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

FORM 10-Q

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

For the quarterly period ended September 30, 2005

or

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

For the transition period from _________ to _________

Commission File Number: 000-30269

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

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

8100 SW Nyberg Road
Tualatin, Oregon 97062
(503) 454-1750
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☑ No ☐

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 October 31, 2005: 47,087,600

PIXELWORKS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2005

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	September 30, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 54,054	$ 32,585
Short-term marketable securities	75,025	160,213
Accounts receivable, net	27,420	14,605
Inventories, net	27,809	18,575
Prepaid expenses and other current assets	14,126	4,856
Total current assets	198,434	230,834
Long-term marketable securities	18,297	79,483
Property and equipment, net	14,806	12,444
Other assets, net	16,843	8,101
Debt issuance costs, net	3,958	4,483
Deferred tax assets, net	13,081	4,868
Acquired intangible assets, net	39,627	2,520
Goodwill	134,022	80,836
Total assets	$ 439,068	$ 423,569
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 8,852	$ 5,946
Accrued liabilities and current portion of long-term liabilities	23,570	12,842
Income taxes payable	—	2,393
Total current liabilities	32,422	21,181
Long-term liabilities, net of current portion	3,372	365
Long-term debt	150,000	150,000
Total liabilities	185,794	171,546
Commitments and contingencies		
Shareholders' equity:		
Preferred stock	—	—
Common stock	316,148	304,996
Shares exchangeable into common stock	5,500	6,144
Accumulated other comprehensive income (loss)	(957)	531
Deferred stock-based compensation	(1,133)	(60)
Accumulated deficit	(66,284)	(59,588)
Total shareholders' equity	253,274	252,023
Total liabilities and shareholders' equity	$ 439,068	$ 423,569

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 September 30, 2005	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Revenue, net	$ 46,794	$ 43,970	$ 128,370	$ 137,749
Cost of revenue (1)	32,147	22,260	80,603	69,620
Gross profit	14,647	21,710	47,767	68,129
Operating expenses:				
Research and development (2)	15,573	8,454	36,586	24,111
Selling, general and administrative (3)	8,202	5,864	22,170	17,394
Stock-based compensation and amortization of purchased intangible assets	1,042	208	1,564	706
Total operating expenses	24,817	14,526	60,320	42,211
Income (loss) from operations	(10,170)	7,184	(12,553)	25,918
Interest income	1,031	1,474	4,439	2,238
Interest expense	(657)	(657)	(1,974)	(952)
Realized loss on sale of marketable securities	—	—	(779)	—
Amortization of debt issuance costs	(177)	(179)	(532)	(294)
Interest and other income, net	197	638	1,154	992
Income (loss) before income taxes	(9,973)	7,822	(11,399)	26,910
Provision for (recovery of) income taxes	(4,716)	2,373	(4,703)	9,149
Net income (loss)	$ (5,257)	$ 5,449	$ (6,696)	$ 17,761
Net income (loss) per share:				
Basic	$ (0.11)	$ 0.12	$ (0.14)	$ 0.38
Diluted	$ (0.11)	$ 0.11	$ (0.14)	$ 0.36
Weighted average shares outstanding:				
Basic	47,520	46,827	47,218	46,596
Diluted	47,520	53,961	47,218	51,185

(1) Includes amortization of:				
Acquired inventory mark-up	$ 3,244	$ —	$ 3,329	$ —
Acquired developed technology	1,972	132	2,543	396
Acquired backlog	581	—	600	—
Stock-based compensation	36	—	47	—
(2) Excludes stock-based compensation of:	424	70	584	223
(3) Excludes stock-based compensation of:	166	17	230	119

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Cash flows from operating activities:		
Net income (loss)	$ (6,696)	$ 17,761
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	9,852	5,515
Amortization of purchased intangible assets	3,893	760
Stock-based compensation	861	342
Realized loss on sale of marketable securities	779	—
Tax benefit from stock options	592	5,579
Amortization of debt issuance costs	532	294
Deferred rent	368	67
Deferred income tax benefit	(363)	(3,276)
Loss on asset disposals	161	390
Amortization of deferred tax charge	41	41
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable, net	(8,351)	(9,434)
Inventories, net	1,574	(10,773)
Prepaid expenses and other current and long-term assets	(6,058)	(186)
Accounts payable	1,091	3,316
Accrued current and long-term liabilities and income taxes payable	(3,333)	6,696
Net cash provided by (used in) operating activities	(5,057)	17,092
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	283,974	54,851
Purchases of marketable securities	(139,867)	(183,207)
Acquisition of Equator Technologies, Inc., net of cash acquired	(107,229)	—
Purchases of property and equipment	(6,421)	(5,657)
Purchases of other assets	(1,929)	(3,031)
Payments on equipment and other asset financing	(4,015)	(3,156)
Proceeds from sale of assets	61	3
Net cash provided by (used in) investing activities	24,574	(140,197)
Cash flows from financing activities:		
Proceeds from the issuance of common stock	1,864	4,966
Proceeds from the issuance of long-term debt	—	145,500
Debt issuance costs	(7)	(429)
Lease incentives	95	124
Net cash provided by financing activities	1,952	150,161
Net increase in cash and cash equivalents	21,469	27,056
Cash and cash equivalents, beginning of period	32,585	16,490
Cash and cash equivalents, end of period	$ 54,054	$ 43,546
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 1,318	$ 2
Income taxes	1,690	230
Supplemental disclosure of non-cash investing and financing activities:		
Acquisitions of property and equipment and other assets under extended payment terms	$ 12,564	$ 6,936
Value of options issued in connection with acquisition of Equator Technologies, Inc.	8,336	—
Transfer of cost-based investment to available-for-sale marketable security	—	10,000
Release and cancellation of common shares held in escrow	—	541
Debt issuance costs withheld from proceeds	—	4,500

See accompanying notes to condensed consolidated financial statements.

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

NOTE 1: BASIS OF PRESENTATION

Nature of Business

Pixelworks, Inc. ("Pixelworks" or the "Company") is a leading designer, developer and marketer of semiconductors and software for use in electronic display devices and equipment for encoding and decoding streaming digital video. Our system-on-chip semiconductors provide the 'intelligence' for these types of applications by processing and optimizing video and computer graphic signals to produce high quality images.

Condensed Consolidated Financial Statements

These condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. 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 nine months ended September 30, 2005 and 2004 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 consolidated financial position, consolidated results of operations and consolidated cash flows of the Company for these interim periods. The financial information as of December 31, 2004 is derived from our audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2004, included in Item 8 of our Annual Report on Form 10-K, and should be read in conjunction with such consolidated financial statements.

The results of operations for the three and nine months ended September 30, 2005 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2005.

Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires us to make estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. Our significant estimates and judgments include those related to product returns, warranty obligations, bad debts, inventory valuation, property and equipment, intangible assets and income taxes. The actual results experienced by the Company could differ materially from our estimates.

Reclassifications

Certain reclassifications have been made to the 2004 condensed consolidated financial statements to conform to the 2005 presentation, including the reclassification of investments in auction rate securities from cash and cash equivalents to available-for-sale short-term marketable securities and the reclassification of tooling depreciation from research and development expense to cost of revenue. Additionally, facilities and information technology expenses have been allocated between selling, general and administrative expense, research and development expense and cost of revenue based on employee headcount.

NOTE 2: STOCK PLANS

We have a 1997 Stock Incentive Plan and a 2001 Nonqualified Stock Option Plan under which employees, officers and directors may be granted stock options to purchase shares of the Company's common stock. We also have a 2000 Employee Stock Purchase Plan under which eligible employees may purchase shares of Pixelworks' common stock at 85% of fair market value at specific, pre-determined dates.

As permitted by Statement of Financial Accounting Standards No. ("SFAS") 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), and SFAS 148, *Accounting for Stock-Based Compensation – Transition and Disclosure, an Amendment of FASB Statement No. 123*, we continue to apply the intrinsic value based method of accounting for stock compensation described in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* ("Opinion 25"). As such, stock-based compensation cost is measured as the excess, if any, of the quoted market price of Pixelworks' stock on the grant, or other measurement date, over the amount that an option holder must pay to acquire the stock.

Entities electing to continue to apply Opinion 25 must make prominent pro-forma disclosure of net income and earnings per share as if the fair value based method prescribed by SFAS 123 had been applied. Had we accounted for our stock-based compensation plans in accordance with SFAS 123, our net income (loss) would have approximated the pro-forma amounts below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss) as reported	$ (5,257)	$ 5,449	$ (6,696)	$ 17,761
Add: Stock-based compensation included in reported net income (loss), net of related tax effects	330	61	505	226
Deduct: Stock-based compensation determined under the fair value based method, net of related tax effects	(2,572)	(3,165)	(7,271)	(7,682)
Pro-forma net income (loss)	$ (7,499)	$ 2,345	$(13,462)	$ 10,305
Basic net income (loss) per share:				
As reported	$ (0.11)	$ 0.12	$ (0.14)	$ 0.38
Pro-forma	$ (0.16)	$ 0.05	$ (0.29)	$ 0.22
Diluted net income (loss) per share:				
As reported	$ (0.11)	$ 0.11	$ (0.14)	$ 0.36
Pro-forma	$ (0.16)	$ 0.05	$ (0.29)	$ 0.22

The fair value of stock-based compensation costs reflected in the above pro-forma amounts were determined using the Black-Scholes option pricing model and the following weighted average assumptions:

	Three Months Ended September 30, 2005	Three Months Ended September 30, 2004	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Stock Option Plans:				
Risk free interest rate	4.04%	3.74%	4.02%	3.92%
Expected dividend yield	0%	0%	0%	0%
Expected life (in years)	6.3	6.1	6.5	6.1
Volatility	93%	99%	94%	101%
Employee Stock Purchase Plan:				
Risk free interest rate	2.92%	1.87%	2.43%	1.87%
Expected dividend yield	0%	0%	0%	0%
Expected life (in years)	0.7	1.3	0.7	1.3
Volatility	73%	102%	84%	103%

The effects of applying SFAS 123 in this pro-forma disclosure are not indicative of future amounts and additional awards are anticipated in future periods.

NOTE 3: BALANCE SHEET COMPONENTS

Marketable Securities

At December 31, 2004, we classified all marketable securities as held-to-maturity in accordance with SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*, with the exception of auction rate securities and our investment in Semiconductor Manufacturing International Corporation ("SMIC"), which we classified as available-for-sale.

On March 31, 2005, we determined that we no longer had the intent to hold any of our securities to maturity based on the potential for future acquisitions, and we reclassified all of our held-to-maturity securities to available-for-sale. The amortized cost of the securities transferred from held-to-maturity to available-for-sale was $159,632 on the March 31, 2005 transfer date.

Short-term marketable securities were classified as follows:

	September 30, 2005	December 31, 2004
Available-for-sale	$ 75,025	$ 77,150
Held-to-maturity	—	83,063
Short-term marketable securities	$ 75,025	$ 160,213

Long-term marketable securities were classified as follows:

	September 30, 2005	December 31, 2004
Available-for-sale	$ 18,297	$ 10,531
Held-to-maturity	—	68,952
Long-term marketable securities	$ 18,297	$ 79,483

Unrealized holding losses on short-term available-for-sale marketable securities, net of tax, were $72 at September 30, 2005. Unrealized holding losses on long-term available-for-sale marketable securities, net of tax, were $885 at September 30, 2005. These unrealized holding losses are recorded in accumulated other comprehensive income, a component of shareholders' equity, at September 30, 2005.

There were no unrealized holding gains or losses on available-for-sale auction rate securities at December 31, 2004, and the unrealized holding gain on our investment in SMIC at December 31, 2004, net of tax, was $531. This unrealized holding gain was recorded in accumulated other comprehensive income at December 31, 2004.

Gross unrealized holding losses on short-term held-to-maturity marketable securities were $48 at December 31, 2004, and gross unrealized losses on long-term held-to-maturity marketable securities were $68 at December 31, 2004.

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:

	September 30, 2005	December 31, 2004
Accounts receivable, gross	$ 27,632	$ 14,817
Less allowance for doubtful accounts	(212)	(212)
Accounts receivable, net	$ 27,420	$ 14,605

Inventories, Net

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

	September 30, 2005	December 31, 2004
Finished goods	$ 21,240	$ 11,648
Work-in-process	8,420	8,516
	29,660	20,164
Less reserve for slow moving and obsolete items	(1,851)	(1,589)
Inventories, net	$ 27,809	$ 18,575

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

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Balance at beginning of period	$ 1,589	$ 1,942
Usage:		
Inventory scrapped	(119)	(442)
Inventory utilized	(418)	(679)
Subtotal — usage	(537)	(1,121)
Provision	799	559
Balance at end of period	$ 1,851	$ 1,380

While we do not currently expect to be able to sell or otherwise use the reserved inventory we have on hand at September 30, 2005 based upon our forecast and backlog, it is possible that a customer will decide in the future to purchase a portion of the reserved inventory. It is not currently possible to predict if or when this will happen, or how much we may sell.

Property and Equipment, Net

Property and equipment, net consists of the following:

	September 30, 2005	December 31, 2004
Gross carrying amount of assets	$ 43,693	$ 34,193
Less accumulated depreciation and amortization	(28,887)	(21,749)
Property and equipment, net	$ 14,806	$ 12,444

Acquired Intangible Assets, Net

Acquired intangible assets, net consists of the following:

	September 30, 2005	December 31, 2004
Gross carrying amount of assets	$ 46,277	$ 5,277
Less accumulated amortization	(6,650)	(2,757)
Acquired intangible assets, net	$ 39,627	$ 2,520

Accrued Liabilities and Current Portion of Long-Term Liabilities

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

	September 30, 2005	December 31, 2004
Accrued payroll and related liabilities	$ 4,815	$ 4,586
Current portion of accrued liabilities for asset financing	9,148	3,185
Accrued manufacturing liabilities	2,938	477
Accrued commissions and royalties	1,452	719
Current portion of deferred lease liability	526	128
Reserve for warranty returns	519	419
Reserve for sales returns and allowances	272	524
Accrued interest payable	992	335
Other	2,908	2,469
Accrued liabilities and current portion of long-term liabilities	$ 23,570	$ 12,842

The following is a summary of the change in our reserve for sales returns and allowances:

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Balance at beginning of period	$ 524	$ 202
Provision	48	601
Charge offs	(300)	(532)
Balance at end of period	$ 272	$ 271

The following is a summary of the change in our reserve for warranty returns:

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Balance at beginning of period	$ 419	$ 569
Provision	534	145
Charge offs	(434)	(257)
Balance at end of period	$ 519	$ 457

Long-Term Debt

On May 18, 2004, we issued $125,000 of convertible subordinated debentures (the “debentures”) due 2024 in a private offering pursuant to Rule 144A under the Securities Act of 1933 and outside of the United States in accordance with Regulation S under the Securities Act. On June 4, 2004, we issued an additional $25,000 of debentures pursuant to the exercise of an option granted to the initial purchasers.

The debentures bear interest at a rate of 1.75% per annum and interest is payable on May 15 and November 15 of each year, beginning November 15, 2004. The debentures are convertible, under certain circumstances, into our common stock at a conversion rate of 41.0627 shares of common stock per $1,000 principal amount of debentures for a total of 6,159 shares. This is equivalent to a conversion price of approximately $24.35 per share. The debentures are convertible if (a) during any calendar quarter, the market price of our common stock exceeds 130% of the conversion price per share for at least 20 trading days during the period of 30 consecutive trading days ending on the last trading day of the previous calendar quarter, (b) the trading price of the debentures declines to less than 98% of the product of the closing sale price of our common stock and the number of shares issuable upon conversion of $1,000 principal amount of the debentures for five consecutive trading days, (c) a call for redemption occurs, or (d) in the event of certain other 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 their debentures on May 15, 2011, May 15, 2014 and May 15, 2019, at a price equal to 100% of the principal amount plus accrued and unpaid interest.

We have filed a shelf registration statement with the Securities and Exchange Commission covering resales of the debentures and the common stock issuable upon conversion of the debentures. The registration statement was declared effective August 24, 2004. The debentures are unsecured obligations and are subordinated in right of payment to all our existing and future senior debt.

NOTE 4: COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	**2004**	**2005**	**2004**
Net income (loss)	$ (5,257)	$ 5,449	$ (6,696)	$ 17,761
Unrealized loss on available-for-sale marketable securities, net of tax	(1,016)	(553)	(1,488)	(78)
Comprehensive income (loss)	$ (6,273)	$ 4,896	$ (8,184)	$ 17,683

NOTE 5: 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 includes 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.

Diluted weighted average shares outstanding includes the increased number of common shares that would be outstanding assuming the exercise of certain stock options and the vesting of certain restricted stock, when such exercise or vesting would have the effect of reducing earnings per share. In the fourth quarter of 2004, we adopted Emerging Issues Task Force Issue No. 04-8, *The Effect of Contingently Convertible Debt on Diluted Earnings per Share.* As a result, diluted weighted average shares outstanding also includes the increased number of common shares that would be outstanding assuming the conversion of our convertible debentures, using the if-converted method, when such conversion would have the effect of reducing earnings per share.

The following schedule reconciles basic and diluted weighted average shares outstanding for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Basic weighted average shares outstanding	47,520	46,827	47,218	46,596
Incremental shares related to conversion of debentures	—	6,159	—	2,971
Incremental shares related to stock options and restricted stock	—	975	—	1,618
Diluted weighted average shares outstanding	47,520	53,961	47,218	51,185

The following schedule reconciles net income (loss) used in the calculation of basic net income (loss) per share to net income (loss) used in the calculation of diluted net income (loss) per share for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss) used in calculating basic net income (loss) per share	$ (5,257)	$ 5,449	$ (6,696)	$ 17,761
Add: Interest expense and amortization of debt issuance costs, net of tax	—	582	—	822
Net income (loss) used in calculating diluted net income (loss) per share	$ (5,257)	$ 6,031	$ (6,696)	$ 18,583

Because of our net loss position for the three and nine months ended September 30, 2005, incremental shares related to stock options of 1,156 and 907, respectively, are excluded from diluted weighted average shares outstanding.

For the three and nine months ended September 30, 2005, weighted average shares related to stock options of 6,858 and 5,811, respectively, were excluded from the calculation of diluted weighted average shares outstanding because the exercise prices of these options were equal to or greater than the average market price of Pixelworks' common stock during the respective periods, and as a result, their inclusion would have been anti-dilutive. For the three and nine months ended September 30, 2004, weighted average shares related to stock options of 3,941 and 2,039, respectively, were excluded for this reason.

NOTE 6: 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 and equipment for encoding and decoding streaming digital video. Substantially all of our assets are located in the United States.

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Geographic Information

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Japan	$ 14,327	$ 22,572	$ 43,986	$ 57,275
Taiwan	6,933	6,622	24,261	30,357
China	5,051	6,648	16,912	23,436
Korea	4,147	2,960	10,975	10,078
Europe	5,586	2,145	19,199	8,247
U.S.	4,173	489	4,972	1,684
Other	6,577	2,534	8,065	6,672
	$ 46,794	$ 43,970	$128,370	$137,749

Significant Customers

Sales to distributors represented 38% and 70% of total revenue for the three months ended September 30, 2005 and 2004, respectively, and 48% and 71% of total revenue for the nine months ended September 30, 2005 and 2004, respectively. The following distributors accounted for 10% or more of total revenue:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Distributor A	19%	40%	23%	32%
Distributor B	6%	10%	7%	8%
Distributor C	0%	10%	2%	14%

Effective February 4, 2005, we terminated our distributor relationship with Neoview, located in Taiwan. We now sell our products directly to Taiwanese customers previously served by Neoview, as well as through our other Taiwanese distributors.

End customers include customers who purchase directly from us, as well as customers who purchase our products indirectly through distributors and contract manufacturers. Sales to our top five end customers represented 34% and 42% of total revenue for the three months ended September 30, 2005 and 2004, respectively, and 34% of total revenue for the nine months ended September 30, 2005 and 2004.

One end customer represented 12% and 11% of total revenue for the three months ended September 30, 2005 and 2004, respectively. A second end customer represented 6% and 15% of total revenue for the three months ended September 30, 2005 and 2004, respectively. No end customer accounted for more than 10% of total revenue for the nine months ended September 30, 2005 and 2004.

The following accounts represented 10% or more of gross accounts receivable:

	September 30, 2005	December 31, 2004
Account A	15%	26%
Account B	5%	11%

NOTE 7: RISKS AND UNCERTAINTIES

Concentration of Suppliers

We do not own or operate a semiconductor fabrication facility and do not have the resources to manufacture our products internally. We rely on four third-party foundries to produce all of our products and 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 8: 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 SFAS 5, *Accounting for Contingencies*. The indemnification is limited to the amount paid by the customer. As of September 30, 2005, 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 would not materially affect our business.

NOTE 9: ACQUISITION

On June 14, 2005, the Company acquired 100% of the outstanding shares of Equator Technologies, Inc. ("Equator"). Equator is at the forefront of delivering programmable advanced video compression technology with system-on-chip integrated circuits and software solutions that unlock broadband networks for video entertainment and communications. This acquisition will provide programmable technologies to Pixelworks customers in order to create a new generation of digital televisions, including those that might integrate Internet Protocol television decoding technology to allow viewing of digital video directly over the Internet. The results of Equator's operations have been included in our consolidated statement of operations beginning on the date of acquisition.

The aggregate purchase price for Equator was $118,091, which consisted of cash of $107,854, the value of 1,263 options exchanged of $8,336, plus acquisition costs of $1,901. The estimated fair value of the options exchanged was calculated using the Black-Scholes option pricing model with the average closing price of Pixelworks' common stock for two days prior to the announcement of the Agreement and Plan of Merger, the day of the announcement, and two days following the announcement ($7.62 per share) and following weighted average assumptions: risk-free interest rate of 2.55%, an expected dividend yield of 0%, an expected life of 1.2 years, and volatility of 59%.

The purchase price was allocated to the assets and liabilities based on fair values as follows:

Purchase price		$118,091
Less net assets acquired:		
Assets acquired:		
Cash	$ 5,044	
Accounts receivable	4,464	
Inventory	10,808	
Other current assets	296	
Non-current assets	5,871	
Developed technology	36,800	
Other acquired intangible assets	4,200	
Deferred stock compensation	2,219	
Less:		
Liabilities assumed	(9,423)	(60,279)
Goodwill		$ 57,812

In connection with this acquisition, we performed a valuation of acquired intangible assets. We assigned $36,800 of the purchase price to acquired developed technology with a five year estimated life, $3,400 to customer relationships with a three year estimated life, and $800 to backlog and trademark with estimated lives of one year or less. In-process research and development was considered in our analysis of the Equator intangible assets; however, it was determined to have no value since the technologies were determined to be too early in the research and development stages.

We also recorded gross deferred tax assets of approximately $63,687, subject to a valuation allowance of $43,372, and deferred tax liabilities of $17,000 to recognize book basis and tax basis differences of various balance sheet assets and liabilities and corporate tax attributes acquired. If the valuation allowance is subsequently changed, the amount of the adjustment may affect net income or goodwill depending on the nature of the adjustment in the period such change is made.

The goodwill resulting from this transaction was assigned to Pixelworks, Inc., our sole reporting unit.

In addition to the $107,854 cash consideration included in the purchase price we paid $2,518 in cash, which was classified as contingent consideration on the acquisition date. The Equator shareholders will receive disbursement of the contingent consideration if certain revenue targets are achieved by March 31, 2006. If the target is not fully achieved by March 31, 2006, we will receive a refund of a portion of the contingent consideration. During the quarter ended September 30, 2005, $558 of the contingent consideration was earned by the shareholders. At September 30, 2005, the remaining $1,960 of contingent consideration is included in prepaid expenses and other current assets in the condensed consolidated balance sheet.

The purchase price allocation is substantially complete. Certain elements, such as the filing of pre-acquisition tax returns, may impact the final purchase price allocation. During the quarter ended September 30, 2005, we reclassified $18,862 from net deferred tax assets to goodwill due to the completion of an analysis of recoverability of acquired deferred tax assets and related limitations. Although we do not anticipate significant revisions to the purchase price allocation, material adjustments could occur.

The following table reflects the unaudited combined results of Pixelworks and Equator as if the merger had taken place as of January 1, 2004. For the three and nine months ended September 30, 2004, weighted average shares related to convertible subordinated debentures of 6,159 and 2,971, respectively, were excluded from the calculation of diluted weighted average shares outstanding because their inclusion would have been anti-dilutive.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net revenue	$ 46,794	$ 48,629	$ 143,336	$ 147,783
Net income (loss)	$ (2,325)	$ 2,041	$ (10,677)	$ 6,977
Net income (loss) per share:				
Basic	$ (0.05)	$ 0.04	$ (0.23)	$ 0.15
Diluted	$ (0.05)	$ 0.04	$ (0.23)	$ 0.14
Weighted average shares outstanding:				
Basic	47,520	46,827	47,218	46,596
Diluted	47,520	48,820	47,218	49,335

The adjustment to mark-up inventory to fair value of $5,190 is not included in cost of revenue in the pro forma results of operations for the nine months ended September 30, 2004 as it is not reflective of the ongoing operations of the combined entities. The pro-forma information does not necessarily reflect the actual results that would have occurred, nor is it necessarily indicative of future results of operations of the combined companies.

NOTE 10: SUBSEQUENT EVENT

During October 2005, we initiated a restructuring of our workforce which resulted in the elimination of 36 positions. We expect to incur approximately $1,000 in severance expenses in the fourth quarter of 2005 as a result of this restructuring. In the future, we expect to incur costs to move employees from two separate facilities in California into one facility. This restructuring is intended to improve the efficiency and effectiveness of our product development efforts.

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 and other sections of this Report contain "forward-looking statements" within the meaning of the Securities Litigation Reform Act of 1995 that are based on current expectations, estimates, beliefs, assumptions and projections about our business. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve 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, increased competition, adverse business conditions, failure to design, develop and manufacture new products, lack of success in technological advancements, lack of acceptance of new products, the timing of orders for our products, unexpected changes in the demand for our products and services, the inability to successfully manage inventory pricing pressures, failure to reduce costs or improve operating efficiencies, changes to and compliance with international laws and regulations, currency fluctuations and our ability to attract, hire and retain key and qualified employees. 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.

(Dollars in thousands)

Overview

We are a leading designer, developer and marketer of semiconductors and software for use in electronic display devices and equipment for encoding and decoding streaming digital video. Our system-on-chip semiconductors provide the 'intelligence' for these types of applications by processing and optimizing video and computer graphic signals to produce high-quality images. Many of the world's leading manufacturers of consumer electronics and computer display products utilize our technology to enhance image quality and ease of use of their products. Our goal is to provide all of the electronics necessary to process the entire signal path in order to provide a turn-key solution for our customers.

On June 14, 2005, we acquired 100% of the outstanding shares of Equator Technologies, Inc. ("Equator"). Equator is at the forefront of delivering programmable advanced video compression technology with system-on-chip integrated circuits and software solutions that unlock broadband networks for video entertainment and communications. This acquisition will provide programmable technologies to Pixelworks customers in order to create a new generation of digital televisions, including those that might integrate Internet Protocol television decoding technology to allow viewing of digital video directly over the Internet. The results of operations of Equator are included in our financial statements beginning on June 14, 2005.

We sell our products worldwide through a direct sales force and indirectly through distributors and manufacturers' representatives. Manufacturers' representatives support some of our European and Asian sales. We sell to distributors in Japan, Taiwan, China and Europe. Sales to distributors represented 48% and 71% of total revenue for the nine months ended September 30, 2005 and 2004, respectively, and 38% and 70% of total revenue for the three months ended September 30, 2005 and 2004, respectively. Effective February 4, 2005, we terminated our distributor relationship with Neoview, one of our Taiwanese distributors. We now sell our products directly to Taiwanese customers previously served by Neoview, as well as through our other Taiwanese distributors. The termination of this relationship led to the decrease in sales to distributors during the three and nine months ended September 30, 2005, compared to the three and nine months ended September 30, 2004.

Historically, significant portions of our revenue have been generated by sales to a relatively small number of end customers and distributors. Sales to our top five end customers represented 34% and 42% of total revenue for the three months ended September 30, 2005 and 2004, respectively, and 34% of revenue for the nine months ended September 30, 2005 and 2004. During the three months ended September 30, 2005, there was one end customer that accounted for more than 10% of total revenue. There were no end customers that accounted for 10% or more of total revenue during the nine months ended September 30, 2005. There were two end customers that represented more than 10% of total revenue during the three months ended September 30, 2004 and no end customer represented more than 10% of total revenue during the nine months ended September 30, 2004. End customers include customers who purchase directly from us, as well as customers who purchase our products indirectly through distributors and contract manufacturers.

Significant portions of our products are sold overseas. Sales outside the U.S. accounted for approximately 91% and 96% of total revenue for the three and nine months ended September 30, 2005, respectively, and 99% of total revenue for the three and nine months ended September 30, 2004. Our integrators, branded manufacturers and branded suppliers incorporate our products into systems that are sold worldwide. All revenue to date has been denominated in U.S. dollars.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP requires us to make estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates, including those related to product returns, warranty obligations, inventories, property and equipment, intangible assets and income taxes. We base our estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect the more significant judgments and estimates we use in preparing our consolidated financial statements:

Revenue Recognition. We recognize revenue in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition*. Accordingly, revenue is recognized when an authorized purchase order has been received, the sales price is fixed and determinable, title and risk of loss have transferred, collection of the resulting receivable is probable and product returns are reasonably estimable. This generally occurs upon shipment of the underlying merchandise.

Sales Returns and Allowances. Our customers do not have a stated right to return product other than under our warranty policy discussed below. As such, customer returns are accepted on a case-by-case basis as customer accommodations only. However, certain of our distributors have stock rotation provisions in their distributor agreements, which allow them to return 5-10% of the products purchased in the prior six months in exchange for products of equal value. Certain distributors also have price protection provisions in their agreements with us.

We record estimated reductions to gross profit for these sales returns and allowances in our reserve for sales returns and allowances. We update the balance in this reserve at each reporting period based on historical experience. If actual returns and allowances increase, we may be required to recognize additional reductions to gross profit.

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

We provide for the estimated cost of product warranties in our warranty reserve. We update the balance in this reserve based on historical experience at each reporting period. While we engage in extensive product quality programs and processes, which include actively monitoring and evaluating the quality of our suppliers, should actual product failure rates or product replacement costs differ from our estimates, revisions to the estimated warranty liability may be required.

Allowance for Doubtful Accounts. We offer credit to customers after careful examination of their creditworthiness. We maintain an allowance for doubtful accounts for estimated losses that may result from the inability of our customers to make required payments. We evaluate the balance in the allowance based on historical experience and the age of outstanding receivables at each reporting period. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

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

Useful Lives and Recoverability of Equipment and Other Long-Lived Assets. In accordance with Statement of Financial Accounting Standards No. ("SFAS") 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we evaluate the remaining useful life and recoverability of equipment and other assets, including identifiable intangible assets with definite lives, whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. If there is an indicator of impairment, we prepare an estimate of future, undiscounted cash flows expected to result from the use of each asset and its eventual disposition. If these cash flows are less than the carrying value of the asset, we adjust the carrying amount of the asset to its estimated fair value.

Goodwill. Goodwill represents the excess cost over the fair value of net assets acquired in business combinations. Goodwill is not amortized, instead we test goodwill annually for impairment, and more frequently if events and circumstances indicate that it might be impaired. The impairment tests are performed in accordance with SFAS 142, *Goodwill and Other Intangible Assets.* Accordingly, an impairment loss is recognized to the extent that the carrying amount of goodwill exceeds its implied fair value. This determination is made at the reporting unit level. We have assigned all goodwill to a single, enterprise-level reporting unit. The impairment test consists of two steps. First, we determine the fair value of the reporting unit. The fair value is then compared to its carrying amount. Second, if the carrying amount of the reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation in accordance with SFAS 141, *Business Combinations*. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. We perform our annual impairment test in the first quarter of each year. We have not recorded any impairment losses against goodwill as a result of impairment tests performed.

Income Taxes. Deferred income taxes are provided for temporary differences between the amount of assets and liabilities for financial and tax reporting purposes. We establish a valuation allowance in accordance with SFAS 109, *Accounting for Income Taxes,* to reduce our deferred tax assets to the amount that is more likely than not to be realized. Should we determine that we will not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset will be charged to income in the period such determination is made.

Tax contingencies are recorded to address potential exposures involving tax positions we have taken that could be challenged by taxing authorities. These potential exposures result from the varying applications of statutes, rules, regulations and interpretations. Our tax contingencies contain assumptions based on past experiences and judgments about potential actions by taxing jurisdictions. The ultimate resolution of these matters may be greater or less than the amount that we have accrued.

Results of Operations

The following table sets forth certain unaudited financial data for the periods indicated:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2005		2004		2005		2004	
	Dollars	% of revenue	Dollars	% of revenue	Dollars	% of revenue	Dollars	% of revenue
Revenue, net	$ 46,794	100.0%	$ 43,970	100.0%	$ 128,370	100.0%	$ 137,749	100.0%
Cost of revenue	32,147	68.7	22,260	50.6	80,603	62.8	69,620	50.5
Gross profit	14,647	31.3	21,710	49.4	47,767	37.2	68,129	49.5
Operating expenses:								
Research and development	15,573	33.3	8,454	19.2	36,586	28.5	24,111	17.5
Selling, general and administrative	8,202	17.5	5,864	13.3	22,170	17.3	17,394	12.6
Stock-based compensation and amortization of purchased intangible assets	1,042	2.2	208	0.5	1,564	1.2	706	0.5
Total operating expenses	24,817	53.0	14,526	33.0	60,320	47.0	42,211	30.6
Income (loss) from operations	(10,170)	(21.7)	7,184	16.3	(12,553)	(9.8)	25,918	18.8
Interest income	1,031	2.2	1,474	3.4	4,439	3.5	2,238	1.6
Interest expense	(657)	(1.4)	(657)	(1.5)	(1,974)	(1.5)	(952)	(0.7)
Realized loss on sale of marketable securities	—	—	—	—	(779)	(0.6)	—	—
Amortization of debt issuance costs	(177)	(0.4)	(179)	(0.4)	(532)	(0.4)	(294)	(0.2)
Interest and other income, net	197	0.4	638	1.5	1,154	0.9	992	0.7
Income (loss) before income taxes	(9,973)	(21.3)	7,822	17.8	(11,399)	(8.9)	26,910	19.5
Provision for (recovery of) income taxes	(4,716)	(10.1)	2,373	5.4	(4,703)	(3.7)	9,149	6.6
Net income (loss)	$ (5,257)	(11.2)%	$ 5,449	12.4%	$ (6,696)	(5.2)%	$ 17,761	12.9%

Percentages may not add due to rounding.

Revenue, net

Revenue, net increased $2,824, or 6%, to $46,794 for the three months ended September 30, 2005 from $43,970 for the three months ended September 30, 2004. Revenue decreased $9,379, or 7%, to $128,370 for the nine months ended September 30, 2005 from $137,749 for the nine months ended September 30, 2004.

Revenue by market as a percentage of total revenue was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Advanced televisions	42%	42%	51%	40%
Multimedia projectors	31%	48%	32%	47%
Advanced media processors	19%	0%	7%	0%
LCD monitors	6%	7%	7%	11%
Other	2%	3%	3%	2%

Advanced Televisions

Advanced television revenue increased $1,317, or 7%, to $19,767 for the three months ended September 30, 2005 from $18,450 for the three months ended September 30, 2004. This increase is due to an increase in units sold of 22%, offset by a decrease in average selling prices of 12%. Advanced television revenue increased $10,302, or 19%, to $65,743 for the nine months ended September 30, 2005, from $55,441 for the nine months ended September 30, 2004. This increase is due to an increase in units sold of 27%, offset by a decrease in average selling prices of 7%.

The advanced television market includes products sold into the flat panel television sector, which is comprised of liquid crystal display (“LCD”) televisions and plasma televisions, and products sold into the digital cathode ray tube (“CRT”) and digital rear projection television sectors. Revenue from products sold into the flat panel television sector comprised approximately 94% of our advanced television revenue during the three and nine months ended September 30, 2005. During the three and nine months ended September 30, 2004, revenue from products sold into the flat panel television sector comprised approximately 74% and 68%, respectively, of our total advanced television revenue. The increases in revenue to the flat panel television sector were attributable to overall growth in the market. These increases were partially offset by decreases in revenue to the CRT sector during the three and nine months ended September 30, 2005 compared to the three and nine months ended September 30, 2004.

Our advanced television revenue is generated on sales to customers primarily located in China, Taiwan, Europe, Korea and Japan.

In the fourth quarter of 2005, we expect our advanced television revenue to increase approximately 10% to 15% from the third quarter of 2005. This increase will be driven largely by the continued ramp of our new products.

Multimedia Projectors

Multimedia projector revenue decreased $6,792, or 32%, to $14,488 for the three months ended September 30, 2005 from $21,280 for the three months ended September 30, 2004. This decrease is due to a decrease in units sold of 21%, combined with a decrease in average selling prices of 14%. Multimedia projector revenue decreased $23,776, or 37%, to $40,604 for the nine months ended September 30, 2005, from $64,380 for the nine months ended September 30, 2004. This decrease is due to a decrease in units sold of 21%, combined with a decrease in average selling prices of 20%.

The decreases in revenue in the multimedia projector market are primarily attributable to market share lost to Texas Instruments in projectors using their Digital Light Processing (“DLP”) display device.

The majority of our multimedia projector revenue is generated on sales to customers located in Japan. Japanese customers accounted for 82% and 76% of total multimedia projector revenue for the three months ended September 30, 2005 and 2004, respectively, and 85% and 69% of total multimedia projector revenue for the nine months ended September 30, 2005 and 2004, respectively.

In the fourth quarter of 2005, we believe multimedia projector revenue will decrease approximately 5% from the third quarter of 2005. This decrease will be driven by softness in demand in the overall market as we move into the second half of the fourth quarter.

Advanced Media Processors

Advanced media processor revenue was $8,804 and $9,053 for the three and nine months ended September 30, 2005, respectively. Sales into this market are a result of our acquisition of Equator Technologies, Inc. in June of 2005. Accordingly, we had no revenue in this market for the comparable periods of 2004.

The advanced media processor market consists of products sold into video conferencing and set-top-box applications, as well as products sold into other miscellaneous applications which include broadcast encoding and imaging. The majority of our advanced media processor revenue is derived from customers located in United States and Canada.

In the fourth quarter of 2005, we believe advanced media processor revenue will decrease approximately 15% to 35% from the third quarter of 2005. This decrease will be due to softness in set-top-box demand as we expect that new orders to support continued rollout from our major customers will push out beyond the fourth quarter.

LCD Monitors

LCD monitor revenue decreased $179, or 6%, to $2,943 for the three months ended September 30, 2005 from $3,122 for the three months ended September 30, 2004. This decrease is due to a decrease in units sold of 9%, offset by an increase in average selling prices of 4%. LCD monitor revenue decreased $5,757, or 39%, to $9,119 for the nine months ended September 30, 2005 from $14,876 for the nine months ended September 30, 2004. This decrease is due to a decrease in units sold of 59%, offset by an increase in average selling prices of 51%.

The overall decrease in LCD monitor revenue is primarily attributable to our strategy to stop developing mainstream products for this market, and to focus on higher end products. The increase in average selling prices resulted from an increase in the percentage of chips sold into Ultra Extended Graphics Array (“UXGA”) monitors, the highest resolution monitors, which carry higher average selling prices than chips sold into Super Extended Graphics Array (“SXGA”), which are high resolution monitors, or Extended Graphics Array (“XGA”) monitors, which are the lowest resolution monitors.

The majority of our LCD monitor revenue is generated on sales to customers located in Taiwan.

In the fourth quarter of 2005, we expect that LCD monitor revenue will decrease approximately 15% to 20% from third quarter of 2005.

Other

Other revenue includes revenue generated from the sales of evaluation kits and from sales into small, niche markets that are unrelated to the four primary markets for our products, as well as the impact of any change in our reserve for sales returns and allowances.

Cost of revenue and gross profit

Cost of revenue includes purchased materials, assembly, test, labor and overhead, warranty expense, royalties, amortization of purchased developed technology, provisions for slow moving and obsolete inventory and information technology and facilities allocations.

Gross profit decreased to 31.3% and 37.2% for the three and nine months ended September 30, 2005, respectively, from 49.4% and 49.5% for the comparable periods in 2004. The decrease is primarily driven by an increase in amortization of acquired inventory mark-up, acquired intangible assets and stock-based compensation of $5,701 and $6,123 for the three and nine months ended September 30, 2005, respectively, and changes in the mix of products sold. The decrease in sales to multimedia projector manufacturers as a percentage of total revenue contributed significantly to the overall decrease in gross profit, as our multimedia projector sales generally have the highest gross profit margins.

We expect our gross profit margin to be approximately 34% to 36% for the fourth quarter of 2005. This increase will primarily be driven by less non-cash acquisition related expenses in the fourth quarter of 2005 compared to the third quarter. We expect non-cash acquisition related expenses to be approximately $3,800 in the fourth quarter compared to $5,797 for the third quarter.

Research and development

Research and development includes compensation and related costs for personnel, depreciation and amortization, fees for outside services and expensed equipment and software.

Research and development expense, inclusive of stock-based compensation expense, increased $7,473, or 88%, to $15,997 for the three months ended September 30, 2005 from $8,524 for the three months ended September 30, 2004 due to the following factors:

- Compensation expense increased $3,463. This increase is attributable to an increase in research and development headcount of 122 from 163 at September 30, 2004 to 285 at September 30, 2005. 55 of the headcount increase is in our Shanghai design center and 43 of the headcount increase is attributable to our acquisition of Equator. The remaining increase is attributable to additional headcount in the U.S. and Canada.
- Non-recurring engineering and outside services expenses increased $1,723. $798 of this increase is attributable to the addition of Equator expenses. The remaining increase is attributable to an increase in the number of projects under development.
- Facilities and information technology expenses allocated to research and development increased $1,091. The increase in the allocation was driven by increases in rent expense, compensation expense, outside services expense, and telephone and other communications charges.
- Depreciation and amortization increased $697 due to increased licensed technology and software asset purchases.
- Stock-based compensation increased $354 due to the assumption of outstanding Equator stock options.

Research and development expense, inclusive of stock-based compensation expense, increased $12,836, or 53%, to $37,170 for the nine months ended September 30, 2005 from $24,334 for the nine months ended September 30, 2004 due to the following offsetting factors:

- Compensation expense increased $4,969 due to the headcount increases described above.
- Non-recurring engineering and outside services expenses increased $2,219. $954 of this increase is attributable to the addition of Equator expenses. The remaining increase is attributable to an increase in the number of projects under development.
- Facilities and information technology expenses allocated to research and development increased $2,312.
- Depreciation and amortization increased $3,470 due to increased licensed technology and software asset purchases.
- Stock-based compensation increased $361 due to the assumption of outstanding Equator stock options.
- Expensed software and equipment decreased $728.

We expect our research and development expenses to continue to increase in future periods as a result of our ongoing investment in new product development programs.

Selling, general and administrative

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

Selling, general and administrative expense, inclusive of stock-based compensation expense, increased $2,487, or 42%, to $8,368 for the three months ended September 30, 2005 from $5,881 for the three months ended September 30, 2004 due to the following offsetting factors:

- Compensation expense increased $1,291. This increase is attributable to an increase in selling, general and administrative headcount of 65 from 139 at September 30, 2004 to 204 at September 30, 2005. 15 of the headcount increase is attributable to our acquisition of Equator.
- Commissions expense increased $473 due to increased sales through our manufacturer's representatives.
- Facilities and information technology expenses allocated to selling, general and administrative increased $416. The increase in the allocation was driven by increases in rent expense, compensation expense, outside services expense, and telephone and other communications charges.
- Travel and entertainment and trade show expenses increased $293.
- Stock-based compensation expense increased $149 due to the assumption of outstanding Equator stock options.

Selling, general and administrative expense, inclusive of stock-based compensation expense, increased $4,887, or 28%, to $22,400 for the nine months ended September 30, 2005 from $17,513 for the nine months ended September 30, 2004 due to the following offsetting factors:

- Compensation expense increased $2,868 due to the headcount increases described above.
- Facilities and information technology expenses allocated to selling, general and administrative increased $1,157.
- Commissions expense increased $728 due to increased sales through our manufacturer's representatives.
- Travel and entertainment and trade show expenses increased $583.
- Stock-based compensation increased $111 due to the assumption of outstanding Equator stock options.
- Insurance expense decreased $284 due to lower directors and officers' insurance premiums.
- Recruiting expense decreased $91.
- Telephone and other communications charges decreased $90.

We expect our selling, general and administrative expenses to increase in future periods. The increases will result from higher sales-related and overhead costs.

Stock-based compensation and amortization of purchased intangible assets

Stock-based compensation and amortization of purchased intangible assets is comprised of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Stock-based compensation	$ 590	$ 87	$ 814	$ 342
Amortization of acquired assembled workforce	119	121	362	364
Amortization of acquired customer relationships	283	—	330	—
Amortization of acquired trademark	50	—	58	—
	$ 1,042	$ 208	$ 1,564	$ 706

Stock-based compensation and amortization of purchased intangible assets increased $834, or 401%, and $858, or 122%, for the three and nine months ended September 30, 2005 from the comparable periods in 2004, respectively. These increases are due to our acquisition of Equator, which closed June 14, 2005, offset by the diminishing amortization of purchased intangible assets from a previous asset purchase. As a result of the acquisition of Equator, we recorded, among other identifiable intangible assets, acquired customer relationships of $3,400, deferred stock-based compensation of $2,219, and acquired trademark of $200.

Interest income, net

Interest income, net includes interest income earned on cash equivalents and short and long-term marketable securities, interest expense related to our 1.75% convertible subordinated debentures, realized loss on the sale of marketable securities and amortization of our debt issuance costs and is comprised of the following for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Interest income	$ 1,031	$ 1,474	$ 4,439	$ 2,238
Interest expense	(657)	(657)	(1,974)	(952)
Realized loss on sale of marketable securities	—	—	(779)	—
Amortization of debt issuance costs	(177)	(179)	(532)	(294)
	$ 197	$ 638	$ 1,154	$ 992

Interest income decreased $443, or 30%, to $1,031 for the three months ended September 30, 2005 from $1,474 for the three months ended September 30, 2004, due to the acquisition of Equator in June 2005 which lowered our combined cash and cash equivalents and short-term and long-term marketable securities balances. Interest income increased $2,201, or 98%, to $4,439 for the nine months ended September 30, 2005 from $2,238 for the nine months ended September 30, 2004, due to the investment of the proceeds from the issuance of the debentures which were issued in May and June of 2004.

Interest expense increased $1,022, or 107%, for the nine months ended September 30, 2005 compared to the comparable period of 2004. Our 1.75% convertible debentures were issued in May and June of 2004 and were therefore not outstanding for the entire nine month period ended September 30, 2004.

During the second quarter of 2005, we realized a loss on the sale of marketable securities of $779 as a result of the sale of marketable securities to fund the acquisition of Equator.

Debt issuance costs related to the convertible debentures have been capitalized and are being amortized over seven years.

Provision for income taxes

We have recorded a recovery of income taxes of $4,716 and $4,703 for the three and nine months ended September 30, 2005, respectively. The provision for income taxes was $2,373 and $9,149 for the three and nine months ended September 30, 2004, respectively. The decrease in the provision was primarily attributable to our decreased income before taxes and the generation of various credits offset by the recognition of valuation allowance and other permanent items. The effective tax rate differs from the federal statutory rate primarily due to the following: the utilization of federal, state and foreign tax credits, non-cash and other permanent expense items treated differently for book and tax purposes, the accrual of contingent amounts related to potential permanent establishment exposure and the establishment of valuation allowance against credits generated in state and foreign jurisdictions.

Liquidity and Capital Resources

Cash and cash equivalents and short and long-term marketable securities

As of September 30, 2005 we had cash and cash equivalents of $54,054, short and long-term marketable securities of $93,322 and working capital of $166,012. Cash used in operating activities during the nine months ended September 30, 2005 was $5,057 compared to cash provided by operating activities of $17,092 during the nine months ended September 30, 2004. The decrease in cash provided by operating activities is primarily attributable to the net loss of $6,696 for the nine months ended September 30, 2005 compared to the net income of $17,761 for the nine months ended September 30, 2004.

Cash provided by investing activities during the nine months ended September 30, 2005 was $24,574. This compares to $140,197 used in investing activities during the nine months ended September 30, 2004. Cash provided by investing activities during the nine months ended September 30, 2005 was primarily generated from sales and maturities of marketable securities offset by the acquisition of Equator, purchases of marketable securities, purchases of property and equipment and other assets, and payments on accrued balances related to asset acquisitions. Cash used in investing activities during the nine months ended September 30, 2004 was primarily attributable to purchases of marketable securities, purchases of property and equipment and other assets, and payments on accrued balances related to asset acquisitions offset by proceeds from sales and maturities of marketable securities.

Cash provided by financing activities was $1,952 for the nine months ended September 30, 2005. This compares to $150,161 provided by financing activities during the nine months ended September 30, 2004. Cash provided by financing activities for the nine months ended September 30, 2005 was primarily generated by proceeds from the issuance of common stock, while cash provided by financing activities for the nine months ended September 30, 2004 was primarily generated from the issuance of the convertible subordinated debentures and issuances of common stock.

We anticipate that our existing cash and investment balances, along with cash expected to be generated from operations 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. 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.

Accounts receivable, net

Accounts receivable, net increased to $27,420 at September 30, 2005 from $14,605 at December 31, 2004. The increase is attributable to the acquisition of Equator which contributed $6,458 to consolidated accounts receivable as of September 30, 2005. The increase is also attributable to higher sales during the last month of the quarter ended September 30, 2005 compared to the quarter ended December 31, 2004. Average days sales outstanding was 53 at September 30, 2005 compared to 34 days at December 31, 2004.

Inventories, net

Inventories, net increased to $27,809 at September 30, 2005 from $18,575 at December 31, 2004. The increase is primarily attributable to the acquisition of Equator. Equator's inventory balance was $7,000 as of September 30, 2005. Inventory turnover on an annualized basis was approximately four at September 30, 2005, which represents approximately 13 weeks of inventory.

Contractual Payment Obligations

A summary of our contractual payment obligations as of September 30, 2005 was as follows:

	Payments Due By Period				
Contractual Obligation	**Total**	**2005**	**2006 and 2007**	**2008 and 2009**	**2010 and beyond**
Long-term debt	$150,000	$ —	$ —	$ —	$150,000
Interest on long-term debt	16,721	2,625	5,250	5,250	3,596
Estimated Q4 2005 non-cancelable purchase commitments to contract manufacturers	23,948	23,948	—	—	—
Operating leases	12,785	4,089	6,060	2,271	365

The lease payments above are net of sublease rentals of $95 and $40 for the years ending December 31, 2005 and 2006, respectively.

Off-Balance Sheet Arrangements

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

Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. ("SFAS") 154, *Accounting Changes and Error Corrections — a replacement of APB Opinion No. 20 and FASB Statement No. 3*. SFAS 154 replaces Accounting Principles Board ("APB") Opinion No. 20, *Accounting Changes*, and SFAS 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting for, and reporting of, a change in accounting principle. This statement carries forward without change the guidance contained in Opinion 20 for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. SFAS 154 is effective for accounting changes and corrections of errors in fiscal years beginning after December 31, 2005. Early adoption is permitted for accounting changes and corrections of errors made in fiscal years beginning after the date SFAS 154 is issued. We do not expect that the adoption of SFAS 154 will have a material impact on our consolidated financial statements.

In April 2005, the Securities and Exchange Commission issued release number 33-8568, *Amendment to Rule 4-01(a) of Regulation S-X Regarding the Compliance Date for Statement of Financial Accounting Standards No. 123 (Revised 2004), Share Based Payment.* This release delays the date for compliance with SFAS 123 (Revised 2004), *Share Based Payment* from the first interim or annual reporting period beginning after June 15, 2005 to the registrant's first fiscal year beginning on or after June 15, 2005. SFAS 123R requires public entities to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award, and no longer allows companies to apply the intrinsic value based method of accounting for stock compensation described in APB Opinion No. 25, *Accounting for Stock Issued to Employees.* While we are still in the process of determining how we will adopt Statement 123R and what the impact will be on our financial statements, we do expect it to have an adverse effect on our consolidated statements of operations and earnings per share.

RISK FACTORS

Investing in our shares of common stock involves a high degree of risk. If any of the following risks occur, the market price of our shares of common stock could decline and investors could lose all or part of their investment.

RISKS RELATED TO OUR OPERATIONS

We face considerable business and financial risks related to our acquisition of Equator Technologies, Inc.

In June 2005, we completed the acquisition of Equator Technologies, Inc. ("Equator"), a privately held company, for an aggregate purchase price of $118,091. The acquisition of Equator required a substantial expenditure and involves substantial risks on our part. Equator's current product offerings and technological developments relate to internet protocol television ("IPTV") set top boxes, digital media appliances, videoconferencing devices and security devices. These are emerging technologies and the markets they serve are as yet developing and largely untested, and we do not have direct experience developing and selling products into these markets. In addition, in making the acquisition of Equator we have made certain assumptions and projections with respect to the following: Equator's revenue for future quarters; our expectations regarding the growth of the markets Equator serves; the ability of Equator to introduce new products and software and the risk that customers will not accept those new products and software; and the synergies we believe we can realize from the acquisition. We cannot be sure that such assumptions are correct. For these reasons we cannot provide assurance that the acquisition of Equator will produce the revenues, earnings or business synergies that we anticipate, or that it will perform as expected.

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

We may not be able to successfully integrate businesses, products, technologies or personnel of Equator or of any other 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 companies with weak internal controls, it will take time to get the acquired company up to the same level of operating effectiveness as Pixelworks 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. in January 2001, nDSP in January 2002, Jaldi Semiconductor in September 2002 and Equator Technologies, Inc. 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 of 2003, and we incurred $8,949 of expenses related to the transaction. In the third quarter of 2003, we made an investment of $10,000 in Semiconductor Manufacturing International Corporation (SMIC). We intend to continue to consider investments in or acquisitions of complementary businesses, products or technologies.

The acquisitions of Panstera, nDSP and Jaldi contained a very high level of risk primarily because the investments were made based on in-process technological development that may not have been completed, or if completed, may not have become commercially viable.

These and any future acquisitions and investments could result in:

- issuance of stock that dilutes current shareholders' percentage ownership;
- incurrence of debt;

- assumption of liabilities;
- amortization expenses related to other intangible assets;
- impairment of goodwill;
- large and immediate write-offs; or
- decrease in cash 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 purchased operations, technologies or products;
- unanticipated costs;
- diversion of management's attention from our core business;
- adverse effects on existing business relationships with customers;
- risks associated with entering markets in which we have no or limited prior experience; and
- potential loss of key employees, particularly those of the acquired organizations.

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

While we had net income of $21,781 for the year ended December 31, 2004, we incurred a net loss of $6,696 in the nine months ended September 30, 2005 and our accumulated deficit is $66,284 through September 30, 2005. The year ended December 31, 2004 was our first year of annual profitability since inception and we do not expect to be profitable in the year ending December 31, 2005. In the future we expect our research and development and selling, general and administrative expenses to increase. Given expected increases in operating expenses, we must increase revenues and gross profit to become profitable again. We cannot be certain that we will achieve profitability in the future or, if we do, that we can sustain or increase profitability on a quarterly or annual basis. This may in turn cause the price of our common stock to decline. In addition, 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 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. Some of these factors are not in our control and any of them may cause the price of our common stock to fluctuate. These factors include:

- our success in integrating the operations of our recently acquired subsidiary, Equator Technologies, Inc.;
- demand for multimedia projectors, advanced televisions, LCD monitors, Internet protocol television ("IPTV") set top boxes, digital media appliances, videoconferencing devices, and other digital video display devices;
- demand for our products and the timing of orders for our products;

- the deferral of customer orders in anticipation of new products or product enhancements from us or our competitors or due to a reduction in our end customers' demand;
- the loss of one or more of our key distributors or customers or a reduction, delay or cancellation of orders from one or more of these parties;
- changes in the available production capacity at the semiconductor fabrication foundries that manufacture our products and 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 costs or pricing, or distribution channels; and
- general economic conditions and economic conditions specific to the advanced display and semiconductor markets.

These factors are difficult or impossible to forecast, and these or other factors could seriously harm our business. We anticipate the rate of new orders may vary significantly from quarter to quarter.

Our operating expenses and inventory levels are based on our expectations of future revenues and our operating expenses are relatively fixed in the short term. Consequently, if anticipated sales and shipments in any quarter do not occur when expected, operating expenses and inventory levels could be disproportionately high, and our operating results for that quarter and, potentially, future quarters may be negatively impacted. Any shortfall in our revenues would have a direct impact on our business. In addition, 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. It is possible that in some 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 time periods, 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 time periods while many of our product costs are fixed. When our average selling prices decline, our gross profits decline 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 margins decline. We have experienced these results 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.

If we do not achieve design wins in the future, or design wins that we do achieve are not commercially successful, our ability to have a sustainable business would be seriously limited.

Our future success will depend 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, 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 harm our business, financial condition and results of operations.

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. Even if our products are chosen to be incorporated into a developer's products, we may not realize sufficient revenue from sales of that product to even offset the expenses associated with achieving the design win if that developer's products are not commercially successful or if the developer chooses to qualify a second source for its products. For example, we have had design wins with leading original design manufacturers in Taiwan who have not been successful in getting design wins from leading television companies in Japan. We have had design wins with customers who cancelled their products well before the product's natural life cycle. We have had design wins at leading companies who have lost market share or who have not been able to gain market share with products that utilize our products. And, we have also had design wins with customers whose product sales were much less than expected due to economic weakness in the particular region in which those products were sold.

Our highly integrated products and high-speed mixed signal products are difficult to manufacture without defects and the existence of defects could result in an increase in our costs and delays in the availability of our products.

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.

The ability to manufacture products of acceptable quality depends on both product design and manufacturing process technology. Since defective products can be caused by either design or manufacturing difficulties, 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. Failure to achieve defect-free products due to their increasing complexity may result in an increase in our cost and delays in the availability of our products. For example, we have experienced field failures of our semiconductors in certain customer system applications that required us to institute additional semiconductor level testing. As a result of these field failures we incurred costs due to customers returning potentially affected products. Additionally, customers have experienced delays in receiving product shipments from us that resulted in the loss of revenue and profits. Shipment of defective products may also harm our reputation with customers.

Because of the complex nature of our semiconductor designs and of the associated manufacturing process 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 revenues.

The development of our semiconductors, some of which incorporate mixed analog and digital signal processing, is highly complex. These complexities require that we employ advanced designs and manufacturing processes that are unproven. We have experienced increased development time and delays in introducing new products that resulted in significantly less revenue than originally expected for those products. We will not always succeed in developing new products or product enhancements nor will we always do so in a timely manner. Acquisitions have significantly added to the complexity of our product development efforts. We must now coordinate very complex product development programs between multiple geographically dispersed locations.

Many of our designs involve the development of new high-speed analog circuits that are difficult to simulate and that require physical prototypes not required by the primarily digital circuits we currently design. The result could be longer and less predictable development cycles.

Successful development and timely introduction of new or enhanced products depends on a number of other factors, including:

- accurate prediction of customer requirements and evolving industry standards, including video decoding, digital interface and content piracy protection standards;
- development of advanced display technologies and capabilities;
- timely completion and introduction of new product designs;

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

If we are not able to successfully develop and introduce our products in a timely manner, our business and results of operations will be adversely affected.

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

Our products incorporate software and software development tools. The integration of software 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. Some customers and potential customers may choose not to use our products because of the additional requirements of implementing our software, preferring to use a product that works with their existing software. This additional level of complexity lengthens the sales cycle and may result in customers selecting competitive products requiring less software integration.

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

We are and will continue to be dependent on a limited number of large distributors and customers for a substantial portion of our revenue. Sales to distributors represented 48% of our total revenue for the nine months ended September 30, 2005, and 69%, 69% and 68% of total revenue for the years ending December 31, 2004, 2003 and 2002, respectively. During the nine months ended September 30, 2005, sales to Tokyo Electron Device Limited, or TED, our Japanese distributor, represented 23% of our total revenue. Sales to TED represented 31%, 39% and 45%, respectively, of our total revenue for the years ended December 31, 2004, 2003 and 2002. Sales to our top five end customers accounted for approximately 34% of our total revenue for the nine months ended September 30, 2005, and 33%, 35% and 41% of our total revenue for the years ended December 31, 2004, 2003 and 2002, respectively. As a result of this distributor and end customer concentration, any one of the following factors could significantly impact our revenues:

- a significant reduction, delay or cancellation of orders from one or more of our key distributors, branded manufacturers or integrators; or
- a decision by one or more significant customers to select products manufactured by a competitor, or its own internally developed semiconductor, for inclusion in future product generations.

The display manufacturing market is highly concentrated among relatively few large manufacturers. We expect our operating results to continue to depend on revenues from a relatively small number of customers.

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.

At September 30, 2005 we had one customer that represented more than 10% of our accounts receivable. TED represented 15% and 26% of total accounts receivable at September 30, 2005 and December 31, 2004, respectively. The failure to pay this balance by this or any other customer would result in an expense that would increase our operating expenses and would reduce our cash flows.

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

Sales outside the U.S. accounted for approximately 96% and 99% of total revenue for the nine months ended September 30, 2005 and 2004, respectively. We anticipate that sales outside the U.S. will continue to account for a substantial portion of our revenue in future periods. In addition, customers who incorporate our products into their products sell a substantial portion outside of the U.S., thereby exposing us indirectly to further international risks. In addition, 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 of our products and components due to varying time zones, languages and business customs;
- foreign currency exchange fluctuations such as the devaluation in the currencies of Japan, People's Republic of China ("PRC"), Taiwan and Korea that could result in an increased cost of procuring our semiconductors;
- potentially adverse tax consequences, such as license fee revenue taxes imposed in Japan;
- difficulties regarding timing and availability of export and import licenses, which have limited our ability to freely move demonstration equipment and samples in and out of Asia;
- political and economic instability, particularly in the PRC, Taiwan and Korea;
- reduced or limited protection of our intellectual property, significant amounts of which are contained 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 for foreign receivables;
- 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, Korea and Taiwan that may significantly impact purchases of our products by our customers;
- outbreaks of SARS or other pandemics in the PRC or other parts of Asia; and
- difficulties in collecting accounts receivable.

Our growing presence and investment within the Peoples 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 and a large number of our customers are geographically concentrated in the PRC. In addition, approximately 40% of our employees are located in this area and we made an investment of $10,000 in SMIC, located in Shanghai, China in the third quarter of 2003. 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 assure, however, 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.

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

Selling through distributors and integrators reduces our ability to forecast sales 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. Some of our products are sold to integrators, who then integrate our semiconductors into a system that is then sold to an original equipment manufacturer or "OEM." This adds another layer between us and the ultimate source of demand for our products, the consumer. These arrangements require us to manage a more complex supply chain and monitor the financial condition and creditworthiness of our distributors, integrators and customers. Our failure to manage one or more of these challenges could result in excess inventory or shortages that could seriously impact our operating revenue or limit the ability of companies using our semiconductors to deliver their products.

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 revenues.

We do not own or operate a semiconductor fabrication facility and we do not have the resources to manufacture our products internally. We rely on third-party foundries for wafer fabrication and other contract manufacturers for assembly and testing of our products. Our requirements represent only a small portion of the total production capacity of our contract manufacturers. Our third-party manufacturers have in the past re-allocated capacity to other customers even during periods of high demand for our products. We expect that this may occur again in the future. We have limited control over delivery schedules, quality assurance, manufacturing yields, potential errors in manufacturing and production costs. We do not have long-term supply contracts with our third-party manufacturers so they are not obligated to supply us with products for any specific period of time, in any specific quantity or at any specific price, except as may be provided in a particular purchase order. From time to time our third-party manufacturers increase prices charged to manufacture our products with little notice. This requires us to either increase the price we charge for our products or suffer a decrease in our gross margins. We try not to maintain substantial inventories of products, but need to order products long before we have firm purchase orders for those products which could result in excess inventory or inventory shortages.

If we are unable to obtain our products from 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 revenues would not be realized. In addition, if the price charged by our third-party manufacturers increases we will be required to increase our prices, which could harm our competitiveness.

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 and 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 and/or impairment 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 likely would 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, if at all.

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

We are building many 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 would result in higher product costs, which could make our products uncompetitive with products offered by our competitors if we chose to increase our prices, or could result in low gross profit margins if we did not increase our prices.

We are dependent on our foundries to implement complex semiconductor technologies, which could adversely affect our operations if those technologies are not available, 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 and adversely affected if advanced manufacturing processes are unavailable to us, substantially delayed or inefficiently implemented.

Manufacturers of our semiconductor products periodically discontinue 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. 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 on the newer process. In the event that a manufacturing process is discontinued, our products could become unavailable from our current suppliers. Additionally, migrating to a new, more advanced process requires significant expenditures for research and development. A significant portion of our products use embedded DRAM technology and the required manufacturing process for this technology may only be available for the next two years. 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. We have commitments from our suppliers to notify us in the event of a discontinuance of a manufacturing process in order to assist us with product transitions.

If we have to qualify a new contract manufacturer or foundry for any of our products, we may experience delays that result in lost revenues and damaged customer relationships.

None of our products are fabricated by more than one supplier. Additionally, our products require manufacturing with state-of-the-art fabrication equipment and techniques. Because 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, there is no readily available alternative source of supply for any specific product. This could cause significant delays in shipping products, which may result in lost revenues and damaged customer relationships.

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.

Our future success depends upon the continued services of our executive officers, key hardware and software engineers, and sales, marketing and support personnel, many of whom would be difficult to replace. The loss of one or more of these employees, particularly Allen Alley, our President and Chief Executive Officer, could seriously harm our business. In addition, because of the highly technical nature of our business, the loss of key engineering personnel could delay product introductions and significantly impair our ability to successfully create future products. We believe our success depends, in large part, upon our ability to identify, attract and retain qualified hardware and software engineers, and 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. We have experienced, and may continue to experience, difficulty in hiring and retaining employees with appropriate qualifications. If we do not succeed in hiring and retaining employees with appropriate qualifications, our product development efforts, revenues and business could be seriously harmed.

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 those 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 multiple demand forecast assumptions, 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. Conversely, if our customers or we underestimate demand or if sufficient manufacturing capacity is unavailable, we would forego revenue opportunities, lose market share and damage our customer relationships.

Development projects may cause us to incur substantial operating expenses without the guarantee of any associated revenue or far in advance of revenue.

We have development projects that consume large amounts of engineering resources far in advance of product revenue. Our work under these projects is technically challenging and places considerable demands on our limited resources, particularly on our most senior engineering talent, and may not result in revenue for twelve to eighteen months, if at all. In addition, allocating significant resources to these projects may detract from or delay the completion of other important development projects. Any of these development projects could be canceled at any time without notice. These factors could have a material and adverse effect on our long-term business and results of operations.

Because of our long product development process and sales cycle, we may incur substantial expenses before we earn associated revenues and may not ultimately sell as many units of our products as we forecasted.

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 revenues. 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 equipment can take up to nine months or more. It can take an additional nine months before a customer commences volume shipments of systems that incorporate our products. Even when we achieve a design win, the customer may never ship systems incorporating our products. We cannot assure you that the time required for the testing, evaluation and design of our products by our customers would not exceed nine months. Because of this lengthy development cycle, we will experience delays between the time we incur expenditures for research and development, sales and marketing, inventory levels and the time we generate revenues, if any, from these expenditures. Additionally, if actual sales volumes for a particular product are substantially less than originally forecasted, we may experience large write-offs of capitalized license fees, product masks and prepaid royalties that would negatively affect our operating results.

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 liquid crystal display panels and other display components, analog-to-digital converters, digital receivers and video decoders. During 2000, some of our customers experienced delays in the availability of key components from other suppliers, which, in turn, caused a delay in demand for the products that we supplied to our customers.

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

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

Our products could become obsolete 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. Future products or product enhancements may require additional third-party licenses that may not be available to us or on terms that are commercially reasonable. If we are unable to obtain any third-party license required to develop new products and product enhancements, we may have to obtain substitute technology of lower quality or performance standards or at greater cost, either of which could seriously harm the competitiveness of our products.

We may not be able to respond to the rapid technological changes in the markets in which we 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 the 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, or HDTV, new video decoding technology (such as H.264 or Windows Media 9), new digital receivers and displays with resolutions that have required us to accelerate development of new products to meet these new standards.

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.

Our existing products incorporate complex software tools designed to help customers bring products 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, software development is a volatile market and new software languages are introduced to the market that 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.

Our integrated circuits and software could contain defects, which could reduce sales of those products or result in claims against us.

Despite testing by both our customers and us, errors or performance problems may be found in existing or new semiconductors and software. This could result in a delay in the recognition or loss of revenues, loss of market share or failure to achieve market acceptance. These defects may cause us to incur significant warranty, support and repair costs. They could also divert the attention of our engineering personnel from our product development efforts and harm our relationships with our customers. The occurrence of these problems could result in the delay or loss of market acceptance of our semiconductors and would likely harm our business. Defects, integration issues or other performance problems in our semiconductors and software could result in financial or other damages to our customers or could damage market acceptance of our products. Our customers could also seek damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend.

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 intellectual property rights. For example, in early 2000, we were notified by InFocus Corporation ("InFocus") that we were infringing on patents held by InFocus. In February 2000, we entered into a license agreement with InFocus granting us the right to use the technology covered by those InFocus patents. As a result, we recorded a one-time charge of $4,078 for patent settlement expense in the first quarter of 2000. Intellectual property claims could subject us to significant liability for damages and invalidate our proprietary rights. In addition, intellectual property 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 future intellectual property 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 intellectual property;
- attempt to obtain a license to the relevant intellectual property, which license may not be available on reasonable terms or at all;
- attempt to redesign those products that contain the allegedly infringing intellectual property; and
- 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 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 could adversely affect our ability to increase our earnings.

Our limited ability to protect our intellectual property 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 rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to protect our proprietary technologies. We hold 36 patents and have 77 patent applications pending for protection of our significant technologies. We cannot assure you that the degree of protection offered by patents 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, if issued, any claims allowed will be sufficiently broad to protect our technology. In addition, it is possible that existing or future patents may be challenged, invalidated or circumvented. Competitors in both the U.S. and foreign countries, many of whom have substantially greater resources, may apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell our products, or develop similar technology independently or design around our patents. Effective copyright, trademark and trade secret protection may be unavailable or limited in foreign countries. In addition, we provide the computer programming code for our software to selected customers in connection with their product development efforts, thereby increasing the risk that customers will misappropriate our proprietary software.

Goodwill represents a significant portion of our total assets.

As of September 30, 2005, goodwill amounted to $134,022 or approximately 31% of our total assets. We are required to review goodwill for possible impairment on an annual basis or when events and circumstances arise which indicate a possible impairment. The review of goodwill for impairment may result in large write-offs of goodwill, which could have a material adverse effect on our results of operations.

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

In the second quarter of 2004, we issued $150,000 of 1.75% convertible debentures due 2024 in a private placement pursuant to Rule 144A and Regulation S under the Securities Act of 1933. As a result of this indebtedness, our principal obligations increased substantially. These debt obligations could materially and adversely affect our ability to obtain debt 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 could make us more vulnerable to industry downturns and competitive pressures. 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, many of which are beyond our control.

Failure to manage our expansion effectively could adversely affect our ability to increase our business and our results of operations.

Our ability to successfully market and sell our products in a rapidly evolving market requires effective planning and management processes. We continue to increase the scope of our operations domestically and internationally and have increased our headcount from 349 employees at the end of 2004 to 515 at September 30, 2005, which includes 61 employees from our acquisition of Equator Technologies, Inc. Our past growth, and our expected future growth, places a significant strain on our management systems and resources including our financial and managerial controls, reporting systems and procedures. To manage our growth effectively, we must implement and improve 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. Moreover, we could spend substantial amounts of time and money in connection with our rapid growth and may have unexpected costs. 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. While we have not, to date, suffered any significant adverse consequences due to our growth, if we do not continue to manage growth effectively our operating expenses could increase more rapidly than our revenue, causing decreased profitability.

Risks Related to Our Industry

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 flat panel displays, digital televisions, IPTV televisions and set top boxes and other emerging display technologies will increase in the future. The success of our products is dependent on increased demand for these display technologies. The potential size of the market for products incorporating these display technologies and the timing of its development are uncertain and will depend upon a number of factors, all of which are beyond our control. In order for the market for many of our products 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. Undercapacity in the advanced display market may limit our ability to increase our revenues because our customers may limit their purchases of our products if they cannot obtain sufficient supplies of LCD panels or other advanced display components. In addition, advanced display prices may remain high because of limited supply, and consumer demand may not grow.

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 these products, or consumers will 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.

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 display screens 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 that 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 advanced display, digital TV and IPTV semiconductor products. Some of these include Analog Devices, ATI, Broadcom, Genesis Microchip, I-Chips, ITE, Macronix, Mediatek, Media Reality Technologies, Micronas, MStar Semiconductor, Inc., Oplus, Realtek, Sigma Designs, Silicon Image, Silicon Optix, STMicroelectronics, Techwell, Topro, Trident, Trumpion, Weltrend, Zoran and other companies. Potential competitors may include diversified semiconductor manufacturers and the semiconductor divisions or affiliates of some of our customers, including Intel, Koninlijke Philips Electronics, LG Electronics, Matsushita Electric Industrial, Mitsubishi, National Semiconductor, NEC, nVidia, Samsung Electronics, Sanyo Electric Company, Sharp Corporation, Sony Corporation, Texas Instruments and Toshiba Corporation. 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. Some of our competitors may 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 and higher quality semiconductors to our customers than those offered by us. 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.

In the past, the semiconductor industry has been characterized by significant downturns and wide fluctuations in supply and demand. Also, during this time, 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. It has also accelerated erosion of average selling prices per unit. We may experience periodic fluctuations in our future financial results because of changes in industry-wide conditions.

Other Risks

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 the shareholders consider the merger or acquisition 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 create and issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us or change our control, commonly referred to as “blank check” preferred stock;
- members of our board of directors can only be removed for cause;
- 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.

Our principal shareholders have significant voting power and may take actions that may make it more difficult to sell our shares at a premium to take over candidates.

Our executive officers, directors and other principal shareholders, in the aggregate, beneficially own 25,917,461 shares or approximately 54% of our outstanding common stock and exchangeable shares as of October 31, 2005. These shareholders currently have, and will continue to have, significant influence with respect to the election of our directors and approval or disapproval of our significant corporate actions. This influence over our affairs might be adverse to the interest of our other shareholders. In addition, the voting power of these shareholders could have the effect of delaying or preventing a change in control of our business or otherwise discouraging a potential acquirer from attempting to obtain control of us, which could prevent our other shareholders from realizing a premium over the market price for their common stock.

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

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:

- actual or anticipated fluctuations in our operating results;
- changes in expectations as to our future financial performance;
- changes in financial estimates of securities analysts;
- announcements by us or our competitors of technological innovations, design wins, contracts, standards or acquisitions;
- the operating and stock price performance of other comparable companies;
- announcements of future expectations by our customers;
- changes in market valuations of other technology companies; and
- inconsistent trading volume levels of our common stock.

In particular, the stock prices of technology companies similar to us have been highly volatile. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. Market fluctuations as well as general economic, political and market 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.

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

We believe our current cash and marketable security balances will be sufficient to meet our capital requirements for the next twelve months. However, we may need, or could elect to seek, additional funding prior to that time. To the extent that currently available funds are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. Additional funds may not be available on terms favorable to us or our shareholders. Further, 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.

We may be unable to meet changing laws, regulations and standards relating to corporate governance and public disclosure.

We are spending an increasing 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 SEC regulations and NASDAQ Stock Market rules. In particular, Section 404 of the Sarbanes-Oxley Act of 2002 requires management's annual review and evaluation of our internal control systems, and attestations of the effectiveness of these systems by our independent registered public accounting firm. The process of documenting and testing our controls has required that we hire additional personnel and outside advisory services and has resulted in additional accounting and legal expenses. 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. In addition, there are inherent limitations to the effectiveness of any system of disclosure 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 disclosure controls and procedures can provide only reasonable assurance of achieving their control objectives.

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 September 30, 2005, we had convertible subordinated debentures of $150,000 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, the People's Republic of China, and Korea, 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. While we cannot reasonably estimate the effect that an immediate 10% change in foreign currency exchange rates would have on our operating results or cash flows, we believe that the effect would not be material. We do not currently hedge against foreign currency rate fluctuations.

Item 4. Controls and Procedures.

(a) *Evaluation of Disclosure Controls and Procedures*.

Our management, with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures as of the end of the period covered by this report pursuant to Securities Exchange Act Rule 13a-15(e) and 15d-15(e). Based upon this evaluation, our CEO and CFO concluded that our controls and procedures are effective in timely alerting them to material information regarding the Company (including its consolidated subsidiaries) required to be included in our periodic SEC filings.

(b) *Changes in Internal Controls*.

There has been no change in our internal control over financial reporting during the quarter ended September 30, 2005 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II — OTHER INFORMATION

Item 6. Exhibits.

10.1	Equator Technologies, Inc. 1996 Stock Option Plan, as amended (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.2	Stock Option Agreement, dated April 18, 2002, between Equator Technologies, Inc. and Christopher H. Basoglu (incorporated by reference to Exhibit 99.2 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.3	Stock Option Agreement, dated April 8, 2003, between Equator Technologies, Inc. and Christopher H. Basoglu (incorporated by reference to Exhibit 99.3 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.4	Stock Option Agreement, dated November 11, 2003, between Equator Technologies, Inc. and Christopher H. Basoglu (incorporated by reference to Exhibit 99.4 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.5	Stock Option Agreement, dated April 18, 2002, between Equator Technologies, Inc. and Richard E. Christopher (incorporated by reference to Exhibit 99.5 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.6	Stock Option Agreement, dated April 8, 2003, between Equator Technologies, Inc. and Richard E. Christopher (incorporated by reference to Exhibit 99.6 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.7	Stock Option Agreement, dated November 11, 2003, between Equator Technologies, Inc. and Richard E. Christopher (incorporated by reference to Exhibit 99.7 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.8	Stock Option Agreement, dated September 15, 2004, between Equator Technologies, Inc. and Richard E. Christopher (incorporated by reference to Exhibit 99.8 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.9	Stock Option Agreement, dated November 11, 2003, between Equator Technologies, Inc. and Michael Myhre (incorporated by reference to Exhibit 99.9 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.10	Stock Option Agreement, dated July 18, 2002, between Equator Technologies, Inc. and Tedford Niday (incorporated by reference to Exhibit 99.10 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.11	Stock Option Agreement, dated April 8, 2003, between Equator Technologies, Inc. and Tedford Niday (incorporated by reference to Exhibit 99.11 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.12	Stock Option Agreement, dated November 11, 2003, between Equator Technologies, Inc. and Tedford Niday (incorporated by reference to Exhibit 99.12 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.13	Stock Option Agreement, dated March 29, 2001, between Equator Technologies, Inc. and John O'Donnell (incorporated by reference to Exhibit 99.13 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +

10.14	Stock Option Agreement, dated July 18, 2002, between Equator Technologies, Inc. and John O'Donnell (incorporated by reference to Exhibit 99.14 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.15	Stock Option Agreement, dated April 8, 2003, between Equator Technologies, Inc. and John O'Donnell (incorporated by reference to Exhibit 99.15 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.16	Stock Option Agreement, dated November 11, 2003, between Equator Technologies, Inc. and John O'Donnell (incorporated by reference to Exhibit 99.16 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.17	Pixelworks, Inc. 1997 Stock Incentive Plan, as amended (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 filed June 21, 2005). +
10.18	Office Lease dated April 12, 2001, by and between Equator Technologies, Inc. and Pike Street Delaware, Inc. (incorporated by reference to Exhibit 10.18 to the Company's Quarterly Report on Form 10-Q filed August 9, 2005)
10.19	Real Property Lease dated March 21, 2001, by and between Equator Technologies, Inc. and Limar Realty Corp. #30. (incorporated by reference to Exhibit 10.19 to the Company's Quarterly Report on Form 10-Q filed August 9, 2005)
10.20	Amendment No. 1 to Office Lease dated July 7, 2005, by and between Equator Technologies, Inc. and 520 Pike Street, Inc.
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.

SIGNATURES

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.
(Registrant)

Date: November 7, 2005

By: /s/ Jeffrey B. Bouchard
Jeffrey B. Bouchard
Vice President, Finance and
Chief Financial Officer

Exhibit 10.20

AMENDMENT NO. 1 TO OFFICE LEASE

THIS AMENDMENT NO. 1 TO OFFICE LEASE (this "Amendment") is made this 7th day of July, 2005, by and between 520 Pike Street, Inc., a Delaware corporation ("Landlord"), and Equator Technologies, Inc., a Delaware corporation ("Tenant").

WITNESSETH:

RECITALS: Landlord and Tenant are now parties to that certain Office Lease dated April 12, 2001 (the "Lease"), whereby Landlord leases to Tenant and Tenant leases from Landlord certain premises commonly known as Suite 900 of the 520 Pike Tower located at 520 Pike Street in the City of Seattle, County of King, State of Washington, all as more particularly described in the Lease. Landlord and Tenant desire to change the location of the Premises, extend the term of the Lease, provide for expansion of the Premises, grant Tenant certain options to further expand the Premises, change the rent and make certain other changes to the Lease. The terms and provisions of this Amendment shall be effective as of August 15, 2005, or such later date on which the Initial Installations are Substantially Complete (as described in Section 6 of the Workletter), but in no event later than August 25, 2005 (the "Effective Date"), except that Sections 2 and 11 of this Amendment shall be effective on the earlier dates set forth in such Sections. The terms and provisions of the Lease, without giving effect to this Amendment, including without limitation, the provisions relating to the Premises, Base Rent Additional Rent, the Base Tax Year, and the Base Expense Year, shall remain effective for all purposes as to all periods prior to the Effective Date. All terms used in this Amendment, but not defined in this Amendment, shall have the same meanings ascribed to them in the Lease. This Recital forms a contractual part of this Amendment.

NOW, THEREFORE, in consideration of the mutual covenants contained in the Lease and herein and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, Landlord and Tenant hereby agree that the Lease is amended, effective as of as of the Effective Date as follows:

1. Article 1, Section B. of the Lease is amended to read as follows:

"B. Premises: Suite 1375 in the Building as outlined or cross-hatched on Exhibit A-2."

2. **Delivery of Possession of Suite 1375; Vacation of Suite 900.** Landlord shall deliver possession of Suite 1375 to Tenant on the Effective Date. Tenant shall vacate Suite 900 on the Effective Date, in accordance with Article 23 of the Lease and all other applicable provisions of the Lease.

3. Article 1, Section D. of the Lease is amended to read as follows:

"D. Expiration Date: October 15, 2011, or the date which is six (6) years and two (2) months after the Effective Date."

4. Article 1, Section E. of the Lease is amended to read as follows:

"E. Rentable Area: The rentable area of the Premises shall be deemed 7,589 square feet, and the rentable area of the Property shall be deemed 374,225 square feet, for purposes of this Lease, subject to Article 32."

5. Article 1, Section F. of the Lease is amended to read as follows:

"F. Tenant's Share: Two and 03/100ths percent (2.02%), subject to Articles 4 and 32."

6. Article 1, Section G. of the Lease is amended to read as follows:

"G. Base Rent: Base Rent shall be the following amounts per month during the following periods:

Period	Monthly Amount
August 15, 2005 — August 14, 2006	$13,596.96
August 15, 2006 — August 14, 2007	$14,229.38
August 15, 2007 — August 14, 2008	$14,861.79
August 15, 2008 — August 14, 2009	$15,494.21
August 15, 2009 — August 14, 2010	$16,126.63
August 15, 2010 — August 14, 2011	$16,759.04
August 15, 2011 — October 15, 2011	$17,391.46

If the Effective Date is later than August 15, 2005, then the above rent schedule shall be appropriately adjusted."

7. Article. 1, Section H. of the Lease is amended to read as follows:

"H. Additional Rent: Tenant shall pay Tenant's Share of Taxes and Expenses in excess of the amounts, respectively, for the year 2005 ("Base Tax Year") and for the year 2005 ("Base Expense Year"), as further described in Article 4."

8. Article 1, Section J. of the Lease is amended to read as follows:

“J. Security Deposit:	$59,000.00, provided, however, that if, as of September 1, 2007, Tenant has not been, and is not then, in default under this Lease beyond applicable notice and cure periods, the Security Deposit shall be reduced to $27,950.00, and the difference of $31,050.00 shall be credited against Base Rent, or, at Landlord’s option and in lieu of such credit, refunded directly to Tenant. The Security Deposit shall be subject to Article 16.”

9. **Termination Payment.** The Lease, without giving effect to this Amendment, provides for Base Rent, Additional Rent and other charges during the period from August 15, 2005 to September 30, 2006, of approximately $750,000. In consideration of the termination of the original terms of the Lease, Tenant agrees to pay to Landlord a termination payment equal to the sum of Four Hundred Thousand and No/100 Dollars ($400,000), without interest (the “Termination Payment”), payable in seventy-three (73) equal monthly installments of Five Thousand Four Hundred Seventy-nine and 45/100 Dollars ($5,479.45) on the first day of each month commencing on September 1, 2005, and ending on September 1, 2011 (the “Amortization Rent”). If the Lease is terminated due to destruction of the Building and/or the Premises or a taking of the Building and/or the Premises by condemnation during the period from September 1, 2005 to September 30, 2006, then the Termination Payment shall be reduced by an amount that is in the same ratio to the Termination Payment as the number of days from the date of such destruction or taking to September 30, 2006 bears to the total number of days from September 1, 2005 to September 30, 2006. If the Lease is terminated for any reason, including the destruction of the Building and/or the Premises or a taking of the Building and/or the Premises by condemnation, Tenant’s obligation to pay the Termination Payment (as the Termination Payment may be reduced pursuant to this Section) to Landlord shall survive the termination of the Lease. If the Termination Payment is reduced pursuant to this Section, then the Amortization Rent shall be proportionately reduced.

10. **Condition of Premises; Landlord’s Contribution; Tenant Improvements.** Tenant accepts Suite 1375 in its “AS IS” condition. Landlord shall provide a tenant improvement allowance for permanent improvements to the Premises, including telephone cabling, data cabling, and other low voltage cabling, of Twelve and 50/100 Dollars ($12.50) times the number of rentable square feet of space in the Premises, for a total tenant improvement allowance of Ninety-four Thousand Eight Hundred Sixty-two and 50/100 Dollars ($94,862.50) (“Landlord’s Contribution”). If the cost of the tenant improvements is more than Landlord’s Contribution, Tenant shall pay such excess cost. If the cost of the tenant improvements is less than Landlord’s Contribution, then Tenant may apply the unused portion of Landlord’s Contribution to pay for permanent improvements to the Must Take Expansion Space, including telephone cabling, data cabling, and other low voltage cabling. Landlord and Tenant shall enter into the Workletter attached to this Amendment as Exhibit B (the “Workletter”), which shall govern construction of the tenant improvements.

11. **Landlord's Additional Contribution.** Landlord shall provide an allowance of One Hundred Fifty-nine Thousand Five Hundred Fourteen and No/100 Dollars ($159,514.00) ("Landlord's Additional Contribution") to Tenant for Tenant's relocation costs, moving costs, tenant improvement costs and other related costs. The Landlord's Additional Contribution shall be paid within thirty (30) days of the date Tenant vacates Suite 900.

12. **Must Take Expansion Space.** Landlord shall deliver vacant possession of Suite 1340, consisting of 2,249 rentable square feet of space (the "Must Take Expansion Space"), to Tenant promptly after the existing lease covering the Must Take Expansion Space expires or after Landlord relocates the existing tenant of the Must Take Expansion Space, and the Premises shall be expanded to include the Must Take Expansion Space upon such delivery of possession. The existing lease covering the Must Take Expansion Space expires on September 30, 2006. Base Rent shall commence sixty (60) days after delivery of possession of the Must Take Expansion Space to Tenant (the "Must Take Expansion Space Rent Commencement Date"). Base Rent per month for the Must Take Expansion Space shall be equal to 2,249, times the applicable rate per square foot per year set forth in the below Rent Schedule, divided by twelve (12). Tenant will accept the Must Take Expansion Space in its then "AS IS" condition. Landlord shall provide a tenant improvement allowance for permanent tenant improvements to the Must Take Expansion Space, including telephone cabling: data cabling, and other low voltage cabling, of Twelve and 50/100 Dollars ($12.50) times the number of rentable square feet of space in the Must Take Expansion Space (the "Must Take Expansion Space Landlord Contribution"). If the cost of the tenant improvements to the Must Take Expansion Space is less than the portion of Landlord's Contribution, if any, applied to pay for tenant improvements to the Must Take Expansion Space and the Must Take Expansion Space Landlord Contribution, then Landlord and Tenant shall split the savings equally

<u>Rent Schedule</u>

Period	Rate per Square Foot per Year
August 15, 2005 — August 14, 2006	$ 21.50
August 15, 2006 — August 14, 2007	$ 22.50
August 15, 2007 — August 14, 2008	$ 23.50
August 15, 2008 — August 14, 2009	$ 24.50
August 15, 2009 — August 14, 2010	$ 25.50
August 15, 2010 — August 14, 2011	$ 26.50
August 15, 2011 — October 15, 2011	$ 27.50

Tenant's Share shall be appropriately adjusted sixty (60) days after delivery of possession of the Must Take Expansion Space to Tenant. If the Premises have not otherwise been expanded prior to that time, then Tenant's Share shall be increased to two and 63/100ths percent (2.63%) sixty (60) days after delivery of possession of the Must Take Expansion Space to Tenant.

13. **Temporary Space.** Landlord shall deliver possession of Suite 1210, consisting of 2,382 rentable square feet of space (the “Temporary Space”), to Tenant the day after execution of this Amendment by both parties (the “Temporary Space Delivery Date”). Tenant shall lease the Temporary Space from Landlord from the Temporary Space Delivery Date to the Must Take Expansion Space Rent Commencement Date. No Base Rent shall be payable by Tenant for the Temporary Space, however, Tenant shall pay to Landlord Tenant’s Temporary Space Share of Taxes and Expenses (as defined in the Lease) during the period from the Temporary Space Delivery Date to the Must Take Expansion Space Rent Commencement Date. Tenant’s Temporary Space Share is 64/100ths percent (.64%). Landlord estimates that Taxes and Expenses will be Ten and 28/100 Dollars ($10.28) per square foot during calendar year 2005. Tenant acknowledges that Tenant’s Temporary Space Share shall apply to the total amount of Taxes and Expenses, rather than to increases in Taxes and Expenses over the Base Tax Year and the Base Expense Year, respectively. Tenant shall vacate the Temporary Space within ten (10) days after the Must Take Expansion Space Rent Commencement Date, in accordance with Article 23 of the Lease and all other applicable provisions of the Lease.

14. **Option to Expand.** Tenant shall have the right, at its option, to expand the Premises to include any or all of the spaces described below (each, an “Expansion Space”) as of the dates set forth below (each, an “Availability Date”), by giving Landlord notice to such effect (the “Expansion Notice”) not less than three (3) months before the relevant Availability Date, or, if the relevant Expansion Space remains or becomes vacant and legally available for lease after the Availability Date, by giving Landlord notice to such effect (the “Expansion Notice”) not less than three (3) months before the anticipated commencement date as to the relevant Expansion Space set forth in the Expansion Notice (the “Expansion Space Commencement Date”). Landlord, at its option, may waive the requirement for three (3) months prior notice by giving notice to such effect to Tenant, and, if Landlord does so, then the Expansion Space Commencement Date shall be ten (10) days after receipt of Tenant’s Expansion Notice. Landlord shall deliver possession of each Expansion Space to Tenant in its “AS IS” condition on the Availability Date, the Expansion Space Commencement Date, or the date ten (10) days after receipt of Tenant’s Expansion Notice, as applicable. As of the Availability Date, the Expansion Space Commencement Date, or the date ten (10) days after receipt of Tenant’s Expansion Notice, as applicable, the Expansion Space shall be added to the Premises, and as of the date sixty (60) days after the Availability Date, the Expansion Space Commencement Date, or the date ten (10) days after receipt of Tenant’s Expansion Notice, as applicable, the Base Rent shall be increased by the then current Fair Market Value of the relevant Expansion Space, and Tenant’s Share shall be appropriately adjusted. The term “Fair Market Value” shall mean the then prevailing market rate per square foot for full service base rent for tenants of comparable quality for leases in comparable Class A office buildings of comparable age, use, location and quality in the Central Business District of Seattle, Washington taking into consideration the extent of the availability of space as large as the Premises in the marketplace and all other economic terms then customarily prevailing in the marketplace, all as

reasonably determined by Landlord, times the number of rentable square feet of space in the relevant Expansion Space. No real estate commissions shall be payable by Landlord with respect to any of the Expansion Spaces.

Space	Area	Availability Date
Suite 1320	1,324 RSF	November 1, 2008
Suite 1330	778 RSF	January 1, 2009
Suite 1310	1,331 RSF	August 1,2009

If an Expansion Space remains or becomes vacant and legally available for lease after the Availability Date; if Tenant gives an Expansion Notice to Landlord as to such Expansion Space, and if Landlord is then engaged in negotiations with one or more third parties to lease part or all of such Expansion Space, then Tenant shall elect to either (i) give Landlord ninety (90) days to complete such negotiations, and, if Landlord completes such negotiations, then Landlord shall have the right to lease such Expansion Space to such third party or parties, or (ii) lease all of such Expansion Space from Landlord on the terms and conditions, including Base Rent, Additional Rent and other terms and conditions set forth in Landlord's last offer to such third party or parties.

15. **Parking.** Tenant shall have the right to use one (1) parking stall in the parking garage of the Building per each 1,450 rentable square feet of space in the Premises from time to time. All such parking stalls shall be on a non-exclusive and unreserved basis. Based on 7,589 rentable square feet of space in the Premises, and either 2,382 rentable square feet of space in the Temporary Space, or 2,249 rentable square feet of space in the Must Take Expansion Space, Tenant shall have the right to use up to seven (7) parking stalls in the parking garage of the Building. Tenant shall pay Landlord's current rates for such parking stalls used during the Term. Upon Landlord's request, Tenant shall execute the parking garage operator's standard form of parking agreement.

16. **Replacement of Exhibit.** Exhibit A-2 of the Lease is replaced with Exhibit A-2 of this Amendment attached hereto

17. **No Other Modification.** Except as expressly amended herein, all of the terms, conditions and provisions of the Lease shall remain unmodified and in full force and effect.

DATED the date and year first above written.

LANDLORD:

520 PIKE STREET, INC.,
a Delaware corporation

By: /s/ Paul A. Galiano
PAUL A. GALIANO
Its: VICE PRESIDENT

TENANT:

Equator Technologies, Inc., a Delaware corporation

By: /s/ Jeff Bouchard
Its: Secretary

Exhibit 31.1

CERTIFICATION

I, Allen H. Alley, 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: November 7, 2005

/s/ Allen H. Alley
Allen H. Alley
Chairman of the Board, President and
Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Jeffrey B. Bouchard, 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: November 7, 2005

/s/ Jeffrey B. Bouchard
Jeffrey B. Bouchard
V*ice President, Finance and*
Chief Financial Officer

Exhibit 32.1

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

In connection with the Quarterly Report of Pixelworks, Inc. (the “Company”) on Form 10-Q for the quarterly period ended September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Allen H. Alley, Chairman of the Board, 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:

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/ Allen H. Alley
Allen H. Alley
Chairman of the Board, President and
Chief Executive Officer

Date: November 7, 2005

Exhibit 32.2

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

In connection with the Quarterly Report of Pixelworks, Inc. (the "Company") on Form 10-Q for the quarterly period ended September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Jeffrey B. Bouchard, Vice President, Finance and Chief Financial 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:

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/ Jeffrey B. Bouchard
Jeffrey B. Bouchard
Vice President, Finance and
Chief Financial Officer

Date: November 7, 2005