring expense	<u>\$ 850</u>	<u>\$ 29,742</u>

The following is a summary of the change in accrued liabilities related to the restructuring plans during the first half of 2008:

	Balance as of December 31, 2007	Expensed	Payments	Balance as of June 30, 2008
Termination and retention benefits	\$ 1,758	\$ 356	\$ (1,747)	\$ 367
Lease termination costs	999	494	(542)	951
Contract termination and other costs	514	—	(514)	—
Total	<u>\$ 3,271</u>	<u>\$ 850</u>	<u>\$ (2,803)</u>	<u>\$ 1,318</u>

NOTE 5: INCOME TAXES

The provision (benefit) for income taxes recorded for the three and six month periods ended June 30, 2008 and 2007 includes current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. Additionally, during the first quarter of 2008, we recorded a benefit of \$1,000 for refundable research and experimentation credits, a benefit of \$559 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, and a deferred tax benefit of \$446 which resulted from an increase in the tax rate of a single foreign jurisdiction.

As of June 30, 2008, we continued to provide a full valuation allowance against essentially all of our U.S. and Canadian net deferred tax assets as we do not believe that it is more likely than not that we will realize a benefit from those assets. We have not recorded a valuation allowance against our other foreign net deferred tax assets as we believe that it is more likely than not that we will realize a benefit from those assets.

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As of June 30, 2008 and December 31, 2007, the amount of our uncertain tax positions was a liability of \$10,524 and \$10,635, respectively. A number of years may elapse before an uncertain tax position is resolved by settlement or statute of limitations. Settlement of any particular position could require the use of cash. If the uncertain tax positions we have accrued for are sustained by the taxing authorities in our favor, the reduction of the liability will reduce our effective tax rate. We reasonably expect reductions in the liability for unrecognized tax benefits of approximately \$1,815 within the next twelve months due to the expiration of a statute of limitations in a foreign jurisdiction. We recognize interest and penalties related to uncertain tax positions in income tax expense in our consolidated statement of operations.

NOTE 6: COMPREHENSIVE INCOME (LOSS)

The components of comprehensive income (loss), net of tax, were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net income (loss)	\$ (1,250)	\$ (7,620)	\$ 4,883	\$ (20,042)
Reclassification adjustment from accumulated other comprehensive income for other-than-temporary loss on marketable security included in net income	—	—	4,810	—
Unrealized gain (loss) on available-for-sale investments	(729)	(80)	(547)	451
Total comprehensive income (loss)	<u>\$ (1,979)</u>	<u>\$ (7,700)</u>	<u>\$ 9,146</u>	<u>\$ (19,591)</u>

NOTE 7: EARNINGS PER SHARE

We calculate earnings per share in accordance with SFAS 128, *Earnings per Share*. Basic earnings per share amounts are computed based on the weighted average number of common shares outstanding, and include exchangeable shares. These exchangeable shares, which were issued on September 6, 2002 by Jaldi, our Canadian subsidiary, to its shareholders in connection with the Jaldi asset acquisition, have characteristics essentially equivalent to Pixelworks' common stock. At June 30, 2008 there were no outstanding exchangeable shares. Basic and diluted weighted average shares outstanding have been calculated to reflect the June 4, 2008 one-for three reverse stock split in all periods presented.

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

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

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Net income (loss)	\$ (1,250)	\$ (7,620)	\$ 4,883	\$ (20,042)
Basic weighted average shares outstanding	14,577	16,286	14,753	16,273
Common share equivalents:				
Dilutive effect of stock options	—	—	13	—
Diluted weighted average shares outstanding	14,577	16,286	14,766	16,273
Net income (loss) per common share — basic and diluted	\$ (0.09)	\$ (0.47)	\$ 0.33	\$ (1.23)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Stock options	1,816	2,020	1,716	2,116
Conversion of debentures	1,228	1,916	1,467	1,916
Unvested stock awards	—	32	—	16
	<u>3,044</u>	<u>3,968</u>	<u>3,183</u>	<u>4,048</u>

NOTE 8: SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental disclosure of cash flow information is as follows:

	Six Months Ended June 30,	
	2008	2007
Cash paid during the period for:		
Interest	\$1,121	\$1,318
Income taxes	238	1,457
Non-cash investing and financing activities:		
Acquisitions of property and equipment and other assets under extended payment terms	\$1,056	\$ —

NOTE 9: SEGMENT INFORMATION

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

Geographic Information

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

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2008	2007	2008	2007
Japan	\$ 12,241	\$ 15,201	\$ 26,246	\$ 28,194
Europe	1,965	1,419	4,342	3,067
Taiwan	2,171	2,798	4,064	5,823
Korea	2,006	1,852	3,609	4,278
U.S.	887	1,461	1,855	2,522
China	390	1,421	1,110	2,823
Other	1,133	2,744	3,543	4,170
	<u>\$ 20,793</u>	<u>\$ 26,896</u>	<u>\$ 44,769</u>	<u>\$ 50,877</u>

Significant Customers

Sales to distributors represented 47% and 63% of total revenue for the second quarter of 2008 and 2007, respectively and 50% and 59% for the first half of 2008 and 2007, respectively. One distributor represented 29% and 36% of total revenue for the second quarter of 2008 and 2007, respectively and 29% and 34% of total revenue for the first half of 2008 and 2007, respectively. No other distributor represented 10% or more of revenue during these periods.

End customers include customers who purchase directly from us, as well as customers who purchase our products indirectly through distributors and manufacturers' representatives. Revenue attributable to our top five end customers represented 54% and 46% of revenue for the second quarter of 2008 and 2007, respectively, and 55% and 47% of revenue for the first half of 2008 and 2007, respectively. One end customer represented 26% and 17% of total revenue for the second quarter of 2008 and 2007, respectively and 27% and 19% of total revenue for the first half of 2008 and 2007, respectively. No other end customer represented 10% or more of revenue during these periods.

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

	June 30, 2008	December 31, 2007
Account A	27%	27%
Account B	18%	21%
Account C	10%	3%

NOTE 10: RISKS AND UNCERTAINTIES**Concentration of Suppliers**

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

Risk of Technological Change

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

Concentrations of Credit Risk

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

NOTE 11: COMMITMENTS AND CONTINGENCIES

Indemnifications

Certain of our agreements include limited indemnification provisions for claims from third-parties relating to our intellectual property. Such indemnification provisions are accounted for in accordance with FASB Summary of Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others-an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No.34*. The indemnification is limited to the amount paid by the customer. As of June 30, 2008, we have not incurred any material liabilities arising from these indemnification obligations. However, in the future such obligations could immediately impact our results of operations but are not expected to materially affect our business.

Legal Proceedings

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

NOTE 12: SUBSEQUENT EVENT

In August 2008, we purchased \$15,000 of our 1.75% convertible subordinated debentures for \$10,610 in cash in a combination of open market and private transactions. As a result of this transaction we will recognize a gain in other income of approximately \$4,200 in the third quarter of 2008.

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

Forward-looking Statements

This Management’s Discussion and Analysis of Financial Condition and Results of Operations contains “forward-looking statements” that are based on current expectations, estimates, beliefs, assumptions and projections about our business. Words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “seeks,” “estimates” and variations of such words and similar expressions are intended to identify such forward-looking statements. Such forward-looking statements include the disclosure contained under the caption “Results of Operations—Business Outlook” below. These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict. Actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors. Such factors include, but are not limited to, changes in growth in the multimedia projector, advanced television, advanced media processor, and liquid crystal display (“LCD”) panel and monitor markets; competitive factors, such as rival chip architectures, introduction or traction by competing designs, or pricing pressures; changes in customer ordering patterns or lead times; seasonality in the consumer electronics market; new product yield rates; supply of products from third party foundries; the success of our products in expanded markets; our efforts to maintain profitability and positive earnings before interest, taxes, depreciation and amortization; insufficient, excess or obsolete inventory and variations in inventory valuation; changes in the recoverability of intangible assets and long lived assets, and other risks identified in the risk factors contained in Part II, Item 1A of this Quarterly Report on Form 10-Q. These forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q. If we do update or correct one or more forward-looking statements, you should not conclude that we will make additional updates or corrections with respect thereto or with respect to other forward-looking statements. Except where the context otherwise requires, in this Quarterly Report on Form 10-Q, the “Company,” “Pixelworks,” “we,” “us” and “our” refer to Pixelworks, Inc., an Oregon corporation, and, where appropriate, its subsidiaries.

Overview

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications. Our solutions enable manufacturers of digital display and projection devices, such as multimedia projectors and large-screen LCD televisions to differentiate their products with a consistently high level of video quality.

Results of Operations

Revenue, net

Net revenue was comprised of the following amounts (dollars in thousands):

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	Three months ended June 30,		2008 v 2007		% of net revenue	
	2008	2007	\$ change	% change	2008	2007
	Multimedia projector	\$ 12,630	\$ 13,536	\$ (906)	(7)%	61%
Advanced television	2,677	4,465	(1,788)	(40)	13	17
Advanced media processor	2,578	4,643	(2,065)	(44)	12	17
LCD monitor, panel and other	2,908	4,252	(1,344)	(32)	14	16
Total revenue	\$ 20,793	\$ 26,896	\$ (6,103)	(23)%	100%	100%

	Six months ended June 30,		2008 v 2007		% of net revenue	
	2008	2007	\$ change	% change	2008	2007
	Multimedia projector	\$ 26,915	\$ 26,221	\$ 694	3%	60%
Advanced television	5,997	10,222	(4,225)	(41)	14	20
Advanced media processor	6,421	8,583	(2,162)	(25)	14	17
LCD monitor, panel and other	5,436	5,851	(415)	(7)	12	11
Total revenue	\$ 44,769	\$ 50,877	\$ (6,108)	(12)%	100%	100%

Multimedia Projector

Revenue from the multimedia projector market decreased 7% in the second quarter of 2008 compared to the second quarter of 2007. This decrease is due to a 3% decrease in both units sold and average selling price (“ASP”). Multimedia projector revenue in the first half of 2008 increased 3% compared to the first half of 2007. This increase is due to a 4% increase in units sold, partially off-set by a 1% decrease in ASP. Revenue fluctuations between 2008 and 2007 are primarily due to timing differences of sales to continuing customers.

Advanced Television

Revenue from the advanced television market decreased 40% in the second quarter of 2008 compared to the second quarter of 2007. This decrease is due to a 38% decrease in units sold and a 3% decrease in ASP. Revenue from the advanced television market decreased 41% in the first half of 2008 compared to the first half of 2007. This decrease is due to a 44% decrease in units sold, partially off-set by a 6% increase in ASP. Decreases in 2008 are primarily attributable to our decision to shift focus away from the commoditized System on Chip segment of the advanced television market. With our new strategy we are developing co-processor ICs that will improve the video performance of any image processor in the large screen, high resolution, high quality segment of the advanced television market.

Advanced Media Processor

Revenue in the advanced media processor market is attributable to products we obtained in connection with our acquisition of Equator Technologies, Inc. (“Equator”) in June 2005. Revenue from this market decreased 44% in the second quarter of 2008 compared to the second quarter of 2007. This decrease resulted from a 42% decrease in units sold and a 5% decrease in ASP. Revenue from this market decreased 25% in the first half of 2008 compared to the first half of 2007. This decrease resulted from a 26% decrease in units sold, partially offset by a 1% increase in ASP.

As a result of our April 2006 restructuring plan we are no longer pursuing stand-alone digital media streaming markets that are not core to our business. We expect to see revenue from this market continue to decrease over time as customers switch to next generation designs from other suppliers.

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LCD Monitor, Panel and Other

LCD monitor, panel and other revenue decreased \$1.3 million in the second quarter of 2008 compared to the second quarter of 2007, and decreased \$415,000 in the first half of 2008 compared to the first half of 2007. The decrease is primarily attributable to our decision to stop developing lower-end LCD monitor chips.

Cost of revenue and gross profit

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

	<u>Three months ended June 30,</u>			
	<u>2008</u>	<u>% of revenue</u>	<u>2007</u>	<u>% of revenue</u>
Direct product costs and related overhead ¹	\$ 9,590	46%	\$ 14,006	52%
Provision for obsolete inventory, net of usage	(20)	(0)	520	2
Amortization of acquired developed technology	705	3	705	3
Restructuring	—	—	35	0
Stock-based compensation	20	0	28	0
Total cost of revenue	<u>\$ 10,295</u>	50%	<u>\$ 15,294</u>	57%
Gross profit	<u>\$ 10,498</u>	50%	<u>\$ 11,602</u>	43%

	<u>Six months ended June 30,</u>			
	<u>2008</u>	<u>% of revenue</u>	<u>2007</u>	<u>% of revenue</u>
Direct product costs and related overhead ¹	\$ 20,492	46%	\$ 26,406	52%
Provision for obsolete inventory, net of usage	660	1	1,422	3
Amortization of acquired developed technology	1,410	3	1,410	3
Restructuring	—	—	136	0
Stock-based compensation	38	0	48	0
Total cost of revenue	<u>\$ 22,600</u>	50%	<u>\$ 29,422</u>	58%
Gross profit	<u>\$ 22,169</u>	50%	<u>\$ 21,455</u>	42%

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

Direct product costs and related overhead decreased to 46% of revenue in the second quarter and first half of 2008, down from 52% in the second quarter and first half of 2007. The decrease in direct product costs and related overhead as a percentage of revenue in the 2008 periods compared to the 2007 periods resulted primarily from lower pricing obtained from vendors, a more favorable mix of products sold and increases in production yields. The net provision for obsolete inventory decreased to 0% of revenue in the second quarter of 2008 from 2% in the second quarter of 2007, and to 1% in the first half of 2008 from 3% in the first half of 2007. The decrease in net provision for obsolete inventory as a percentage of revenue in the 2008 periods compared to 2007 periods is attributable to our increased focus on inventory management.

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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 for the three month periods ended June 30, 2008 and 2007 was as follows (dollars in thousands):

	<u>Three months ended June 30,</u>		<u>2008 v 2007</u>	
	<u>2008</u>	<u>2007</u>	<u>\$ change</u>	<u>% change</u>
<u>Research and development</u> ¹	\$ 7,193	\$ 9,675	\$(2,482)	(26)%

¹ Includes stock-based compensation expense of:

449	510
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Research and development expense decreased 26% in the second quarter of 2008 compared with the second quarter of 2007. The decrease in research and development expense is directly attributable to the restructuring efforts that we initiated in 2006. These efforts resulted in the following expense reductions:

- Depreciation and amortization expense decreased \$1.9 million. This decrease is primarily due to the December 31, 2007 write off of engineering software tools, which we are no longer using due to reductions in research and development personnel and changes in product development strategy.
- Facilities and information technology expense allocations decreased \$381,000, primarily due to reductions in outsourced IT support and decreased equipment depreciation. These decreases are primarily due to reduced headcount.
- Compensation expense decreased \$173,000. At June 30, 2008, we had 137 research and development employees compared to 186 at June 30, 2007.

Research and development expense for the six month periods ended June 30, 2008 and 2007 was as follows (dollars in thousands):

	<u>Six months ended June 30,</u>		<u>2008 v 2007</u>	
	<u>2008</u>	<u>2007</u>	<u>\$ change</u>	<u>% change</u>
<u>Research and development</u> ¹	\$13,915	\$21,650	\$(7,735)	(36)%

¹ Includes stock-based compensation expense of:

898	1,180
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Research and development expense decreased 36% in the first half of 2008 compared with the first half of 2007. The decrease in research and development expense is directly attributable to the restructuring efforts that we initiated in 2006. These efforts resulted in the following expense reductions:

- Depreciation and amortization expense decreased \$3.8 million. This decrease is primarily due to the December 31, 2007 write off of engineering software tools.

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- Compensation expense decreased \$1.7 million due to fewer research and development personnel.
- Facilities and information technology expense allocations decreased \$1.1 million, primarily due to reductions in outsourced IT support, lower rent and decreased equipment depreciation.
- Development-related expenses, including non-recurring engineering and outside services, decreased \$547,000 as a result of our restructuring efforts.
- Stock-based compensation expense decreased \$282,000 due to personnel reductions and reduced valuation of our stock options.
- Travel and related expenses decreased \$278,000.

Selling, general and administrative

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

Selling, general and administrative expense for the three month periods ended June 30, 2008 and 2007 was as follows (dollars in thousands):

	Three months ended June 30,		2008 v 2007	
	2008	2007	\$ change	% change
Selling, general and administrative ¹	\$ 4,491	\$ 7,013	\$(2,522)	(36)%
¹ Includes stock-based compensation expense of:	313	916		

Selling, general and administrative expense decreased 36% in the second quarter of 2008 compared with the second quarter of 2007. The decrease in selling, general and administrative expenses is directly attributable to the restructuring efforts that we initiated in 2006. These efforts resulted in the following expense reductions:

- Compensation expense decreased \$1.0 million. As of June 30, 2008, we had 70 employees in selling, general and administrative functions, compared to 130 as of June 30, 2007.
- Stock-based compensation expense decreased \$603,000 due to personnel reductions and reduced valuation of our stock options.
- Facilities and information technology allocations decreased \$274,000.
- Travel and related expenses decreased \$256,000.
- Recruiting fees decreased \$178,000 due to executive search charges during the second quarter of 2007.

Selling, general and administrative expense for the six month periods ended June 30, 2008 and 2007 was as follows (dollars in thousands):

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	Six months ended June 30,		2008 v 2007	
	2008	2007	\$ change	% change
Selling, general and administrative ¹	\$9,177	\$14,538	\$(5,361)	(37)%
¹ Includes stock-based compensation expense of:	738	1,949		

Selling, general and administrative expense decreased 37% in the first half of 2008 compared with the first half of 2007. The decrease in selling, general and administrative expense is directly attributable to the restructuring efforts that we initiated in 2006. These efforts resulted in the following expense reductions:

- Compensation expense decreased \$2.5 million due to fewer selling, general and administrative personnel.
- Stock-based compensation expense decreased \$1.2 million due to personnel reductions and reduced valuation of our stock options.
- Facilities and information technology allocations decreased \$585,000.
- Travel and related expenses decreased \$477,000.
- Recruiting fees decreased \$300,000 due to executive search charges during the first half of 2007.

Restructuring

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

	Three months ended June 30,		Six months ended June 30,	
	2008	2007	2008	2007
Termination and retention benefits ¹	\$ (111)	\$ 1,202	\$ 356	\$ 3,650
Consolidation of leased space ²	(47)	883	494	891
Net write off of assets and reversal of related liabilities	—	523	—	555
Payments, non-cancelable contracts	—	—	—	313
Other	—	62	—	130
Total restructuring expenses	<u>\$ (158)</u>	<u>\$ 2,670</u>	<u>\$ 850</u>	<u>\$ 5,539</u>
Included in cost of revenue	\$ —	\$ 35	\$ —	\$ 136
Included in operating expenses	(158)	2,635	850	5,403

¹ Termination and retention benefits related to our restructuring plans included severance and retention payments for terminated employees and retention payments for certain continuing employees. The benefit in the second quarter of 2008 is due to true ups of prior estimates of severance payments.

² Expenses related to the consolidation of leased space included future non-cancelable rent payments due for vacated space (net of estimated sublease income) and moving expenses. The benefit in the second quarter of 2008 is due to true ups of a prior estimate.

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Amortization of acquired intangible assets

Amortization of acquired intangible assets relates to a customer relationship asset that we recorded in connection with our June 2005 Equator acquisition. Amortization of the customer relationship asset was \$74,000 and \$90,000 for the second quarter of 2008 and 2007, respectively and \$164,000 and \$180,000 for the first half of 2008 and 2007, respectively. The asset was fully amortized as of June 30, 2008.

Interest and other income, net

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

	Three months ended			Six months ended		
	June 30,		\$ change	June 30,		\$ change
	2008	2007		2008	2007	
Interest income ¹	\$ 553	\$ 1,444	\$ (891)	\$ 1,536	\$ 2,971	\$ (1,435)
Other income ²	218	—	218	218	—	218
Interest expense ³	(419)	(688)	269	(992)	(1,345)	353
Amortization of debt issuance costs ⁴	(125)	(166)	41	(271)	(331)	60
Gain on repurchase of long-term debt, net ⁵	—	—	—	11,557	—	11,557
Other-than-temporary impairment of marketable security, net ⁶	—	—	—	(6,490)	—	(6,490)
Total interest and other income, net	<u>\$ 227</u>	<u>\$ 590</u>	<u>\$ (363)</u>	<u>\$ 5,558</u>	<u>\$ 1,295</u>	<u>\$ 4,263</u>

¹ Interest income is earned on cash equivalents and short- and long-term marketable securities. The decrease in the 2008 periods is due to lower balances of marketable securities which resulted from our February 2008 repurchase of long-term debt and decreased yields on our debt securities.

² In the second quarter of 2008, we recognized a gain of \$218,000 on the sale of a non-marketable equity security.

³ Interest expense primarily relates to interest payable on our long-term debt. The decrease in the 2008 periods is due to the reduced outstanding principal balance which resulted from our February 2008 repurchase of long-term debt.

⁴ The fees associated with the 2004 issuance of our long-term debt have been capitalized and are being amortized over a period of seven years. The remaining amortization period is approximately three years as of June 30, 2008. The decrease in the 2008 periods is due to the write-off of fees associated with the portion of long-term debt repurchased in February 2008.

⁵ In February 2008, we repurchased and retired \$50.2 million of our outstanding debt for \$37.9 million in cash, including legal and other professional fees of \$755,000. We recognized a gain on this repurchase of \$11.6 million, net of a write off of debt issuance costs of \$752,000.

⁶ In the first quarter of 2008, we recognized an other-than-temporary impairment of \$6.5 million on a publicly-traded equity security, due to the duration of time that the investment had been below cost and the decline in the public stock price during the quarter. At December 31, 2007, \$4.8 million unrealized loss was included in accumulated other comprehensive loss in shareholders' deficit.

Provision (benefit) for income taxes

The provision (benefit) for income taxes recorded for the second quarter of 2008 and 2007 was \$375,000 and \$399,000, respectively and \$(1.3) million and \$1.0 million for the first half of 2008 and 2007, respectively. The provision (benefit) includes current and deferred tax expense in profitable cost-plus

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foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. Additionally, during the first quarter of 2008, we recorded a benefit of \$1.0 million for refundable research and experimentation credits, a benefit of \$559,000 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, and a deferred tax benefit of \$446,000 which resulted from an increase in the tax rate of a single foreign jurisdiction.

Business Outlook

On July 24, 2008, we provided an outlook for the third quarter of 2008 in our earnings release, which was furnished on a current report on Form 8-K. The outlook provided the following anticipated financial results prepared in accordance with U.S. generally accepted accounting principles:

We expect to record net loss per share in the third quarter of 2008 of \$(0.17) to \$0.00, based on the following estimates:

- Third quarter revenue of \$20.0 million to \$22.0 million.
- Gross profit margin of approximately 47.5% to 50.5%.
- Operating expenses of \$10.8 million to \$11.8 million.
- Nominal interest and other income, net.
- Tax provision of approximately \$300,000.

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 (dollars in thousands):

	<u>June 30,</u> <u>2008</u>	<u>December 31,</u> <u>2007</u>	<u>\$ change</u>	<u>% change</u>
Cash and cash equivalents	\$ 59,394	\$ 74,572	\$(15,178)	(20)%
Short-term marketable securities	14,804	34,581	(19,777)	(57)
Long-term marketable securities	7,495	9,804	(2,309)	(24)
Total cash and marketable securities	<u>\$ 81,693</u>	<u>\$ 118,957</u>	<u>\$(37,264)</u>	<u>(31)%</u>

Total cash and marketable securities decreased 31% during the first half of 2008. The decrease in total cash and marketable securities during the first half of 2008 resulted primarily from \$7.9 million cash flow from operations, offset by \$37.9 million for the repurchase of long-term debt, \$2.8 million in payments on property and equipment and other asset financing, \$1.4 million for the repurchase of our common stock and \$1.2 million for purchases of property and equipment and other long-term assets.

We anticipate that our existing cash and investment balances will be adequate to fund our operating and investing needs for the next twelve months and the foreseeable future. From time to time, we may evaluate acquisitions of businesses, products or technologies that complement our business. We also may repurchase additional amounts of our long-term debt or repurchase shares of our common stock, as authorized under our share repurchase program. Any such 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.

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Accounts receivable, net

Accounts receivable, net increased to \$6.7 million at June 30, 2008 from \$6.2 million at December 31, 2007. The average number of days sales outstanding increased to 29 days at June 30, 2008 from 21 days at December 31, 2007.

Inventories, net

Inventories, net decreased to \$6.3 million at June 30, 2008 from \$11.3 million at December 31, 2007. Inventory turnover on an annualized basis increased to 5.3 at March 31, 2008 from 3.9 at December 31, 2007. As of June 30, 2008, this represented approximately ten weeks of inventory on hand.

Capital resources

In 2004, we issued \$150.0 million of 1.75% convertible subordinated debentures (the “debentures”) due 2024. In February 2006, we repurchased and retired \$10.0 million of the debentures. In January 2008, we commenced a modified dutch auction tender offer under which we offered to purchase, for cash, up to \$50.0 million aggregate principal amount of the debentures at a price not greater than \$750 nor less than \$680 per \$1,000 principal amount. The tender offer expired on February 28, 2008 and we repurchased \$50.2 million principal amount of the debentures, which included \$248,000 that we were allowed to purchase without extending the tender offer in accordance with applicable securities laws. The purchase price was \$740 per \$1,000. We recognized a net gain of \$11.6 million on the repurchase, which included the \$13.1 million discount, offset by legal and professional fees of \$755,000 and a write-off of debt issuance costs of \$752,000.

We may redeem some or all of the debentures for cash on or after May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest. The holders of the debentures have the right to require us to purchase all or a portion of the \$89.8 million 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 our existing and future senior debt.

On September 25, 2007, we announced a share repurchase program under which the board of directors authorized the repurchase of up to \$10.0 million of our common stock over the next twelve months. During 2007, we repurchased 1,260,833 common shares at a cost of \$4.3 million. During the first half of 2008, we purchased an additional 607,737 shares at a cost of \$1.3 million. As of June 30, 2008, \$4.4 million remained available for repurchase under the plan. The above share numbers reflect the one-for-three reverse split of our common stock on June 4, 2008.

Contractual Payment Obligations

Our contractual obligations for 2008 and beyond are included in our Annual Report on Form 10-K for the year ended December 31, 2007, filed with the Securities and Exchange Commission (“SEC”) on March 12, 2008. Our obligations for 2008 and beyond have not changed materially as of June 30, 2008, except for the reduction of \$50.2 million of principal amount of long-term debt that we expect the holders of the outstanding debentures to require us to purchase in 2011, as presented above in “Liquidity and Capital Resources.”

Off-Balance Sheet Arrangements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Our primary market risk exposure is the impact of interest rate fluctuations on interest income earned on our investment portfolio. 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.

As of June 30, 2008, we had convertible subordinated debentures of \$89.8 million outstanding with a fixed interest rate of 1.75%. Interest rate changes affect the fair value of the debentures, but do not affect our earnings or cash flow.

All of our sales are denominated in U.S. dollars and as a result, we have relatively little exposure to foreign currency exchange risk with respect to our sales. We have employees located in offices in Canada, Japan, Taiwan and the People's Republic of China and as such, a portion of our operating expenses 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 do not currently hedge against foreign currency rate fluctuations.

Item 4. Controls and Procedures.

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(d) as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this Quarterly Report on Form 10-Q, these disclosure controls and procedures were effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is (i) recorded, processed, summarized and reported within the time periods specified in the SEC'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 required disclosure.

There were no changes in our internal control over financial reporting which were identified in connection with management's evaluation required by Rules 13a-15(d) and 15d-15(d) under the Exchange Act, that occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1A. Risk Factors.

Investing in our shares of common stock involves a high degree of risk, and investors should carefully consider the risks described below before making an investment decision. If any of the following risks occur, the market price of our shares of common stock could decline and investors could lose all or

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part of their investment. Additional risks that we currently believe are immaterial may also impair our business operations. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2007, including our consolidated financial statements and related notes, and our other filings made from time to time with the Securities and Exchange Commission.

The June 4, 2008 one-for-three reverse split of outstanding shares of our common stock may not result in a long-term or permanent increase in the bid price of our common stock and we may be unable to maintain compliance with NASDAQ Marketplace Rules without taking additional action, which could include effecting an additional reverse stock split. If we are delisted from the NASDAQ Global Market, there may not be a market for our common stock, which could cause a decrease in the value of an investment in us and adversely affect our business, financial condition and results of operations.

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

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

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

and results of operations, including our ability to attract and retain qualified executives and employees and to raise capital.

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

We have adopted a new 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 development of our ImageProcessor architecture for the multimedia projector market, with particular focus on adding increased performance and functionality. For the advanced television market, we are shifting away from our previous approach of implementing our intellectual property (“IP”) exclusively in system-on-chip integrated circuits (“ICs”), to an approach designed to improve video performance of our customers’ image processors through the use of a co-processor IC. This strategy is designed to address the needs of the large-screen, high-resolution, high-quality segment of the advanced television market. Additionally, we are focusing our research and development efforts on new areas beyond our traditional applications, which may not result in increased revenue or gross profit.

We have designed our new strategy to help us take advantage of expected market trends. However, our expectations may not be accurate and these markets may not develop or they may take longer to develop than we expect. Additionally, developers of products may not choose to incorporate our products into their products and we cannot assure you that our customers and potential customers will accept our products quickly enough or in sufficient volume to grow revenue and gross profit. A lack of market acceptance or insufficient market acceptance would materially and adversely affect our results of operations.

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

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

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

We have incurred substantial indebtedness as a result of the sale of convertible debentures.

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As of June 30, 2008, \$89.8 million of our 1.75% convertible subordinated debentures due 2024 were outstanding. Although the debt obligations are due in 2024, the holders of debentures have the right to require us to purchase all or a portion of the \$89.8 million debentures outstanding at each of the following dates: May 15, 2011, May 15, 2014 and May 15, 2019. Since the market price of our common stock is significantly below the conversion price of the debentures, the holders of our outstanding debentures are unlikely to convert the debentures into common stock in accordance with the existing terms of the debentures. Accordingly, we expect holders of the debentures to require us to purchase all of the outstanding debentures on May 15, 2011, the earliest date allowed. Our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, some of which are beyond our control. These debentures could materially and adversely affect our ability to obtain additional debt or equity financing for working capital, acquisitions or other purposes, limit our flexibility in planning for or reacting to changes in our business, reduce funds available for use in our operations and make us more vulnerable to industry downturns and competitive pressures.

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

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

The markets in which we compete or seek to compete are subject to rapid technological change, frequent new product introductions, changing customer requirements for new products and features and evolving industry standards. The introduction of new technologies and emergence of new industry standards could render our products less desirable or obsolete, which could harm our business. Examples of changing industry standards include the introduction of high-definition television, which includes a variety of new formats, new video decoding technology, such as H.264 or Windows Media 11, new digital receivers and displays with higher resolutions, all of which have required us to accelerate development of new products to meet these new standards. Our failure to adequately respond to such technological changes could render our products obsolete or significantly decrease our revenue.

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

The development of our semiconductors is highly complex. These complexities require us to employ advanced designs and manufacturing processes that are unproven. The result can be longer and less predictable development cycles. Timely introduction of new or enhanced products depends on a number of other factors, including, but not limited to:

- accurate prediction of customer requirements and evolving industry standards;
- development of advanced display technologies and capabilities;

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- use of advanced foundry processes and achievement of high manufacturing yields; and
- market acceptance of new products.

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

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 that would negatively affect our operating results. For example, in 2005 and 2006, we invested significant amounts in research and development efforts for projects that were ultimately canceled and for which we will not realize any revenue. In 2007, we wrote off assets with a net book value of \$6.9 million, which consisted primarily of engineering software tools that we were no longer using due to reductions in research and development personnel and changes in product development strategy.

The year ended December 31, 2004 was our only year of profitability since inception and we may be unable to achieve profitability in future periods.

The year ended December 31, 2004 was our first and only year of profitability since inception. Since then, we have incurred net losses. In addition, the profitability we achieved during the first quarter of 2008 was primarily the result of gain we recognized on the repurchase of certain of our convertible subordinated debentures, and we incurred operating losses during the period. In 2006, we initiated restructuring plans, which we implemented throughout 2007 and the first half of 2008, aimed at returning the Company to

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profitability. We cannot be certain that these plans will be successful or that future restructuring efforts will not be necessary. We may not achieve profitability in the future and, if we do, we may not be able to sustain or increase profitability on a quarterly or annual basis. If we are not profitable in the future, we may be unable to continue our operations.

Fluctuations in our quarterly operating results make it difficult to predict our future performance and may result in volatility in the market price of our common stock.

Our quarterly operating results have varied significantly from quarter to quarter and are likely to vary in the future based on a number of factors related to our industry and the markets for our products that are difficult or impossible to predict. Some of these factors are not in our control and any of them may cause our quarterly operating results or the price of our common stock to fluctuate. These factors include, but are not limited to:

- demand for projectors and advanced televisions;
- demand and timing of orders for our products;
- the deferral of customer orders in anticipation of new products or product enhancements from us or our competitors;
- the deferral of, or reduction in, customer orders due to a reduction in our end customers' demand;
- the loss of one or more of our key distributors or customers;
- changes in the available production capacity at the semiconductor fabrication foundries that manufacture our products;
- changes in the costs of manufacturing;
- our ability to provide adequate supplies of our products to customers and avoid excess inventory;
- the announcement or introduction of products and technologies by our competitors;
- changes in product mix, product pricing or distribution channels; and
- general economic conditions and economic conditions specific to the advanced display and semiconductor markets.

Fluctuations in our quarterly results could adversely affect the price of our common stock in a manner unrelated to our long-term operating performance. Because our operating results are volatile and difficult to predict, you should not rely on the results of one quarter as an indication of our future performance. Additionally, it is possible that in any future quarter our operating results will fall below the expectations of securities analysts and investors. In this event, the price of our common stock may decline significantly.

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

Average selling prices for our products decline over relatively short periods of time, while many of our product costs are fixed. When our average selling prices decline, our gross profit declines unless we are able to sell more units or reduce the cost to manufacture our products. Our operating results are negatively affected when revenue or gross profit declines. We have experienced declines in our average selling prices and expect that we will continue to experience them in the future, although we cannot predict when they may occur or how severe they will be. Our financial results will suffer if we are unable to offset any reductions in our average selling prices by increasing our sales volumes, reducing our costs, adding new features to our existing products or developing new or enhanced products in a timely basis with higher selling prices or gross profits.

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

Our sales are made on the basis of purchase orders rather than long-term purchase commitments. Our customers may cancel or defer purchase orders at any time. This process requires us to make numerous forecast assumptions concerning demand, each of which may introduce error into our estimates. If our customers or we overestimate demand, we may purchase components or have products manufactured that we may not be able to use or sell. As a result, we would have excess inventory, which would negatively affect our operating results. For example, we overestimated demand for certain of our products which led to charges for obsolete inventory in 2006, 2007 and the first half of 2008. Conversely, if our customers or we underestimate demand, or if sufficient manufacturing capacity is not available, we would forego revenue opportunities, lose market share and damage our customer relationships.

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

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

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

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

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

We believe our success depends, in large part, upon our ability to identify, attract and retain qualified hardware and software engineers, sales, marketing, finance and managerial personnel. Competition for talented personnel is intense and we may not be able to retain our key personnel or identify, attract or retain other highly qualified personnel in the future. Because of the highly technical nature of our business, the loss of key engineering personnel could delay product introductions and significantly impair our ability to

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successfully create future products. If we do not succeed in hiring and retaining employees with appropriate qualifications, our product development efforts, revenue and business could be seriously harmed.

We have experienced, and may continue to experience, difficulty in hiring and retaining employees with appropriate qualifications. Currently, this risk has increased as we continue to implement restructuring plans to consolidate our operating sites and change our strategic direction. In the last two years a significant portion of our executive management team has turned over, including the Chief Executive Officer, Chief Financial Officer, Chief Technology Officer, Vice President of Sales, Vice President of Business Operations and Vice President, General Manager of China. During 2006 and 2007, we also experienced difficulties hiring and retaining qualified engineers in our Shanghai design center.

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

The display manufacturing market is highly concentrated and we are, and will continue to be, dependent on a limited number of customers and distributors for a substantial portion of our revenue. Sales to distributors represented 50%, 57% and 52% of revenue for the first half of 2008 and the years ended December 31, 2007 and 2006, respectively. Sales to Tokyo Electron Device, or TED, our Japanese distributor, represented 29%, 33% and 26% of revenue for the first half of 2008 and years ended December 31, 2007 and 2006, respectively. Revenue attributable to our top five end customers represented 55%, 47% and 39% of revenue for the first six half of 2008 and years ended December 31, 2007 and 2006, respectively. Sales to Seiko Epson Corporation, our top end customer, represented 27%, 21% and 15% of revenue for the first half of 2008 and years ended December 31, 2007 and 2006, respectively. A reduction, delay or cancellation of orders from one or more of our significant customers, or a decision by one or more of our significant customers to select products manufactured by a competitor or to use its own internally-developed semiconductors, would significantly impact our revenue. For example, our loss of a key OEM customer in Europe contributed to a \$45.5 million, or 51%, decrease in advanced television revenue from 2005 to 2006.

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

As of June 30, 2008 and December 31, 2007, we had three and two customers, respectively, that each represented 10% or more of accounts receivable. The concentration of our accounts receivable with a limited number of customers increases our credit risk. The failure of these customers to pay their balances, or any other customer to pay future outstanding balances, would result in an operating expense and reduce our cash flows.

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

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

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

Our ability to compete effectively with other companies will depend, in part, on our ability to maintain the proprietary nature of our technology, including our semiconductor designs and software. We provide the computer programming code for our software to customers in connection with their product development efforts, thereby increasing the risk that customers will misappropriate our proprietary software. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to help protect our proprietary technologies. As of June 30, 2008 we held 78 patents and had 75 patent applications pending for protection of our significant technologies. Competitors in both the U.S. and foreign countries, many of whom have substantially greater resources than we do, may apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell our products, or they may develop similar technology independently or design around our patents. Effective copyright, trademark and trade secret protection may be unavailable or limited in foreign countries.

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

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

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

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

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

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

We contract with third-party foundries for wafer fabrication and other manufacturers for packaging, assembly and testing of our products. We do not own or operate a semiconductor fabrication facility and do not have the resources to manufacture our products internally. Our wafers are fabricated by Semiconductor

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Manufacturing International Corporation, Taiwan Semiconductor Manufacturing Corporation and Toshiba Corporation. The wafers used in each of our products are fabricated by only one of these manufacturers.

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

Our requirements represent only a small portion of the total production capacity of our contract manufacturers, who have in the past re-allocated capacity to other customers even during periods of high demand for our products. We expect this may occur again in the future. If we are unable to obtain our products from our contract manufacturers on schedule, our ability to satisfy customer demand will be harmed and revenue from the sale of products may be lost or delayed. If orders for our products are cancelled, expected revenue would not be realized. For example, in the fourth quarter of 2005, one of our contract manufacturers experienced temporary manufacturing delays due to unexpected manufacturing process problems, which caused delays in delivery of our products and made it difficult for us to satisfy our customer demand. We are currently experiencing capacity related delays with one of our primary contract manufacturers that could reduce our ability to satisfy customer demand.

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

Our products require manufacturing with state-of-the-art fabrication equipment and techniques. The lead-time needed to establish a relationship with a new contract manufacturer is at least nine months, and the estimated time for us to adapt a product's design to a particular contract manufacturer's process is at least four months. If we have to qualify a new foundry or packaging, assembly and testing supplier for any of our products, we could incur significant delays in shipping products, which may result in lost revenue and damaged customer relationships.

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

Semiconductor manufacturing technologies change rapidly and manufacturers typically discontinue older manufacturing processes in favor of newer ones. For instance, a portion of our products use embedded dynamic random access memory, ("DRAM") technology, which requires manufacturing processes that are being phased out. We also utilize 0.18um, 0.15um and 0.13um standard logic processes, which may only be available for the next five to seven years. Once a manufacturer makes the decision to retire a manufacturing process, notice is generally given to its customers. Customers will then either retire the affected part or develop a new version of the part that can be manufactured with a newer process. In the event that a manufacturing process is discontinued, our current suppliers may not be able to manufacture our current products. Additionally, migrating to a new, more advanced process requires significant expenditures for research and development and takes significant time. For example in the third quarter of 2006, one of our third-party foundries discontinued the manufacturing process used to produce one of our products. While we were able to place last time buy orders, we underestimated demand for this part. As a result, we had to pay additional amounts to the foundry to restart production and we were unable to fulfill customer orders in a timely manner.

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

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

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

The manufacture of semiconductors is a complex process and it is often difficult for semiconductor foundries to produce semiconductors free of defects. Because many of our products are more highly integrated than other semiconductors and incorporate mixed analog and digital signal processing and embedded memory technology, they are even more difficult to produce without defects. Defective products can be caused by design or manufacturing difficulties. Therefore, identifying quality problems can occur only by analyzing and testing our semiconductors in a system after they have been manufactured. The difficulty in identifying defects is compounded because the process technology is unique to each of the multiple semiconductor foundries we contract with to manufacture our products.

Despite testing by both our customers and us, errors or performance problems may be found in existing or new semiconductors. Failure to achieve defect-free products may result in increased costs and delays in the availability of our products. Additionally, customers could seek damages from us for their losses and shipments of defective products may harm our reputation with our customers.

We have experienced field failures of our semiconductors in certain customer system applications that required us to institute additional testing. As a result of these field failures, we incurred warranty costs due to customers returning potentially affected products. Our customers have also experienced delays in receiving product shipments from us that resulted in the loss of revenue and profits. Shipments of defective products could cause us to lose customers or incur significant replacement costs, either of which would harm our business.

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

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

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

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

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

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

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

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

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

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

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

Sales outside the U.S. accounted for approximately 96% of revenue for the first half of 2008 and years ended December 31, 2007 and 2006. 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;
- foreign currency exchange fluctuations in the currencies of Japan, the People's Republic of China ("PRC"), Taiwan or Korea;
- potentially adverse tax consequences;

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- difficulties regarding timing and availability of export and import licenses;
- political and economic instability, particularly in the PRC, Japan, Taiwan, or Korea;
- reduced or limited protection of our IP, particularly in software, which is more prone to design piracy;
- increased transaction costs related to sales transactions conducted outside of the U.S., such as charges to secure letters of credit;
- difficulties in maintaining sales representatives outside of the U.S. that are knowledgeable about our industry and products;
- changes in the regulatory environment in the PRC, Japan, Taiwan and Korea that may significantly impact purchases of our products by our customers;
- outbreaks of SARS, bird flu or other pandemics in the PRC or other parts of Asia; and
- difficulties in collecting outstanding accounts receivable balances.

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

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

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

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

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

We have historically used stock options and other forms of share-based payment awards as key components of our total compensation program in order to retain employees, officers and directors and to provide competitive compensation and benefit packages. In accordance with Statement of Financial

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Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, (“SFAS 123R”), we began recording stock-based compensation expense for share-based awards in the first quarter of 2006. As a result, we have incurred and will continue to incur significant compensation costs associated with our share-based programs, making it more expensive for us to grant share-based payment awards to employees, officers and directors. To the extent that SFAS 123R makes it more expensive to grant stock options or to continue to have an employee stock purchase plan, we may decide to incur cash compensation costs in the future. Actions that we take to reduce stock-based compensation expense that might be more aggressive than actions implemented by our competitors could make it difficult to attract, retain and motivate employees, officers, or directors, which could adversely affect our competitive position as well as our business and results of operations. As a result of reviewing our equity compensation strategy, in 2006 we reduced the total number of options granted to employees and the number of employees who receive share-based payment awards.

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

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

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

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

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

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

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

- problems combining the acquired operations, technologies or products;
- unanticipated costs;
- diversion of management’s attention from our core business;

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- adverse effects on existing business relationships with customers;
- risks associated with entering markets in which we have no or limited prior experience; and
- potential loss of key employees, particularly those of the acquired organizations.

Our acquisition of Equator has not been as successful as we had anticipated. We acquired Equator for an aggregate purchase price of \$118.1 million and recorded, among other assets, \$57.5 million in goodwill, \$36.8 million in acquired developed technology and \$4.2 million in other acquired intangible assets. However, the Equator technology has not proven as useful as we had hoped, and thus we have recorded impairment losses on goodwill and intangible assets acquired from Equator. Only \$4.5 million of the developed technology acquired from Equator remains on our consolidated balance sheet as of June 30, 2008 and only a few of the Equator employees remain employed by us. Additionally, while we are continuing to provide customers with existing products, we are no longer pursuing stand-alone advanced media processor markets that are not core to our business.

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

We are subject to numerous environmental laws and regulations. Compliance with current or future environmental laws and regulations could require us to incur substantial expenses which could harm our business, financial condition and results of operations. For example, during 2006 the European Parliament enacted the Restriction of Hazardous Substances Directive, or RoHS, which restricts the sale of new electrical and electronic equipment containing certain hazardous substances, including lead. In 2006, we incurred increased inventory provisions as a result of the enactment of RoHS, which adversely affected our gross profit margin. Additionally during 2006, the European Parliament enacted the Waste Electrical and Electronic Equipment Directive, or WEEE Directive, which makes producers of electrical and electronic equipment financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. Additionally, some jurisdictions have begun to require various levels of Electronic Product Environmental Assessment Tool (“EPEAT”) certification, which are based on the Institute of Electrical and Electronics Engineers 1680 standard. The highest levels of EPEAT certification restrict the usage of halogen. Although our older generation products, many of which are still shipping to customers, do contain halogen, our next generation designs do not. 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. These 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.

Risks Related to Our Industry

Insufficient supplies of advanced display components or failure of consumer demand for advanced displays and other digital display technologies to increase would impede our growth and adversely affect our business.

Our product development strategies anticipate that consumer demand for projectors, advanced televisions and other emerging display technologies will increase in the future. The success of our products is

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dependent on increased demand for these display technologies. The potential size of the market for products incorporating these display technologies and the timing the market's development are uncertain and will depend upon a number of factors, all of which are beyond our control. In order for the market in which we participate to grow, advanced display products must be widely available and affordable to consumers. In the past, the supply of advanced display products has been cyclical. We expect this pattern to continue. Under-capacity in the advanced display market may limit our ability to increase our revenue because our customers may limit their purchases of our products if they cannot obtain sufficient supplies of advanced display components. In addition, advanced display prices may remain high because of limited supply, and consumer demand may not grow.

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

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

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

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

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

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In the past, the semiconductor industry has been characterized by significant downturns and wide fluctuations in supply and demand. Also, the industry has experienced significant fluctuations in anticipation of changes in general economic conditions, including economic conditions in Asia and North America. The cyclical nature of the semiconductor industry has led to significant variances in product demand and production capacity. We may experience periodic fluctuations in our future financial results because of changes in industry-wide conditions.

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

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

Other Risks

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

On June 4, 2008, we effected a one-for-three reverse split of our common stock. Though the per share price of our common stock increased to over \$2.00 per share immediately after the reverse split, the price has since declined and we cannot guarantee that we will continue to meet the minimum requirements for listing on the NADAQ Global Market. If the per share price of our common stock drops below \$1.00, our common stock could again become subject to the risk of being delisted and we may seek shareholder approval for an additional reverse split. Even if the per share price of our common stock remains above \$1.00, investors may not be able to sell shares of our common stock at or above the price they paid due to a number of factors, including, but not limited to:

- actual or anticipated fluctuations in our operating results;
- actual reduction in our operating results due to the adoption of SFAS 123R on January 1, 2006, which requires the expensing of stock options;
- changes in expectations as to our future financial performance;
- changes in financial estimates of securities analysts;
- announcements by us or our competitors of technological innovations, design wins, contracts, standards or acquisitions;
- the operating and stock price performance of other comparable companies;
- announcements of future expectations by our customers;
- changes in market valuations of other technology companies; and
- inconsistent trading volume levels of our common stock.

The stock prices of technology companies similar to Pixelworks have been highly volatile. 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. Therefore, the price of our common stock may decline, and the value of your investment may be reduced regardless of our performance. Any scenario in which investors may not be able to realize a gain when they

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sell our common stock would have an adverse effect on our business, financial condition and results of operations, including our ability to attract and retain qualified employees and 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:

- 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 only be removed 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;
- the 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.

We may be unable to meet our future capital requirements, which would limit our ability to grow.

As of June 30, 2008, we had \$89.8 million of unsecured convertible debentures due 2024 outstanding and \$81.7 million in cash and marketable securities, resulting in a net cash deficit position. Although the obligations are due in 2024, the holders of debentures have the right to require us to purchase all or a portion of the \$89.8 million debentures outstanding as of each of the following dates: May 15, 2011, May 15, 2014, and May 15, 2019. Since the market price of our common stock is significantly below the conversion price of the debentures, the holders of our outstanding debentures are unlikely to convert the debentures to common stock in accordance with the existing terms of the debentures. Accordingly, we expect holders of the debentures to require us to purchase all of the outstanding debentures on May 15, 2011.

On September 25, 2007, we announced a share repurchase program under which the board of directors authorized the repurchase of up to \$10.0 million of our common stock over the following twelve months. During 2007, we repurchased 1,260,833 common shares at a cost of \$4.3 million. From January 1, 2008 through June 30, 2008, we repurchased 607,737 shares for \$1.3 million. As of June 30, 2008, \$4.4 million remained available for repurchase under the plan. The above share numbers reflect the one-for-three reverse split of our common stock effected on June 4, 2008.

While we believe that our current cash and marketable securities balances will be sufficient to meet our capital requirements for the next twelve months, we cannot assure you that we will be able to generate

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sufficient cash flows from operations in the future to refinance or service the potential exercise of the put option on the convertible debentures. We may need, or could elect to seek, additional funding prior to that time through public or private equity or debt financing. Additional funds may not be available on terms favorable to us or our shareholders. Furthermore, 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. If we cannot raise funds on acceptable terms, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements.

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

We are spending 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 the Sarbanes-Oxley Act of 2002, new Securities and Exchange Commission rules and regulations and NASDAQ Global Market rules. In particular, Section 404 of the Sarbanes-Oxley Act of 2002 requires management's annual review and evaluation of internal control over financial reporting. While we invested significant time and money in our effort to evaluate and test our internal control over financial reporting, a material weakness was identified in our internal control over financial reporting in 2004. Although the material weakness was remediated in the first quarter of 2005, there are inherent limitations to the effectiveness of any system of internal controls and procedures, including cost limitations, the possibility of human error, judgments and assumptions regarding the likelihood of future events, and the circumvention or overriding of the controls and procedures. Accordingly, even effective controls and procedures can provide only reasonable assurance of achieving their control objectives.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

The following table sets forth information about shares repurchased during the second quarter of 2008 under the share repurchase program we announced on September 25, 2007 (in thousands except share and per share data). These numbers reflect the one-for-three reverse split of our common stock effected on June 4, 2008.

Period	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs
April 1, 2008 - April 30, 2008	—	\$ —	—	\$ 4,533
May 1, 2007 - May 31, 2008	—	—	—	4,533
June 1, 2008 - June 30, 2008	76,470	2.26	76,470	4,360
Total	<u>76,470</u>	\$ 2.26	<u>76,470</u>	

- (1) All purchases made on the open market pursuant to the share repurchase program announced on September 25, 2007, under which the board of directors authorized the repurchase of up to \$10.0 million of our common stock over the next twelve months. The program does not obligate us to acquire any particular amount of common stock and may be modified or suspended at any time at our discretion.

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Share repurchases under the program may be made through open market or privately negotiated transactions at our discretion, subject to market conditions and other factors.

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

The 2008 Annual Meeting of Shareholders of Pixelworks, Inc. was held on May 20, 2008 to conduct the following items of business:

1. To elect seven Directors to serve one-year terms and until their successors are duly elected and qualified;
2. Approval of amendment to the 2006 Stock Incentive Plan;
3. Grant of discretionary authority to the Board of Directors to amend the articles of incorporation of the Company to effect a reverse stock split at an exchange ratio within the specified range and at any time on or prior to the date of the 2009 Annual Meeting of Shareholders;
4. To ratify the appointment of KPMG LLP as Pixelworks' independent registered public accounting firm for the current fiscal year; and
5. To transact any other business that properly came before the meeting or any postponement or adjournment of the meeting.

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

Nominee	For	Withheld	Term Ending
Allen H. Alley	34,129,508	4,353,922	2009
Mark A. Christensen	33,941,203	4,542,227	2009
James R. Fiebiger	33,561,466	4,921,964	2009
C. Scott Gibson	33,673,903	4,809,527	2009
Daniel J. Heneghan	33,947,153	4,536,277	2009
Hans H. Olsen	34,205,186	4,278,244	2009
Bruce A. Walicek	34,648,155	3,835,275	2009

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

	No. of Votes
For	12,588,912
Against	2,100,839
Abstain	44,055
Broker Non-Votes	23,749,624

The proposal to grant discretionary authority to the Board of Directors to amend the articles of incorporation of the Company to effect a reverse stock split at an exchange ratio within the specified range and at any time on or prior to the date of the 2009 Annual Meeting of Shareholders was approved and received the following votes:

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	No. of Votes
For	35,644,133
Against	2,638,141
Abstain	201,155

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

	No. of Votes
For	36,415,572
Against	1,924,888
Abstain	142,969

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

Item 6. Exhibits.

3.1 Third Amendment to Sixth Amended and Restated Articles of Incorporation of Pixelworks, Inc.

10.1 Pixelworks, Inc. 2008 Senior Management Bonus Plan. +

10.2 Amended and Restated 2006 Stock Incentive Plan. +

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.

SIGNATURE

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

PIXELWORKS, INC.

Dated: August 11, 2008

/s/ Steven L. Moore

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

**THIRD AMENDMENT TO
SIXTH AMENDED AND RESTATED ARTICLES OF INCORPORATION
OF
PIXEL WORKS, INC.**

Pursuant to the Oregon Business Corporation Act (ORS Chapter 60), Pixelworks, Inc. (the "Corporation") hereby adopts the following Third Amendment to its Sixth Amended and Restated Articles of Incorporation.

1. Section 2.5 is added to ARTICLE 2. to read as follows:

2.5 Reverse Stock Split. Effective as of June 4, 2008 at 12:01 am, each three (3) shares of Common Stock, \$.001 par value per share (the "Old Common Stock"), then issued and outstanding shall automatically be combined into one (1) share of Common Stock, \$.001 par value per share (the "New Common Stock"), of the Corporation without any further action by the holders of such shares of Old Common Stock.

a. Fractional Shares. Any fractional shares resulting from that exchange will not be issued, but will be paid out in cash equal to such fraction multiplied by the closing trading price of the Corporation's Common Stock on the Nasdaq Global Market or the Nasdaq Capital Market, as the case may be, on the trading day immediately before the Effective Date.

b. Effect of Old Certificates. Each stock certificate representing shares of Old Common Stock shall thereafter represent that number of shares of New Common Stock into which the shares of Old Common Stock represented by such certificate shall have been combined.

c. Exchange. Each person holding of record a stock certificate or certificates that represented shares of Old Common Stock shall receive, upon surrender of such certificate or certificates, a new certificate or certificates evidencing and representing the number of shares of New Common Stock to which such person is entitled, or, at the discretion of the Corporation and unless otherwise instructed by such holder, book-entry shares in lieu of a new certificate or certificates evidencing and representing the number of whole shares of New Common Stock to which such person is entitled, under the foregoing reclassification and combination,

d. Rights of New Common Stock. The New Common Stock issued in this exchange shall have the same rights, preferences and privileges as the Common Stock (as defined below).

2. Section 3.2 of ARTICLE 3. is amended by deleting the first sentence thereof.



2008 SENIOR MANAGEMENT BONUS PLAN

PURPOSE

The 2008 Senior Management Bonus Plan ("2008 Bonus Plan") was adopted to promote a shared sense of responsibility for growth and financial success of Pixelworks, Inc. (the "Company"). The 2008 Bonus Plan is intended to motivate and reward Plan Participants for both Company and individual performance.

DEFINITIONS

Plan Participant	An employee of the Company or its subsidiaries, approved by the Plan Administrator for participation in the 2008 Bonus Plan.
Target Bonus	A percentage of base pay intended to be paid to a Plan Participant if 100% of goals are achieved. Detailed in Exhibit A.
Bonus Payout	The actual award to the Plan Participant.
Plan Administrator	The Company's Board of Directors, acting through its Compensation Committee. The Committee may assign certain administrative duties related to the 2008 Bonus Plan to employees of the Company.
Plan Year	January 1, 2008 through December 31, 2008.
Performance Measures and Goals	Specific financial and operational goals approved by the Plan Administrator.
Termination	Cessation of employment for any reason except retirement, death or disability.

PARTICIPATION

An employee must meet the following criteria to participate in the 2008 Bonus Plan:

- Be a regular full-time employee of the Company or any of its subsidiaries in a Director, Principal Architect, Senior Director, Fellow, Chief Architect, Senior Fellow, Vice President, Chief Financial Officer ("CFO"), President and/or Chief Executive Officer ("CEO"), or equivalent position;
 - Be employed in an eligible position for a minimum of three months during the 2008 calendar year; and
 - Be actively employed by the Company on the day the bonus is approved by the Plan Administrator, anticipated to be on a date in the first quarter of 2009. If employment is terminated for any reason other than death, retirement or extended disability before the Plan Administrator approves the bonus, the award shall be forfeited.
-

PERFORMANCE MEASURES AND GOALS

Two specific results must be achieved for any bonus amounts to be earned under the 2008 Bonus Plan:

- (1) Revenue must meet or exceed a baseline target that has been established for the year ending December 31, 2008.
- (2) Earnings Before Interest, Taxes, Depreciation and Amortization (“EBITDA”) must be positive in all four quarters of 2008.

If both of the above results are achieved, bonuses will be calculated based on attainment of specific goals related to each of the following measures:

- (1) Revenue

The bonus, if any, related to this measure is based on the excess of actual revenue over the baseline target, up to a specified maximum amount.

- (2) EBITDA

The bonus, if any, related to this measure is based on the excess of actual EBITDA over a baseline target, up to a specified maximum amount.

- (3) Product Design Wins

The bonus, if any, related to this measure is based on the number of actual design wins achieved as a percentage of a pre-determined quantity of qualifying design wins.

- (4) New Product Introductions

The bonus, if any, related to this measure is based on the number of actual new product introductions achieved as a percentage of a pre-determined quantity of qualifying new product introductions.

A weight is assigned to each of the four Performance Measures above. The weight assigned represents the maximum percentage of the Target Bonus that can be earned through that Performance Measure when all of the goals related to the Performance Measure are met. The weight assigned to each of the four Performance Measures varies by Participant, based on the Plan Participant’s position / function with the Company.

The specific goals for each of the four Performance Measures above are included in Appendix B. The weight assigned to each of the Performance Measures is detailed in Appendix C.

DISCRETIONARY ELEMENT

The CEO has authority to recommend adjustments to Target Bonuses for individual performance, extraordinary results or other uncommon factors. The Plan Administrator will approve discretionary adjustments.

AWARD DISTRIBUTION

Bonus payouts will be based on actual salary paid during the Plan Year. Salary will include all base pay, but will exclude any allowances, bonus payments or other compensation. Awards will be distributed in the first quarter of 2009.

PRO-RATA AWARDS

If the Participant is promoted, demoted, or changes job responsibilities during the year, his/her Target Bonus will be re-evaluated. If a change is warranted, it will be effective on the date of the change in responsibilities for the balance of the year. All mid-year participation will be paid on a pro-rata basis based on the percentage of time spent as a participant in the plan. If the Participant is no longer in an eligible position due to a change in responsibilities or demotion, any accrued bonus shall be forfeited.

All pro-rata awards will be determined by using the salary actually paid to the Participant during the portion of the Plan Year that the individual was a Participant.

A Plan Participant may receive a pro-rata share of an award if he or she leaves the company during the year due to death, retirement, or extended disability.

PLAN ADMINISTRATION AND AUTHORITIES

Bonus awards are not earned until approved by the Plan Administrator.

To provide for unusual occasions when business achievement is realized through little or no effort on the part of the Plan Participants, the Plan Administrator reserves the right to declare such business a "windfall." Windfall business is subject to special treatment. Such treatment will be handled at the sole discretion of the Plan Administrator.

Adjustments to performance may be made to provide for circumstances where performance is not achieved due to factors beyond the control of the Participants. Such treatment will be handled at the sole discretion of the Plan Administrator.

This Plan is not a contract of employment. It creates no rights for the Plan Participant to continue employment with the Company for any length of time, nor does it create any rights for the Plan Participant or any obligations on the part of the Company, other than those set forth herein.

The CEO shall have the authority to act as the final arbiter of any appeals, disputes or interpretations emanating from the 2008 Bonus Plan except in matters related to his own participation. All decisions, actions or interpretations by the CEO shall be final and conclusive and binding on all parties. The Plan Administrator shall arbitrate any disputes related to the CEO's participation.

The Company reserves the right, in its sole discretion, to continue, amend, modify or terminate the 2008 Bonus Plan at any time.

PIXELWORKS, INC.
2008 SENIOR MANAGEMENT BONUS PLAN
APPENDIX A: TARGET BONUS PERCENTAGES

Following are the Target Bonus Percentages for the President, Chief Executive Officer, Chief Financial Officer and other Vice Presidents:

<u>Position(s)</u>	<u>Target Bonus</u>
President, Chief Executive Officer	100%
Chief Financial Officer, Vice President	50%

Following are the Target Bonus Percentages for other members of Senior Management:

[confidential]

PIXELWORKS, INC.
2008 SENIOR MANAGEMENT BONUS PLAN
APPENDIX B: PERFORMANCE MEASURES AND GOALS
[confidential]

PIXELWORKS, INC.
2008 SENIOR MANAGEMENT BONUS PLAN

APPENDIX C: PERFORMANCE MEASURES AND GOALS: WEIGHTING

The weighting of each of the four Performance Measures is as follows for the President, Chief Executive Officer, Chief Financial Officer and other Vice Presidents:

Performance Measure	Weighting
Revenue	25%
EBITDA	25%
Product Design Wins	25%
New Product Introductions	25%

The weighting of each of the four Performance Measures is as follows for other members of Senior Management:

[confidential]

PIXELWORKS, INC.

AMENDED AND RESTATED 2006 STOCK INCENTIVE PLAN

1. Purposes of the Plan. The purposes of this Stock Incentive Plan are to attract, retain and reward individuals who can and do contribute to the Company's success by providing Employees and Consultants an opportunity to share in the equity of the Company and to more closely align their interests with the Company and its shareholders.

2. Definitions. As used herein, the following definitions shall apply:

2.1. **Administrator** shall mean the Board or any of its Committees appointed to administer the Plan, in accordance with Section 4.1.

2.2. **Board** shall mean the Board of Directors of the Company.

2.3. **Code** shall mean the Internal Revenue Code of 1986, as amended.

2.4. **Committee** shall mean a committee appointed by the Board in accordance with Section 4.1 of the Plan.

2.5. **Common Stock** shall mean the common stock of the Company.

2.6. **Company** shall mean Pixelworks, Inc., an Oregon corporation.

2.7. **Consultant** shall mean any non-Employee who is engaged by the Company or any Parent or Subsidiary to render consulting services and is compensated for such consulting services and any Director of the Company whether compensated for such services or not.

2.8. **Continuous Status as an Employee or Consultant** shall mean the absence of any interruption or termination of service as an Employee or Consultant. Continuous Status as an Employee or Consultant shall not be considered interrupted in the case of: (i) any sick leave, military leave, or any other leave of absence approved by the Company; provided, however, that for purposes of Incentive Stock Options, any such leave is for a period of not more than ninety days or reemployment upon the expiration of such leave is guaranteed by contract or statute, provided, further, that on the ninety-first day of such leave (where re-employment is not guaranteed by contract or statute) the Grantee's Incentive Stock Option shall automatically convert to a Nonqualified Stock Option; or (ii) transfers between locations of the Company or between the Company, its Parent, its Subsidiaries or its successor.

2.9. **Director** shall mean a member of the Board.

2.10. **Disability** shall mean total and permanent disability as defined in Section 22(e)(3) of the Code.

2.11. **Employee** shall mean any person, including Officers and Directors, employed by the Company or any Parent or Subsidiary. Neither the payment of a director's fee by the Company nor service as a Director or Consultant shall be sufficient to constitute "employment" by the Company.

2.12. “**Exchange Act**” shall mean the Securities Exchange Act of 1934, as amended.

2.13. “**Fair Market Value**” shall mean, as of any date, the value of a Share determined as follows:

2.13.1. If the Common Stock is listed on any established stock exchange or a national market system, including without limitation the Nasdaq National Market or the Nasdaq SmallCap Market of the Nasdaq Stock Market, Fair Market Value shall be the closing sales price for a Share (or the closing bid, if no sales were reported) as quoted on such exchange or system on the date of determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable; provided, if the date of determination does not fall on a day on which the Common Stock has traded on such securities exchange or market system, the date on which the Fair Market Value shall be established shall be the last day on which the Common Stock was so traded prior to the date of determination, or such other appropriate day as shall be determined by the Administrator, in its sole discretion;

2.13.2. If the Common Stock is regularly quoted by a recognized securities dealer but selling prices are not reported, Fair Market Value shall be the mean between the high bid and low asked prices for a Share on the date of determination, as reported in *The Wall Street Journal* or such other source as the Administrator deems reliable; provided, if the date of determination does not fall on a day on which the Common Stock has been so quoted, the date on which the Fair Market Value shall be established shall be the last day on which the Common Stock was so quoted prior to the date of determination, or such other appropriate day as shall be determined by the Administrator, in its sole discretion;

2.13.3. In the absence of an established market for the Common Stock, the Fair Market Value of a Share shall be determined in good faith by the Administrator.

2.14. “**Grantee**” shall mean an Employee or Consultant who holds an Option or Stock Appreciation Right, or their permitted successor or legal representative.

2.15. “**Incentive Stock Option**” shall mean an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.

2.16. “**Nonqualified Stock Option**” shall mean an Option not intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.

2.17. “**Notice of Grant**” shall mean a written notice evidencing certain terms and conditions of an individual Option or Stock Appreciation Right. The Notice of Grant is part of the Option or Stock Appreciation Right Agreement.

2.18. “**Officer**” shall mean a person who is an officer of the Company within the meaning of Section 16 of the Exchange Act and the rules and regulations promulgated thereunder.

2.19. “**Option**” shall mean an Incentive Stock Option or a Nonqualified Stock Option granted pursuant to the Plan.

2.20. “**Option Agreement**” shall mean a written agreement between the Company and a

Grantee evidencing the terms and conditions of an individual Option grant. The Option Agreement is subject to the terms and conditions of the Plan.

2.21. **“Optioned Stock”** shall mean the Shares subject to an Option or Stock Appreciation Right.

2.22. **“Parent”** shall mean a “parent corporation,” whether now or hereafter existing, as defined in Section 424(e) of the Code.

2.23. **“Plan”** shall mean this Amended and Restated 2006 Stock Incentive Plan.

2.24. **“Rule 16b-3”** shall mean Rule 16b-3 of the Exchange Act or any successor to Rule 16b-3, as in effect when discretion is being exercised with respect to the Plan.

2.25. **“Sale”** or **“Sold”** shall include, with respect to the sale of Shares under the Plan, the sale of Shares for any form of consideration specified in Section 8.2, as well as a grant of Shares for consideration in the form of past or future services.

2.26. **“Share”** shall mean a share of the Common Stock, as adjusted in accordance with Section 11 of the Plan.

2.27. **“SAR Agreement”** means a written agreement between the Company and a Grantee evidencing the terms and conditions of an individual Stock Appreciation Right. The SAR Agreement is subject to the terms and conditions of the Plan.

2.28. **“Stock Appreciation Right”** or **“SAR”** shall mean a right to receive from the Company, with respect to each Share as to which the SAR is exercised, payment in an amount equal to the excess of the Share’s Fair Market Value on the exercise date over its Fair Market Value on the date the SAR was granted. Such payment will be made solely in Shares valued at Fair Market Value on the exercise date.

2.29. **“Subsidiary”** shall mean a “subsidiary corporation,” whether now or hereafter existing, as defined in Section 424(f) of the Code.

3. Stock Subject to the Plan.

3.1. Subject to the provisions of Section 3.2 below and the provisions of Section 11 of the Plan, the maximum aggregate number of Shares which may be subject to Options, SARs and/or Sold under the Plan is 7,000,000 shares. The Shares may be authorized, but unissued, or reacquired Common Stock.

3.2. If an Option or SAR should expire, or become unexercisable for any reason, or is otherwise terminated or forfeited, without having been exercised in full, the Optioned Stock which was subject thereto shall, unless the Plan shall have been terminated, become available for future Option or SAR grants and/or Sales under the Plan. If any Shares issued pursuant to a Sale or exercise of an Option or SAR shall be reacquired, canceled or forfeited for any reason, such Shares shall become available for future Option or SAR grants and/or Sales under the Plan, unless the Plan shall have been terminated. If any reacquired, canceled or forfeited Shares were

originally issued upon exercise of an Incentive Stock Option, then once so reacquired, canceled or forfeited, such Shares shall not be considered to have been issued for purposes of applying the limitation set forth in Section 3.3 below.

3.3. Notwithstanding any other provision of this Section 3, the maximum number of Shares that may be issued upon the exercise of Incentive Stock Options shall be 7,000,000.

4. Administration of the Plan.

4.1. Procedure.

4.1.1. **Multiple Administrative Committees.** If permitted by Rule 16b-3, the Plan may be administered by different Committees with respect to Directors, Officers who are not Directors, and Employees who are neither Directors nor Officers.

4.1.2. **Administration With Respect to Directors and Officers Subject to Section 16(b).** With respect to Option or SAR grants or Sales to Employees who are also Officers or Directors subject to Section 16(b) of the Exchange Act, the Plan shall be administered by (A) the Board, if the Board may administer the Plan in compliance with the rules governing a plan intended to qualify as a discretionary plan under Rule 16b-3, or (B) a Committee designated by the Board to administer the Plan, which Committee shall be constituted to comply with the rules, if any, governing a plan intended to qualify as a discretionary plan under Rule 16b-3. Once appointed, such Committee shall continue to serve in its designated capacity until otherwise directed by the Board. From time to time the Board may increase the size of the Committee and appoint additional members, remove members (with or without cause) and substitute new members, fill vacancies (however caused), and remove all members of the Committee and thereafter directly administer the Plan, all to the extent permitted by the rules, if any, governing a plan intended to qualify as a discretionary plan under Rule 16b-3. With respect to persons subject to Section 16 of the Exchange Act, transactions under the Plan are intended to comply with all applicable conditions of Rule 16b-3. To the extent any provision of the Plan or action by the Administrator fails to so comply, it shall be deemed null and void, to the extent permitted by law and deemed advisable by the Administrator.

4.1.3. **Administration With Respect to Other Persons.** With respect to Option or SAR grants or Sales to Employees or Consultants who are neither Directors nor Officers of the Company, the Plan shall be administered by the Board or a Committee designated by the Board, which Committee shall be constituted to satisfy the legal requirements relating to the administration of stock option plans under applicable corporate and securities laws and the Code. Once appointed, such Committee shall serve in its designated capacity until otherwise directed by the Board. The Board may increase the size of the Committee and appoint additional members, remove members (with or without cause) and substitute new members, fill vacancies (however caused), and remove all members of the Committee and thereafter directly administer the Plan, all to the extent permitted by the legal requirements relating to the administration of stock option plans under state corporate and securities laws and the Code.

4.2. **Powers of the Administrator.** Subject to the provisions of the Plan, and in the case of a Committee, subject to the specific duties delegated by the Board to such Committee, the

Administrator shall have the authority, in its discretion:

- 4.2.1. to grant Incentive Stock Options, Nonqualified Stock Options, or SARs;
 - 4.2.2. to authorize Sales of Shares hereunder;
 - 4.2.3. to determine, upon review of relevant information, the Fair Market Value of a Share;
 - 4.2.4. to determine the exercise/purchase price per Share of Options or SARs to be granted or Shares to be Sold, which exercise/purchase price shall be determined in accordance with Section 8.1 of the Plan;
 - 4.2.5. to determine the Employees or Consultants to whom, and the time or times at which, Options or SARs shall be granted and the number of Shares to be represented by each Option or SAR;
 - 4.2.6. to determine the Employees or Consultants to whom, and the time or times at which, Shares shall be Sold and the number of Shares to be Sold;
 - 4.2.7. to administer and interpret the Plan;
 - 4.2.8. to prescribe, amend and rescind rules and regulations relating to the Plan;
 - 4.2.9. to determine the terms and provisions of each Option or SAR granted (which need not be identical) and, with the consent of the holder thereof, modify or amend each Option or SAR;
 - 4.2.10. to determine the terms and provisions of each Sale of Shares (which need not be identical) and, with the consent of the purchaser thereof, modify or amend each Sale;
 - 4.2.11. to accelerate (with the consent of the Grantee) the exercise date of any Option;
 - 4.2.12. to accelerate (with the consent of the Grantee or purchaser of Shares) the vesting restrictions applicable to Shares Sold or Options or SARs granted under the Plan;
 - 4.2.13. to authorize any person to execute on behalf of the Company any instrument required to effectuate the grant of an Option, SAR or Sale of Shares previously granted or authorized by the Administrator;
 - 4.2.14. to determine the transfer or vesting restrictions, repurchase rights or other restrictions applicable to Shares issued under the Plan;
 - 4.2.15. to establish, on a case-by-case basis, different terms and conditions pertaining to exercise or vesting rights upon termination of employment, but only at the time of an Option or SAR grant or Sale of Shares;
 - 4.2.16. to approve forms for use under the Plan;
 - 4.2.17. To reduce the exercise price of any Option to the then current fair market value if the fair market value of the Common Stock covered by such Option shall have declined since the
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date the Option was granted; provided, however, that the Administrator may not reduce the exercise price of any outstanding Option without shareholder approval; and

4.2.18. to make all other determinations deemed necessary or advisable for the administration of the Plan.

4.3. **Effect of Administrator's Decision.** All decisions, determinations and interpretations of the Administrator shall be final and binding on all Grantees and any other holders of any Shares Sold under the Plan.

5. Eligibility.

5.1. **Persons Eligible.** Options and SARs may be granted and/or Shares Sold only to Employees and Consultants. Incentive Stock Options may be granted only to Employees. An Employee or Consultant who has been granted an Option, SAR or Sold Shares may, if he or she is otherwise eligible, be granted additional Options, SARs or Sold additional Shares.

5.2. **ISO Limitation.** To the extent that the aggregate Fair Market Value of Shares subject to a Grantee's Incentive Stock Options granted by the Company, any Parent or Subsidiary which become exercisable for the first time during any calendar year (under all plans of the Company or any Parent or Subsidiary) exceeds \$100,000, such excess Options shall be treated as Nonqualified Stock Options. For purposes of this Section 5.2, Incentive Stock Options shall be taken into account in the order in which they were granted, and the Fair Market Value of the Shares shall be determined as of the time of grant.

5.3. **Section 5.2 Limitations.** Section 5.2 of the Plan shall apply only to an Option evidenced by an Option Agreement which sets forth the intention of the Company and the Grantee that such Option shall qualify as an Incentive Stock Option. Section 5.2 of the Plan shall not apply to any Option evidenced by a Option Agreement which sets forth the intention of the Company and the Grantee that such Option shall be a Nonqualified Stock Option.

5.4. **No Right to Continued Employment.** The Plan shall not confer upon any Grantee any right with respect to continuation of employment or consulting relationship with the Company, nor shall it interfere in any way with his or her right or the Company's right to terminate their employment or consulting relationship at any time, with or without cause.

5.5. **Other Limitations.** The following limitations shall apply to grants of Options or SARs to Employees:

5.5.1. No Employee shall be granted, in any fiscal year of the Company, Options or SARs to acquire more than 300,000 Shares.

5.5.2. In connection with his or her initial employment, an Employee may be granted Options or SARs for up to an additional 300,000 Shares which shall not count against the limit set forth in subsection 5.5.1 above.

5.5.3. The foregoing limitations shall be adjusted proportionately in connection with any change in the Company's capitalization as described in Section 11.

5.5.4. If an Option or SAR is canceled in the same fiscal year of the Company in which it was granted (other than in connection with a transaction described in Section 11), the canceled Option or SAR shall be counted against the limits set forth in subsections 5.5.1 and 5.5.2 above.

6. Term of Plan. The Plan shall become effective upon the earlier to occur of its adoption by the Board or its approval by the shareholders of the Company as described in Section 17 of the Plan. It shall continue in effect for a term of ten (10) years, unless sooner terminated under Section 13 of the Plan. However, if the Company's shareholders approve an increase in the number of Shares available for issuance under section 3.1, such approval shall be deemed the adoption of a new plan with respect to the increased number of Shares, which may be issued for a term of ten (10) years following the date of such shareholder approval.

7. Term of Options and SARs. The term of each Option and SAR shall be stated in the Notice of Grant; provided, however, that in the case of an Incentive Stock Option, the term shall be ten (10) years from the date of grant or such shorter term as may be provided in the Notice of Grant. However, in the case of an Incentive Stock Option granted to a Grantee who, on the date the Incentive Stock Option is granted, owns stock representing more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the term of the Incentive Stock Option shall be five (5) years from the date of grant thereof or such shorter term as may be provided in the Notice of Grant.

8. Exercise/Purchase Price and Consideration.

8.1. Exercise/Purchase Price. The per Share exercise/purchase price for the Shares to be issued pursuant to exercise of an Option, SAR or a Sale shall be such price as is determined by the Administrator, but shall be subject to the following:

8.1.1. In the case of an Incentive Stock Option

(1) granted to an Employee who, at the time of the grant of such Incentive Stock Option, owns more than ten percent (10%) of the voting power of all classes of stock of the Company or any Parent or Subsidiary, the per Share exercise price shall be at least one hundred ten percent (110%) of the Fair Market Value on the date of the grant.

(2) granted to any other Employee, the per Share exercise price shall be at least one hundred percent (100%) of the Fair Market Value on the date of grant.

8.1.2. In the case of a Nonqualified Stock Option, SAR or Sale, the per Share exercise/purchase price shall be at least one hundred percent (100%) of the Fair Market Value on the date of grant or Sale, as the case may be.

8.2. Consideration. The consideration to be paid for the Shares to be issued upon exercise of an Option or pursuant to a Sale, including the method of payment, shall be determined by the Administrator. In the case of an Incentive Stock Option, the Administrator shall determine the acceptable form of consideration at the time of grant. Such consideration may consist of:

8.2.1. cash;

8.2.2. check;

8.2.3. promissory note;

8.2.4. transfer to the Company of Shares which

and (1) in the case of Shares acquired upon exercise of an Option, have been owned by the Grantee for more than six months on the date of transfer,

(2) have a Fair Market Value on the date of transfer equal to the aggregate exercise price of the Shares to be acquired;

8.2.5. if and so long as the Common Stock is registered under Section 12(b) or 12(g) of the Exchange Act, delivery of a properly executed exercise notice together with irrevocable instructions to a broker to promptly deliver to the Company the amount of sale or loan proceeds required to pay the exercise price;

8.2.6. such other consideration and method of payment for the issuance of Shares to the extent permitted by legal requirements relating to the administration of stock option plans and issuances of capital stock under applicable corporate and securities laws and the Code; or

8.2.7. any combination of the foregoing methods of payment.

If the Fair Market Value of the number of whole Shares transferred or the number of whole Shares surrendered is less than the total exercise price of the Option, the shortfall must be made up in cash or by check. Notwithstanding the foregoing provisions of this Section 8.2, the consideration for Shares to be issued pursuant to a Sale may not include, in whole or in part, the consideration set forth in subsection 8.2.5 above.

9. Exercise of Option or SAR.

9.1. Procedure for Exercise; Rights as a Shareholder. Any Option or SAR granted hereunder shall be exercisable at such times and under such conditions as determined by the Administrator, including performance criteria with respect to the Company and/or the Grantee, and as shall be permissible under the terms of the Plan.

An Option or SAR may not be exercised for a fraction of a Share. If the exercise of a SAR would result in the issuance of a fractional Share, the Shares to be issued shall be rounded to the nearest whole Share.

An Option or SAR shall be deemed to be exercised when written notice of such exercise has been given to the Company in accordance with the terms of the Option or SAR by the Grantee and full payment for the Shares with respect to which the Option is exercised has been received by the Company. Full payment may, as authorized by the Administrator, consist of any consideration and method of payment allowable under the Option Agreement and Section 8.2 of the Plan. Each Grantee who exercises an Option or SAR shall, upon notification of the amount due (if any) and prior to or concurrent with delivery of the certificate representing the Shares, pay to the Company amounts necessary to satisfy applicable federal, state and local tax

withholding requirements. A Grantee must also provide a duly executed copy of any stock transfer agreement then in effect and determined to be applicable by the Administrator. Until the issuance (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the stock certificate evidencing such Shares, no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the Optioned Stock represented by such stock certificate, notwithstanding the exercise of the Option or SAR. No adjustment will be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in Section 11 of the Plan. Subject to section 3, exercise of an Option or settlement of a SAR shall decrease the number of Shares thereafter available, both for purposes of the Plan and for issuance under the Option or SAR by the number of Shares issued upon such exercise.

9.2. Termination of Employment or Consulting Relationship. In the event that a Grantee's Continuous Status as an Employee or Consultant terminates (other than upon the Grantee's death or Disability), the Grantee may exercise his or her Option or SAR, but only within such period of time as is determined by the Administrator, and only to the extent that the Grantee was entitled to exercise it at the date of termination (but in no event later than the expiration of the term of such Option or SAR as set forth in the Notice of Grant). In the case of an Incentive Stock Option, the Administrator shall determine such period of time (in no event to exceed three (3) months from the date of termination) when the Option is granted. If, at the date of termination, the Grantee is not entitled to exercise his or her entire Option or SAR, the Shares covered by the unexercisable portion of the Option or SAR shall revert to the Plan. If, after termination, the Grantee does not exercise his or her Option or SAR within the time specified by the Administrator, the Option or SAR shall terminate, and the Shares covered by such Option shall revert to the Plan.

9.3. Disability of Grantee. In the event that a Grantee's Continuous Status as an Employee or Consultant terminates as a result of the Grantee's Disability, the Grantee may exercise his or her Option or SAR at any time within twelve (12) months from the date of such termination, but only to the extent that the Grantee was entitled to exercise it at the date of such termination (but in no event later than the expiration of the term of such Option or SAR as set forth in the Notice of Grant). If, at the date of termination, the Grantee is not entitled to exercise his or her entire Option or SAR, the Shares covered by the unexercisable portion of the Option or SAR shall revert to the Plan. If, after termination, the Grantee does not exercise his or her Option or SAR within the time specified herein, the Option or SAR shall terminate, and the Shares covered by such Option or SAR shall revert to the Plan.

9.4. Death of Grantee. In the event of the death of a Grantee, the Option or SAR may be exercised at any time within twelve (12) months following the date of death (but in no event later than the expiration of the term of such Option or SAR as set forth in the Notice of Grant), by the Grantee's estate or by a person who acquired the right to exercise the Option or SAR by bequest or inheritance, but only to the extent that the Grantee was entitled to exercise the Option or SAR at the date of death. If, at the time of death, the Grantee was not entitled to exercise his or her entire Option or SAR, the Shares covered by the unexercisable portion of the Option or SAR shall revert to the Plan. If, after death, the Grantee's estate or a person who acquired the right to exercise the Option or SAR by bequest or inheritance does not exercise the Option or SAR within the time specified herein, the Option or SAR shall terminate, and the Shares covered

by such Option shall revert to the Plan.

9.5. **Rule 16b-3.** Options or SARs granted to persons subject to Section 16(b) of the Exchange Act must comply with Rule 16b-3 and shall contain such additional conditions or restrictions as may be required thereunder to qualify for the maximum exemption from Section 16 of the Exchange Act with respect to Plan transactions.

10. Nontransferability of Options and SARs. Except as otherwise specifically provided in the Option or SAR Agreement, an Option or SAR may not be sold, pledged, assigned, hypothecated, transferred or disposed of in any manner other than by will, or by the laws of descent and distribution, and may be exercised during the lifetime of the Grantee only by the Grantee or, if incapacitated, by his or her legal guardian or legal representative.

11. Adjustments Upon Changes in Capitalization or Merger.

11.1. **Changes in Capitalization.** Subject to any required action by the shareholders of the Company, the number of shares of Common Stock covered by each outstanding Option or SAR and the number of shares of Common Stock which have been authorized for issuance under the Plan but as to which no Options or SARs have yet been granted or Sales made or which have been returned to the Plan upon cancellation or expiration of an Option or SAR, as well as the price per share of Common Stock covered by each such outstanding Option or SAR, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, stock dividend, combination or reclassification of the Common Stock, or any other increase or decrease in the number of issued shares of Common Stock effected without receipt of consideration by the Company; provided, however, that conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Administrator, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Optioned Shares.

11.2. **Dissolution or Liquidation.** In the event of the proposed dissolution or liquidation of the Company, each outstanding Option or SAR will terminate immediately prior to the consummation of such proposed action, unless otherwise provided by the Administrator. The Administrator may, in the exercise of its sole discretion in such instances, declare that any Option or SAR shall terminate as of a date fixed by the Board and give each Grantee the right to exercise Grantee's Option or SAR as to all or any part of the Optioned Stock subject to the Option or SAR, including Shares as to which the Option or SAR would not otherwise be exercisable.

11.3. **Merger or Asset Sale.** Except as otherwise provided in an Option or SAR Agreement, in the event of a proposed sale of all or substantially all of the assets of the Company, or the merger of the Company with or into another corporation, each outstanding Option or SAR shall be assumed or an equivalent option shall be substituted by such successor corporation or a Parent or Subsidiary of such successor corporation, unless the Administrator determines, in the exercise of its sole discretion and in lieu of such assumption or substitution, that each Grantee

shall have the right to exercise the Grantee's Options or SARs as to all or any part of the Optioned Stock subject to the Option or SAR, including Shares as to which the Option or SAR would not otherwise be exercisable. If the Administrator determines that an Option or SAR shall be exercisable in lieu of assumption or substitution in the event of a merger or sale of assets, the Administrator shall notify the Grantee that the Option or SAR shall be so exercisable for a period of thirty (30) days from the date of such notice or such shorter period as the Administrator may specify in the notice, and the Option or SAR will terminate upon the expiration of such period. For the purposes of this paragraph, the Option or SAR shall be considered assumed or substituted if, following the merger or sale of assets, the Option or SAR confers the right to purchase, for each Share of Optioned Stock subject to the Option or SAR immediately prior to the merger or sale of assets, the consideration (whether stock, cash, or other securities or property) received in the merger or sale of assets by holders of Common Stock for each Share held on the effective date of the transaction (and if holders were offered a choice of consideration, the type of consideration chosen by the holders of a majority of the outstanding Shares); provided, however, that if such consideration received in the merger or sale of assets was not solely common stock of the successor corporation or its Parent, the Administrator may, with the consent of the successor corporation, provide for the consideration to be received upon the exercise of the Option or SAR, for each Share of Optioned Stock subject to the Option or SAR, to be solely common stock of the successor corporation or its Parent substantially equal in Fair Market Value to the per share consideration received by holders of Common Stock in the merger or sale of assets. The determination of such substantial equality of value of consideration shall be made by the Administrator and its determination shall be conclusive and binding.

12. Time of Granting Options or SARs. The date of grant of an Option or SAR shall, for all purposes, be the date on which the Administrator makes the determination granting such Option or SAR. Notice of the determination shall be given to each Grantee within a reasonable time after the date of such grant.

13. Amendment and Termination of the Plan.

13.1. **Amendment and Termination.** The Board may amend or terminate the Plan from time to time in such respects as the Board may deem advisable.

13.2. **Shareholder Approval.** The Company shall obtain shareholder approval of any Plan amendment to the extent necessary and desirable to comply with Rule 16b-3 or with Section 422 of the Code (or any successor rule or statute or other applicable law, rule or regulation, including the requirements of any exchange or quotation system on which the Common Stock is listed or quoted). Such shareholder approval, if required, shall be obtained in such a manner and to such a degree as is required by the applicable law, rule or regulation.

13.3. **Effect of Amendment or Termination.** Any such amendment or termination of the Plan shall not affect Options or SARs already granted, and such Options or SARs shall remain in full force and effect as if this Plan had not been amended or terminated, unless mutually agreed otherwise between the Grantee and the Administrator, which agreement must be in writing and signed by the Grantee and the Administrator.

14. Conditions Upon Issuance of Shares. Shares shall not be issued pursuant to the exercise of

an Option, SAR or a Sale unless the exercise of such Option, SAR or consummation of the Sale and the issuance and delivery of such Shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, the Securities Act of 1933, as amended, applicable state securities laws, the Exchange Act, the rules and regulations promulgated thereunder, and the requirements of any stock exchange (including NASDAQ) upon which the Shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance.

15. Reservation of Shares. The Company, during the term of this Plan, will at all times reserve and keep available such number of Shares as shall be sufficient to satisfy the requirements of the Plan.

16. Liability of Company.

16.1. Inability to Obtain Authority. Inability of the Company to obtain authority from any regulatory body having jurisdiction, which authority is deemed by the Company's counsel to be necessary to the lawful issuance and sale of any Shares hereunder, shall relieve the Company of any liability in respect of the failure to issue or sell such Shares as to which such requisite authority shall not have been obtained.

As a condition to the exercise of an Option or SAR or a Sale, the Company may require the person exercising such Option or SAR or to whom Shares are being Sold to represent and warrant at the time of any such exercise or Sale that the Shares are being purchased only for investment and without any present intention to sell or distribute such Shares if, in the opinion of counsel for the Company, such a representation is required by any of the aforementioned relevant provisions of law.

16.2. Grants Exceeding Allotted Shares. If the grant of an Option or SAR causes the number of Shares of Optioned Stock to exceed, as of the date of grant, the number of Shares which may be issued under the Plan without additional shareholder approval, such Option or SAR shall be void with respect to such excess Optioned Stock, unless shareholder approval of an amendment sufficiently increasing the number of Shares subject to the Plan is timely obtained in accordance with Section 13 of the Plan.

17. Shareholder Approval. Continuance of the Plan shall be subject to approval by the shareholders of the Company within twelve (12) months before or after the date the Plan is adopted. Such shareholder approval shall be obtained in the manner and to the degree required under applicable federal and state law.

18. Market Standoff.

In connection with any underwritten public offering by the Company of its equity securities pursuant to an effective registration statement filed under the Securities Act, including the Company's initial public offering, a Grantee or other participant in the Plan shall not sell, make any short sale of, loan, hypothecate, pledge, grant any option for the purchase of, or otherwise dispose or transfer for value or otherwise agree to engage in any of the foregoing transactions with respect to, any shares issuable or issued under the Plan, whether pursuant to an Option, SAR or a Sale, without the prior written consent of the Company or its underwriters. Such

limitations shall be in effect for such period of time as may be requested by the Company or such underwriters and agreed to by the Company's officers and directors with respect to their shares; provided, however, that in no event shall such period exceed 180 days. The limitations of this paragraph shall in all events terminate five years after the effective date of the Company's initial public offering. Participants shall be subject to the market standoff provisions of this Section 18 only if the officers and directors of the Company are also subject to similar arrangements.

In the event of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change affecting the Company's outstanding Common Stock effected as a class without the Company's receipt of consideration, then any new, substituted or additional securities distributed with respect to the purchased shares shall be immediately subject to the provisions of this Section 18, to the same extent the purchased shares are at such time covered by such provisions.

In order to enforce the limitations of this Section 18, the Company may impose stop-transfer instructions with respect to the purchased shares until the end of the applicable standoff period.

**PLAN ADOPTION AND AMENDMENT/ADJUSTMENTS
SUMMARY PAGE**

<u>Date of Board Action</u>	<u>Action</u>	<u>Section/Effect of Amendment</u>	<u>Date of Shareholder Approval</u>
May 23, 2006	Initial Plan Adoption	N/A	May 23, 2006
May 20, 2008	Increase in Authorized Shares	Section 3: shares authorized for issuance under the plan increased to 7,000,000 shares.	May 20, 2008

CERTIFICATION

I, Bruce A. Walicek, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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: August 11, 2008

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

CERTIFICATION

I, Steven L. Moore, certify that:

1. I have reviewed this quarterly report on Form 10-Q 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: August 11, 2008

By: /s/ Steven L. Moore
Steven L. Moore
*Vice President, Chief Financial
Officer, Secretary and Treasurer*

**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 Quarterly Report of Pixelworks, Inc. (the "Company") on Form 10-Q for the quarterly period ended June 30, 2008 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. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

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: August 11, 2008

**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 Quarterly Report of Pixelworks, Inc. (the "Company") on Form 10-Q for the quarterly period ended June 30, 2008 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. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

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: August 11, 2008