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

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended March 31, 2008.**

**or**

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

**For the transition period from ________________ to ________________.**

**Commission File Number: 000-30269**

# PIXELWORKS, INC.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **OREGON** | **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 of principal executive offices, including zip code,
and Registrant's telephone number, including area code)

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer ☐ | Accelerated filer ☑ | Non-accelerated filer ☐<br>(Do not check if a smaller reporting company) | Smaller reporting company ☐ |

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

Number of shares of Common Stock outstanding as of April 30, 2008: 43,784,946

**PIXELWORKS, INC.**
**FORM 10-Q**
**FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2008**

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## PART I – FINANCIAL INFORMATION

### Item 1. Financial Statements.

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

| | March 31, 2008 | December 31, 2007 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 45,314 | $ 74,572 |
| Short term marketable securities | 27,920 | 34,581 |
| Accounts receivable, net | 5,844 | 6,223 |
| Inventories, net | 8,253 | 11,265 |
| Prepaid expenses and other current assets | 4,465 | 3,791 |
| Total current assets | 91,796 | 130,432 |
| Long term marketable securities | 8,177 | 9,804 |
| Property and equipment, net | 6,188 | 6,148 |
| Other assets, net | 7,276 | 6,902 |
| Debt issuance costs, net | 1,362 | 2,260 |
| Acquired intangible assets, net | 5,576 | 6,370 |
| Total assets | $ 120,375 | $ 161,916 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)** | | |
| Current liabilities: | | |
| Accounts payable | $ 3,751 | $ 3,992 |
| Accrued liabilities and current portion of long-term liabilities | 11,864 | 13,848 |
| Current portion of income taxes payable | 208 | 232 |
| Total current liabilities | 15,823 | 18,072 |
| Long-term liabilities, net of current portion | 1,723 | 1,236 |
| Income taxes payable, net of current portion | 10,250 | 10,635 |
| Long-term debt | 89,752 | 140,000 |
| Total liabilities | 117,548 | 169,943 |
| Commitments and contingencies | | |
| Shareholders' equity (deficit): | | |
| Preferred stock | — | — |
| Common stock | 333,776 | 333,934 |
| Shares exchangeable into common stock | — | 113 |
| Accumulated other comprehensive income (loss) | 214 | (4,778) |
| Accumulated deficit | (331,163) | (337,296) |
| Total shareholders' equity (deficit) | 2,827 | (8,027) |
| Total liabilities and shareholders' equity | $ 120,375 | $ 161,916 |

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 March 31, | |
|---|---|---|
| | **2008** | **2007** |
| Revenue, net | $ 23,976 | $ 23,981 |
| Cost of revenue (1) | 12,305 | 14,128 |
| Gross profit | 11,671 | 9,853 |
| Operating expenses: | | |
| Research and development (2) | 6,722 | 11,975 |
| Selling, general and administrative (3) | 4,686 | 7,525 |
| Restructuring | 1,008 | 2,768 |
| Amortization of acquired intangible assets | 90 | 90 |
| Total operating expenses | 12,506 | 22,358 |
| Loss from operations | (835) | (12,505) |
| Gain on repurchase of long-term debt, net | 11,557 | — |
| Other-than-temporary impairment of marketable security | (6,490) | — |
| Interest income | 983 | 1,527 |
| Interest expense | (573) | (657) |
| Amortization of debt issuance costs | (146) | (165) |
| Interest and other income, net | 5,331 | 705 |
| Income (loss) before income taxes | 4,496 | (11,800) |
| Provision (benefit) for income taxes | (1,637) | 622 |
| Net income (loss) | $ 6,133 | $(12,422) |
| Net income (loss) per share — basic and diluted | $ 0.14 | $ (0.25) |
| Weighted averages shares outstanding: | | |
| Basic | 44,791 | 48,780 |
| Diluted | 49,943 | 48,780 |

| | | |
|---|---|---|
| (1) Includes: | | |
| Amortization of acquired developed technology | $ 705 | $ 705 |
| Restructuring | — | 101 |
| Stock-based compensation | 18 | 20 |
| (2) Includes stock-based compensation | 449 | 670 |
| (3) Includes stock-based compensation | 425 | 1,033 |

See accompanying notes to condensed consolidated financial statements.

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

| | Three Months Ended March 31, 2008 | Three Months Ended March 31, 2007 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income (loss) | $ 6,133 | $(12,422) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | |
| Gain on repurchase of long-term debt, net | (11,557) | — |
| Other than temporary impairment of marketable security | 6,490 | — |
| Depreciation and amortization | 1,706 | 3,886 |
| Stock-based compensation | 892 | 1,723 |
| Amortization of acquired intangible assets | 794 | 795 |
| Deferred income tax benefit | (446) | — |
| Accretion on short- and long term marketable securities | (194) | (70) |
| Amortization of debt issuance costs | 146 | 165 |
| Loss on asset disposals | 33 | 49 |
| Other | 12 | (66) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable, net | 379 | (3,324) |
| Inventories, net | 3,012 | (83) |
| Prepaid expenses and other current and long-term assets, net | (952) | 689 |
| Accounts payable | (241) | 1,264 |
| Accrued current and long-term liabilities | (667) | (2,181) |
| Income taxes payable | (409) | (624) |
| Net cash provided by (used in) operating activities | 5,131 | (10,199) |
| Cash flows from investing activities: | | |
| Proceeds from maturities of marketable securities | 22,174 | 22,602 |
| Purchases of marketable securities | (15,189) | (6,324) |
| Payments on asset financings | (1,803) | (2,116) |
| Purchases of property and equipment | (473) | (694) |
| Proceeds from sales of property and equipment | 4 | — |
| Net cash provided by investing activities | 4,713 | 13,468 |
| Cash flows from financing activities: | | |
| Repurchase of long-term debt | (37,939) | — |
| Repurchase of common stock | (1,198) | — |
| Proceeds from issuances of common stock | 35 | 243 |
| Net cash provided by (used in) financing activities | (39,102) | 243 |
| Net change in cash and cash equivalents | (29,258) | 3,512 |
| Cash and cash equivalents, beginning of period | 74,572 | 63,095 |
| Cash and cash equivalents, end of period | $ 45,314 | $ 66,607 |

See accompanying notes to condensed consolidated financial statements.

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

## NOTE 1: BASIS OF PRESENTATION

### Nature of Business

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

### Condensed Consolidated Financial Statements

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

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

The results of operations for the three month period ended March 31, 2008 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2008.

### Use of Estimates

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

**Reclassifications**

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

## NOTE 2: BALANCE SHEET COMPONENTS

**Marketable Securities**

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

Unrealized holding gains (losses) on short- and long-term available-for-sale securities, net of tax, were $89 and $168, respectively, as of March 31, 2008 and ($22) and ($4,713), respectively, as of December 31, 2007. These unrealized holding gains and losses are recorded in accumulated other comprehensive income (loss), a component of shareholders' equity (deficit), in the condensed consolidated balance sheets.

On March 31, 2008 we analyzed our long-term equity security for other-than-temporary impairment in accordance with Financial Accounting Standards Board ("FASB") Staff Position 115-1/124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. As of March 31, 2008, the fair value of our investment had decreased $6,490 from our cost basis of $10,000 to $3,510. After reviewing the investment's rapid decline in value from December 31, 2007 to March 31, 2008, the extended duration of time which the fair value of the investment had been below our cost, as well as decreased target price estimates, analyst downgrades and macroeconomic factors, we determined that we will not recover the cost basis of the investment. Accordingly, we recognized an other-than-temporary impairment loss of $6,490 in our statement of operations during the three months ended March 31, 2008. At December 31, 2007, $4,810 unrealized loss was included in accumulated other comprehensive loss.

**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:

| | March 31, 2008 | December 31, 2007 |
|---|---|---|
| Accounts receivable, gross | $ 6,386 | $ 6,765 |
| Less: allowance for doubtful accounts | (542) | (542) |
| Accounts receivable, net | $ 5,844 | $ 6,223 |

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Balance at beginning of period | $ 542 | $ 200 |
| Provision | — | 313 |
| Recoveries | — | — |
| Balance at end of period | $ 542 | $ 513 |

**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:

| | March 31, 2008 | December 31, 2007 |
|---|---|---|
| Finished goods | $ 8,106 | $ 12,733 |
| Work-in-process | 5,779 | 4,482 |
| | 13,885 | 17,215 |
| Less: reserve for slow-moving and obsolete items | (5,632) | (5,950) |
| Inventory, net | $ 8,253 | $ 11,265 |

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Balance at beginning of period | $ 5,950 | $ 5,950 |
| Provision | 967 | 1,105 |
| Usage: | | |
| Sales | (287) | (203) |
| Scrap | (998) | (667) |
| Total usage | (1,285) | (870) |
| Balance at end of period | $ 5,632 | $ 6,185 |

Based upon our forecast and backlog, we do not currently expect to be able to sell or otherwise use the reserved inventory we have on hand at March 31, 2008. However, it is possible that a customer will decide in the future to purchase a portion of the reserved inventory. It is not possible for us to predict if or when this may happen, or how much we may sell. If such sales occur, we do not expect that they will have a material effect on gross profit margin.

**Property and Equipment, Net**

Property and equipment, net consists of the following:

| | March 31, 2008 | December 31, 2007 |
|---|---|---|
| Gross carrying amount | $ 18,322 | $ 17,109 |
| Less: accumulated depreciation and amortization | (12,134) | (10,961) |
| Property and equipment, net | $ 6,188 | $ 6,148 |

**Acquired Intangible Assets, Net**

Acquired intangible assets, net consists of the following:

| | March 31, 2008 | December 31, 2007 |
|---|---|---|
| Gross carrying amount: | | |
| Developed technology | $ 19,170 | $ 19,170 |
| Customer relationships | 1,689 | 1,689 |
| | 20,859 | 20,859 |
| Less accumulated amortization: | | |
| Developed technology | (13,669) | (12,964) |
| Customer relationships | (1,614) | (1,525) |
| | (15,283) | (14,489) |
| Acquired intangible assets, net | $ 5,576 | $ 6,370 |

Estimated future amortization of acquired intangible assets is as follows:

| | |
|---|---|
| Nine Months Ending December 31: | |
| 2008 | $ 2,190 |
| Year Ending December 31: | |
| 2009 | 2,336 |
| 2010 | 1,050 |
| | $ 5,576 |

**Accrued Liabilities and Current Portion of Long-Term Liabilities**

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

| | March 31, 2008 | December 31, 2007 |
|---|---|---|
| Current portion of accrued liabilities for asset financings | $ 3,224 | $ 4,150 |
| Accrued payroll and related liabilities | 2,592 | 3,366 |
| Accrued costs related to restructuring | 2,291 | 2,918 |
| Reserve for warranty returns | 742 | 932 |
| Accrued interest payable | 715 | 405 |
| Accrued commissions and royalties | 257 | 381 |
| Reserve for sales returns and allowances | 175 | 175 |
| Other | 1,868 | 1,521 |
| | $ 11,864 | $ 13,848 |

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

| | Three Months Ended March 31, 2008 | 2007 |
|---|---|---|
| Reserve for warranty returns: | | |
| Balance at beginning of period | $ 932 | $ 662 |
| Provision | (122) | 195 |
| Charge offs | (68) | (71) |
| Balance at end of period | $ 742 | $ 786 |
| | | |
| Reserve for sales returns and allowances: | | |
| Balance at beginning of period | $ 175 | $ 479 |
| Provision | 3 | 3 |
| Charge offs | (3) | (307) |
| Balance at end of period | $ 175 | $ 175 |

**Long-Term Debt**

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

The remaining $89,752 of debentures are convertible, under certain circumstances, into our common stock at a conversion rate of 41.0627 shares of common stock per $1 principal amount of debentures for a total of 3,685,459 shares. This is equivalent to a conversion price of approximately $24.35 per share. The debentures are convertible if (a) our stock trades above 130% of the conversion price for 20 out of 30 consecutive trading days during any calendar quarter, (b) the debentures trade at an amount less than or equal to 98% of the if-converted value of the debentures for five consecutive trading days, (c) a call for redemption occurs, or (d) in the event of certain other specified corporate transactions.

We may redeem some or all of the debentures for cash on or after May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest. The holders of the debentures have the right to require us to purchase all or a portion of the $89,752 debentures outstanding at each of the following dates: May 15, 2011, May 15, 2014, and May 15, 2019, at a purchase price equal to 100% of the principal amount plus accrued and unpaid interest. The debentures are unsecured obligations and are subordinated in right of payment to all our existing and future senior debt.

**Shareholders' Equity (Deficit)**

On September 25, 2007, we announced a share repurchase program under which the Board of Directors authorized the repurchase of up to $10,000 of our common stock over the next twelve months. The program does not obligate us to acquire any particular amount of common stock and may be modified or suspended at any time at our discretion. Share repurchases under the program may be made through open market and privately negotiated transactions at our discretion, subject to market conditions and other factors. During 2007 we repurchased 3,782,500 common shares at a cost of $4,269. From January 1, 2008 through March 31, 2008, we repurchased 1,593,800 shares for $1,198. As of March 31, 2008, $4,533 remained available for repurchase under the plan.

**NOTE 3: FAIR VALUE MEASUREMENT**

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

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

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

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

The table below presents information about our financial assets and liabilities measured at fair value at March 31, 2008:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Cash equivalents | $ 31,454 | $ 4,399 | — | $ 35,853 |
| Short-term marketable securities | — | 27,920 | — | 27,920 |
| Long-term marketable securities | 3,510 | 4,667 | — | 8,177 |
| Total | $ 34,964 | $ 36,986 | — | $ 71,950 |

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

The adoption of SFAS 157 for financial assets and financial liabilities did not have a material impact on our consolidated financial statements. FSP 157-2 *Partial Deferral of the Effective Date of Statement 157*

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

On January 1, 2008, we adopted SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities* ("SFAS 159"). SFAS 159 allows us to measure many financial instruments and certain other items at fair value. We have currently chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with GAAP.

**NOTE 4: RESTRUCTURING PLANS**

In 2006, we initiated restructuring plans aimed at returning the Company to profitability. We continued to implement these plans throughout 2007 and during the quarter ended March 31, 2008. The following is a summary of restructuring expense incurred during the three months ended March 31, 2008 and the cumulative amount incurred through March 31, 2008:

| | Three Months Ended March 31, 2007 | Cumulative Amount Incurred To March 31, 2008 |
|---|---|---|
| Cost of revenue — restructuring: | | |
| Termination and retention benefits | $ — | $ 219 |
| Licensed technology and tooling write-offs | — | 2,072 |
| | — | 2,291 |
| Operating expenses — restructuring: | | |
| Consolidation of leased space | 541 | 3,101 |
| Termination and retention benefits | 467 | 8,449 |
| Net write off of assets and reversal of related liabilities | — | 13,451 |
| Contract termination fee | — | 1,693 |
| Payments, non-cancelable contracts | — | 827 |
| Other | — | 88 |
| | 1,008 | 27,609 |
| Total restructuring expense | $ 1,008 | $ 29,900 |

The following is a summary of the change in accrued liabilities related to the restructuring plans for the three months ended March 31, 2008:

| | Balance as of December 31, 2007 | Expensed | Payments | Balance as of March 31, 2008 |
|---|---|---|---|---|
| Termination and retention benefits | $ 1,758 | $ 467 | $ (882) | $ 1,343 |
| Lease termination costs | 999 | 541 | (287) | 1,253 |
| Contract termination and other costs | 514 | — | (496) | 18 |
| Total | $ 3,271 | $ 1,008 | $ (1,665) | $ 2,614 |

We expect to incur additional restructuring expenses during 2008 as we continue implementing the restructuring plan announced in November 2006.

**NOTE 5: INCOME TAXES**

The provision (benefit) for income taxes recorded for the three month periods ended March 31, 2008 and 2007 includes current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. Additionally, during the three months ended March 31, 2008, we recorded a benefit of $1,000 for refundable research and experimentation credits, a benefit of $559 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, and a deferred tax benefit of $446 which resulted from an increase in the tax rate of a single foreign jurisdiction.

As of March 31, 2008, we continued to provide a full valuation allowance against essentially all of our U.S. and Canadian net deferred tax assets as we do not believe that it is more likely than not that we will realize a benefit from those assets. We have not recorded a valuation allowance against our other foreign net deferred tax assets as we believe that it is more likely than not that we will realize a benefit from those assets.

As of March 31, 2008 and December 31, 2007, the amount of our uncertain tax positions was a liability of $10,250 and $10,635, respectively. A number of years may elapse before an uncertain tax position is resolved by settlement or statute of limitations. Settlement of any particular position could require the use of cash. If the uncertain tax positions we have accrued for are sustained by the taxing authorities in our favor, the reduction of the liability will reduce our effective tax rate. We reasonably expect reductions in the liability for unrecognized tax benefits of approximately $1,760 within the next twelve months due to the expiration of a statute of limitations in a foreign jurisdiction. We recognize interest and penalties related to uncertain tax positions in income tax expense in our consolidated statement of operations.

**NOTE 6: COMPREHENSIVE INCOME (LOSS)**

Total comprehensive income (loss) was as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Net income (loss) | $ 6,133 | $(12,422) |
| Reclassification adjustment from accumulated other comprehensive income for other-than-temporary loss on marketable security included in net income, net of tax | 4,810 | — |
| Unrealized gain on available-for-sale investments, net of tax | 182 | 532 |
| Total comprehensive income (loss) | $ 11,125 | $(11,890) |

**NOTE 7: EARNINGS PER SHARE**

We calculate earnings per share in accordance with SFAS 128, *Earnings per Share*. Basic earnings per share amounts are computed based on the weighted average number of common shares outstanding, and include exchangeable shares. These exchangeable shares, which were issued on September 6, 2002 by Jaldi, our Canadian subsidiary, to its shareholders in connection with the Jaldi asset acquisition, have characteristics essentially equivalent to Pixelworks' common stock. At March 31, 2008 there were no outstanding exchangeable shares.

Diluted weighted average shares outstanding includes the incremental number of common shares that would be outstanding assuming the exercise of certain stock options, when such exercise would have the effect of reducing earnings per share, and the conversion of our convertible debentures, using the if-converted method, when such conversion is dilutive. If our convertible debentures are dilutive, interest expense and amortization of debt issuance costs, net of tax, are added to net income used in calculating basic net income per share to arrive at net income used in calculating diluted net income per share.

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Net income (loss) used in basic net income (loss) per share | $ 6,133 | $(12,422) |
| Interest expense on long-term debt, net of tax and amortization of debt issuance costs, net of tax (if dilutive) | 692 | — |
| Net income (loss) used in diluted net income (loss) per share | $ 6,825 | $(12,422) |
| | | |
| Basic weighted average shares outstanding | 44,791 | 48,780 |
| Common share equivalents: | | |
| Dilutive effect of stock options | 38 | — |
| Dilutive effect of conversion of long-term debt | 5,114 | — |
| Diluted weighted average shares outstanding | 49,943 | 48,780 |
| Net income (loss) per common share — basic and diluted | $ 0.14 | $ (0.25) |

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Stock options | 4,906 | 6,638 |
| Conversion of debentures | — | 5,749 |
| | 4,906 | 12,387 |

**NOTE 8: SUPPLEMENTAL CASH FLOW INFORMATION**

Supplemental disclosure of cash flow information is as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Cash paid during the period for: | | |
| Interest | $ 281 | $ 44 |
| Income taxes | 207 | 1,246 |
| | | |
| Non-cash investing and financing activities: | | |
| Acquisitions of property and equipment and other assets under extended payment terms | $ 973 | $ — |

**NOTE 9: SEGMENT INFORMATION**

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

**Geographic Information**

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

| | Three Months Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Japan | $ 14,005 | $ 12,993 |
| Europe | 2,377 | 1,648 |
| Taiwan | 1,893 | 3,025 |
| Korea | 1,603 | 2,426 |
| U.S. | 968 | 1,061 |
| China | 720 | 1,402 |
| Other | 2,410 | 1,426 |
| | $ 23,976 | $ 23,981 |

**Significant Customers**

Sales to distributors represented 52% and 55% of total revenue for the three months ended March 31, 2008 and 2007, respectively. The following distributors represented 10% or more of total revenue in at least one of the periods presented:

| | Three Months Ended March 31, | |
|---|---|---|
| | 2008 | 2007 |
| Distributor A | 28% | 32% |
| Distributor B | 10% | 6% |

End customers include customers who purchase directly from us, as well as customers who purchase our products indirectly through distributors and manufacturers' representatives. Revenue attributable to our top five end customers represented 57% and 48% of revenue for the three months ended March 31, 2008 and 2007, respectively. One end customer represented 27% and 21% of total revenue for the three months ended March 31, 2008 and 2007. No other end customer represented 10% or more of revenue during these periods.

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

| | March 31, 2008 | December 31, 2007 |
|---|---|---|
| Account A | 31% | 27% |
| Account B | 11% | 7% |
| Account C | 10% | 21% |
| Account D | 10% | 3% |

**NOTE 10: RISKS AND UNCERTAINTIES**

**Concentration of Suppliers**

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

**Risk of Technological Change**

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

**Concentrations of Credit Risk**

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

**NOTE 11: COMMITMENTS AND CONTINGENCIES**

**Indemnifications**

Certain of our agreements include limited indemnification provisions for claims from third-parties relating to our intellectual property. Such indemnification provisions are accounted for in accordance with FASB Summary of Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others-an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No.34*. The indemnification is limited to the amount paid by the customer. As of March 31, 2008, we have not incurred any material liabilities arising from these indemnification obligations. However, in the future such obligations could immediately impact our results of operations but are not expected to materially affect our business.

**Legal Proceedings**

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

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

**Forward-looking Statements**

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains "forward-looking statements" that are based on current expectations, estimates, beliefs, assumptions and projections about our business. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and variations of such words and similar expressions are intended to identify such forward-looking statements. 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 economic conditions in the U.S. and internationally, including adverse economic conditions in the specific markets for our products, adverse business conditions, failure to design, develop and manufacture new products, lack of success in technological advancements, lack of acceptance of new 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, our ability to attract, hire and retain key and qualified employees, and other risks identified in the risk factors contained in Part II, Item 1A of this Quarterly Report on Form 10-Q. These forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q. If we do update or correct one or more forward-looking statements, you should not conclude that we will make additional updates or corrections with respect thereto or with respect to other forward-looking statements. Except where the context otherwise requires, in this Quarterly Report on Form 10-Q, the "Company," "Pixelworks," "we," "us" and "our" refer to Pixelworks, Inc., an Oregon corporation, and, where appropriate, its subsidiaries.

**Overview**

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

**Results of Operations**

<u>Revenue, net</u>

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

| | Three months ended March 31, 2008 | 2007 | 2008 v 2007 $ change | % change | % of net revenue 2008 | 2007 |
|---|---|---|---|---|---|---|
| Multimedia projector | $ 14,285 | $ 12,685 | $ 1,600 | 13% | 60% | 53% |
| Advanced television | 3,320 | 5,757 | (2,437) | (42) | 14 | 24 |
| Advanced media processor | 3,843 | 3,940 | (97) | (2) | 16 | 16 |
| LCD monitor, panel and other | 2,528 | 1,599 | 929 | 58 | 10 | 7 |
| Total revenue | $ 23,976 | $ 23,981 | $ (5) | 0% | 100% | 100% |

Net revenue was constant at $24.0 million in the first quarters of 2008 and 2007. Although revenue was flat, average selling price ("ASP") and units sold increased 15% and decreased 13%, respectively, from the first quarter of 2007 to the first quarter of 2008. The increase in ASP from the first quarter of 2007 to the first quarter of 2008 was primarily due to an increase in the percentage of total revenue from the multimedia projector market.

*Multimedia Projector*

Revenue from the multimedia projector market increased 13% from the first quarter of 2007 to the first quarter of 2008. This increase resulted from our end customers' strength in the market and to growth of the market. Units sold and ASP in the multimedia projector market increased 11% and 2%, respectively, from the first quarter of 2007 to the first quarter of 2008.

*Advanced Television*

Revenue from the advanced television market decreased 42% from the first quarter of 2007 to the first quarter of 2008. This decrease was primarily attributable to our decision to shift focus away from the commoditized SoC segment of the advanced television market. With our new strategy we are developing co-processor ICs that will improve the video performance of any image processor in the large screen, high resolution, high quality segment of the advanced television market. Units sold and ASP in the advanced television market decreased 49% and increased 12%, respectively, from the first quarter of 2007 to the first quarter of 2008.

*Advanced Media Processor*

Revenue in the advanced media processor market resulted from our acquisition of Equator Technologies, Inc. in June 2005. Revenue from this market decreased 2% from the first quarter of 2007 to the first quarter of 2008. The decrease resulted from a 10% decrease in units sold, partially offset by an 8% increase in ASP.

As a result of our April 2006 restructuring plan, we expect to see revenue from this market decrease over time as customers switch to next generation designs from other suppliers.

*LCD Monitor, Panel and Other*

LCD monitor, panel and other revenue increased $0.9 million from the first quarter of 2007 to the first quarter of 2008. We have decided to no longer focus development efforts on any of these markets, and expect to see this revenue decrease over time.

Cost of revenue and gross profit

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

| | Three months ended March 31, | | | |
|---|---|---|---|---|
| | 2008 | % of revenue | 2007 | % of revenue |
| Direct product costs and related overhead [1] | $ 10,902 | 45% | $ 12,400 | 52% |
| Provision for obsolete inventory, net of usage | 680 | 3 | 902 | 4 |
| Amortization of acquired developed technology | 705 | 3 | 705 | 3 |
| Restructuring | — | — | 101 | 0 |
| Stock-based compensation | 18 | 0 | 20 | 0 |
| Total cost of revenue | $ 12,305 | 51% | $ 14,128 | 59% |
| Gross profit | $ 11,671 | 49% | $ 9,853 | 41% |

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

Direct product costs and related overhead decreased to 45% of total revenue in the first quarter of 2008, down from 52% of total revenue in the first quarter of 2007. This decrease resulted primarily from lower pricing obtained from vendors, a more favorable mix of products sold, increases in production yields and a decrease in royalty expense.

Research and development

Research and development expense includes compensation and related costs for personnel, development-related expenses including non-recurring engineering and fees for outside services, depreciation and amortization, expensed equipment, facilities and information technology expense allocations and travel and related expenses. Research and development expense was as follows (dollars in thousands):

| | Three months ended March 31, | | 2008 v 2007 | |
|---|---|---|---|---|
| | 2008 | 2007 | $ change | % change |
| Research and development [1] | $6,722 | $ 11,975 | $(5,253) | (44)% |
| [1] Includes stock-based compensation expense of: | 449 | 670 | | |

Research and development expense decreased $5.3 million, or 44%, from the first quarter of 2007 to the first quarter of 2008. This decrease is directly attributable to the restructuring efforts that we initiated in 2006 and continued to implement throughout 2007 and during the first quarter of 2008. These efforts are focused on returning the Company to profitability and resulted in the following reductions in research and development expenses:

- Depreciation and amortization expense, software maintenance expense and expensed equipment and software decreased $1.9 million. This decrease is primarily due to the December 31, 2007 write off of engineering software tools, which we are no longer using due to reductions in research and development personnel and changes in product development strategy.

- Compensation expense decreased $1.5 million. At March 31, 2008, we had 142 research and development employees compared to 200 at March 31, 2007.
- Development-related expenses, including non-recurring engineering and outside services, decreased $734,000.
- Facilities and information technology expense allocations decreased $714,000, primarily due to lower rent expense and reductions in outsourced IT support.
- Stock-based compensation expense decreased $221,000.
- Travel and related expenses decreased $136,000.

Selling, general and administrative

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

| | Three months ended March 31, | | 2008 v 2007 | |
|---|---|---|---|---|
| | 2008 | 2007 | $ change | % change |
| Selling, general and administrative [1] | $ 4,686 | $ 7,525 | $(2,839) | (38)% |
| [1] Includes stock-based compensation expense of: | 425 | 1,033 | | |

Selling, general and administrative expense decreased $2.8 million, or 38%, from the first quarter of 2007 to the first quarter of 2008. This decrease is directly attributable to the restructuring efforts that we initiated in 2006 and continued to implement throughout 2007 and during the first quarter of 2008. These efforts are focused on returning the Company to profitability and resulted in the following reductions in selling, general and administrative expenses:

- Compensation expense decreased $1.5 million. As of March 31, 2008, we had 66 employees in selling, general and administrative functions, compared to 137 as of March 31, 2007.
- Stock-based compensation expense decreased $608,000.
- Facilities and information technology allocations decreased $312,000.
- Travel and related expenses decreased $221,000.

Restructuring

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

| | Three months ended March 31, 2008 | Three months ended March 31, 2007 |
|---|---|---|
| Consolidation of leased space [1] | $ 541 | $ 8 |
| Termination and retention benefits [2] | 467 | 2,448 |
| Net write off of assets and reversal of related liabilities [3] | — | 347 |
| Other | — | 66 |
| Total restructuring expenses | $ 1,008 | $ 2,869 |
| Included in cost of revenue | $ — | $ 101 |
| Included in operating expenses | 1,008 | 2,768 |

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

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

3 During the three month period ended March 31, 2007, we wrote off assets with a net book value of $347,000 as a result of our restructuring plans. These assets consisted primarily of prepaid software maintenance.

Amortization of acquired intangible assets

Amortization of acquired intangible assets was $90,000 for each of the three month periods ended March 31, 2008 and 2007. Estimated future amortization expense is $75,000 for the remainder year ending December 31, 2008.

Interest and other income, net

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

| | Three months ended March 31, 2008 | Three months ended March 31, 2007 | $ change |
|---|---|---|---|
| Gain on repurchase of long-term debt, net [1] | $ 11,557 | $ — | $ 11,557 |
| Other-than-temporary impairment of marketable security, net [2] | (6,490) | — | (6,490) |
| Interest income [3] | 983 | 1,527 | (544) |
| Interest expense [4] | (573) | (657) | 84 |
| Amortization of debt issuance costs [5] | (146) | (165) | 19 |
| Total interest and other income, net | $ 5,331 | $ 705 | $ 4,626 |

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

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

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

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

5 The fees associated with the 2004 issuance of our long-term debt have been capitalized and are being amortized over a period of seven years. The remaining amortization period is approximately three years as of March 31, 2008.

Provision (benefit) for income taxes

The provision (benefit) for income taxes recorded for the three month periods ended March 31, 2008 and 2007 was $(1.6) million and $622,000, respectively, and includes current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. Additionally, during the three months ended March 31, 2008, we recorded a benefit of $1.0 million for refundable research and experimentation credits, a benefit of $559,000 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, and a deferred tax benefit of $446,000 which resulted from an increase in the tax rate of a single foreign jurisdiction. The tax rate change in the foreign jurisdiction will result in an adjustment to the carrying amount of our deferred tax assets.

Business Outlook

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

We expect to record net loss per share in the second quarter of 2008 of $(0.03) to $(0.10), based on the following estimates:

- Second quarter revenue of $19.0 million to $21.0 million.
- Gross profit margin of approximately 46% to 49%.
- Operating expenses of $11.5 million to $12.5 million.
- Interest and other income, net of approximately $150,000.
- Tax provision of $250,000 to $750,000.

**Liquidity and Capital Resources**

Cash and short- and long-term marketable securities

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

| | March 31, 2008 | December 31, 2007 | $ change | % change |
|---|---|---|---|---|
| Cash and cash equivalents | $ 45,314 | $ 74,572 | $(29,258) | (39)% |
| Short-term marketable securities | 27,920 | 34,581 | (6,661) | (19) |
| Long-term marketable securities | 8,177 | 9,804 | (1,627) | (17) |
| Total cash and marketable securities | $ 81,411 | $ 118,957 | $(37,546) | (32)% |

Total cash and marketable securities decreased 32% from December 31, 2007 to March 31, 2008. The net decrease in the first quarter of 2008 resulted primarily from $5.1 million cash flow from operations, offset by $37.9 million for the repurchase of long-term debt, $1.8 million in payments on property and equipment and other asset financing, $1.2 million for the repurchase of our common stock and $473,000 for purchases of property and equipment and other long-term assets.

We anticipate that our existing cash and investment balances will be adequate to fund our operating and investing needs for the next twelve months and the foreseeable future. From time to time, we may evaluate acquisitions of businesses, products or technologies that complement our business. 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 decreased to $5.8 million at March 31, 2008 from $6.2 million at December 31, 2007. The average number of days sales outstanding increased to 22 days at March 31, 2008 from 21 days at December 31, 2007.

Inventories, net

Inventories, net decreased to $8.3 million at March 31, 2008 from $11.3 million at December 31, 2007. Inventory turnover on an annualized basis increased to 4.7 at March 31, 2008 from 3.9 at December 31, 2007. As of March 31, 2008, this represented approximately eleven weeks of inventory on hand.

Capital resources

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

We may redeem some or all of the debentures for cash on or after May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest. The holders of the debentures have the right to require us to purchase all or a portion of the $89.8 million debentures outstanding at each of the following dates: May 15, 2011, May 15, 2014, and May 15, 2019, at a purchase price equal to 100% of the principal amount plus accrued and unpaid interest.

The debentures are unsecured obligations and are subordinated in right of payment to all our existing and future senior debt.

On September 25, 2007, we announced a share repurchase program under which the board of directors authorized the repurchase of up to $10.0 million of our common stock over the next twelve months. During 2007, we repurchased 3,782,500 common shares at a cost of $4.3 million. During the first quarter of 2008, we purchased an additional 1,593,800 shares at a cost of $1.2 million. As of March 31, 2008, $4.5 million remained available for repurchase under the plan.

**Contractual Payment Obligations**

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

**Off-Balance Sheet Arrangements**

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

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

Our primary market risk exposure is the impact of interest rate fluctuations on interest income earned on our investment portfolio. We mitigate risks associated with such fluctuations, as well as the risk of loss of principal, by investing in high-credit quality securities and limiting concentrations of issuers and maturity dates. Derivative financial instruments are not part of our investment portfolio.

As of March 31, 2008, we had convertible subordinated debentures of $89.8 million outstanding with a fixed interest rate of 1.75%. Interest rate changes affect the fair value of the debentures, but do not affect our earnings or cash flow.

All of our sales are denominated in U.S. dollars and as a result, we have relatively little exposure to foreign currency exchange risk with respect to our sales. We have employees located in offices in Canada, Japan, Taiwan and the People’s Republic of China and as such, a portion of our operating expenses are denominated in foreign currencies. Accordingly, our operating results are affected by changes in the exchange rate between the U.S. dollar and those currencies. Any future strengthening of those currencies against the U.S. dollar could negatively impact our operating results by increasing our operating expenses as measured in U.S. dollars. We do not currently hedge against foreign currency rate fluctuations.

**Item 4. Controls and Procedures.**

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

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

## PART II – OTHER INFORMATION

### Item 1A. Risk Factors.

*Investing in our shares of common stock involves a high degree of risk, and investors should carefully consider the risks described below before making an investment decision. If any of the following risks occur, the market price of our shares of common stock could decline and investors could lose all or part of their investment. Additional risks that we currently believe are immaterial may also impair our business operations. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2007, including our consolidated financial statements and related notes, and our other filings made from time to time with the Securities and Exchange Commission.*

***If we are delisted from the NASDAQ Global Market, there may not be a market for our common stock, causing a decrease in the value of an investment in us and adversely affecting our business, financial condition and results of operations.***

On December 24, 2007, the NASDAQ Global Market notified us that, for the prior 30 consecutive business days, the bid price of our common stock closed below the minimum $1.00 per share requirement for continued inclusion of our common stock on the NASDAQ Global Market. NASDAQ has provided us with 180 calendar days, or until June 23, 2008, to regain compliance with NASDAQ Marketplace Rules. If the bid price of our common stock does not close at or above $1.00 per share for a period of at least ten consecutive business days by June 23, 2008, we expect NASDAQ to provide written notice that our common stock will be delisted. Should that occur, we may appeal the delisting determination. If our common stock is delisted, trading of our common stock will most likely take place on an over-the-counter market established for unlisted securities, such as the Pink Sheets or the OTC Bulletin Board. An investor is likely to find it less convenient to sell, or to obtain accurate quotations in seeking to buy, our common stock on an over-the-counter market, and many investors may not buy or sell our common stock due to difficulty in accessing over-the-counter markets, policies preventing them from trading in securities not listed on a national exchange or other reasons. In addition, as a delisted security, our common stock would be subject to SEC rules regarding "penny stock," which impose additional disclosure requirements on broker-dealers. The regulations relating to penny stocks, coupled with the typically higher cost per trade to the investor of penny stocks due to factors such as broker commissions generally representing a higher percentage of the price of a penny stock than of a higher priced stock, would further limit the ability of investors to trade in our common stock. For these reasons and others, delisting would adversely affect the liquidity and trading volume and price of our common stock, causing the value of an investment in us to decrease and having an adverse effect on our business, financial condition and results of operations, including our ability to attract and retain qualified employees and to raise capital.

***If our shareholders approve a reverse split of the outstanding shares of our common stock pursuant to the proposal to be voted on at our 2008 annual meeting of shareholders, any such reverse split effected by our board of directors may not have the desired effect of increasing the bid price of our common stock and facilitating our efforts to regain compliance with NASDAQ Marketplace Rules and may instead harm our business by reducing the liquidity and trading volume of our common stock.***

Our board of directors has submitted for approval at our 2008 annual meeting of shareholders a proposal that would grant the board the discretionary authority to effect a reverse split of the outstanding shares of our common stock (a "Reverse Split"), at any time on or prior to the date of our 2009 annual meeting of shareholders, at an exchange ratio to be set by the board within the range of exchange ratios between one-for-two and one-for-five. The primary reason for the Reverse Split would be to allow us to attempt to increase the bid price of our common stock by reducing the number of outstanding shares of our common stock and facilitate our efforts to regain compliance with NASDAQ Marketplace Rules. However, even if we regain compliance, it could be temporary and our common stock could again become subject to the risk of being delisted. Furthermore, the Reverse Split would make it more difficult for us to meet certain other requirements for continued listing on the NASDAQ Global Market, including rules related to the minimum number of shares that must be in the public float, the minimum market value of the public float and the minimum number of round lot holders. Our common stock might experience reduced liquidity and trading volume due to the availability of fewer shares for trading after the Reverse Split and certain investors could still consider the bid price of our common stock to be too low, including investors with express policies prohibiting transactions involving lower-priced stocks or investors who are reluctant to incur transaction costs that represent a higher percentage of the stock price of lower-priced stocks than of higher-priced stocks. In addition, customers, suppliers or employees might consider a company with a low stock price and reduced liquidity and trading volume as risky and might accordingly be less likely to transact business with us.

The immediate effect of a Reverse Split would be to reduce the number of shares of our outstanding common stock and to increase the bid price of our common stock. However, we cannot guarantee that a Reverse Split would lead to an increase in the bid price of our common stock in proportion to the reduction in the number of shares of our outstanding common stock or result in a long-term or permanent increase in the bid price of our common stock. Because the bid price of our common stock depends on our performance, prospects, general market conditions and other factors unrelated to the number of shares of our common stock outstanding at any given time, and the market might perceive a decision to effect a Reverse Split as a negative indicator of our future prospects, the bid price of our common stock might decline after the Reverse Split (perhaps by an even greater percentage than would have occurred in the absence of the Reverse Split). As a result, we might still be at risk for adverse consequences associated with lower-priced stocks generally. The Reverse Split might also produce other negative effects. Investors might consider the increased proportion of unissued authorized shares to issued shares to have an anti-takeover effect under certain circumstances, by allowing for dilutive issuances which could prevent certain shareholders from changing the composition of the board or render tender offers for a combination with another entity more difficult to complete successfully. Investors should refer to our Definitive Proxy Statement on Schedule 14A filed with the Securities and Exchange Commission on April 7, 2008 for more information regarding the Reverse Split proposal.

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

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

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

***We may not realize the anticipated benefits from the restructuring efforts announced in 2006 and implemented throughout 2007 and during the first quarter of 2008 and we may need to initiate additional restructuring efforts in the future.***

Our restructuring plan announced in April 2006 was designed to reduce our breakeven point by decreasing manufacturing overhead and operating expenses and focusing on our core business. In November 2006 we announced an additional restructuring plan designed to further reduce operating expenses. This plan, which we continued to implement throughout 2007 and during the first quarter of 2008, included additional consolidation of our operations in order to reduce compensation and rent expense, while at the same time making critical infrastructure investments in people, process and information systems to improve efficiency.

Unforeseen circumstances may result in our not being able to obtain the full benefits of the restructuring plans, or our assumptions about the benefits of the plans may prove incorrect or inaccurate, leading to a reduced benefit. Therefore, we cannot assure you that future restructuring efforts will not be necessary, or that the expected benefits from any future restructuring efforts will be attained.

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

As of March 31, 2008, $89.8 million of our 1.75% convertible subordinated debentures due 2024 were outstanding. Although the debt obligations are due in 2024, the holders of debentures have the right to require us to purchase all or a portion of the $89.8 million debentures outstanding at each of the following dates: May 15, 2011, May 15, 2014 and May 15, 2019. Since the market price of our common stock is significantly below the conversion price of the debentures, the holders of our outstanding debentures are unlikely to convert the debentures to common stock in accordance with the existing terms of the debentures. Accordingly, we expect holders of the debentures to require us to purchase all of the outstanding debentures on May 15, 2011, the earliest date allowed. Our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, some of which are beyond our control. These debentures could materially and adversely affect our ability to obtain additional debt or equity financing for working capital, acquisitions or other purposes, limit our flexibility in planning for or reacting to changes in our business, reduce funds available for use in our operations and make us more vulnerable to industry downturns and competitive pressures.

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

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

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

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

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

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

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

The development of our semiconductors is highly complex. These complexities require us to employ advanced designs and manufacturing processes that are unproven. Many of our designs involve the development of new high-speed analog circuits that are difficult to simulate and require physical prototypes. The result can 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, but not limited to:

- 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 new products.

We will not always succeed in developing new products or product enhancements nor will we always do so in a timely manner. If we are unable to successfully develop and introduce products in a timely manner, our business and results of operations will be adversely affected. We have experienced increased development time and delays in introducing new products that have resulted in significantly less revenue than originally expected for those products. Acquisitions have significantly added to the complexity of our product development efforts as we must now coordinate very complex product development programs between multiple geographically dispersed locations. Restructuring plans have also significantly affected our product development efforts. We may not be successful in timely delivery of new products with reduced numbers of employees or with newer inexperienced employees. Any such failure could cause us to lose customers or potential customers, which would decrease our revenue.

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

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

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

Because of the lengthy development and sales cycles, we will experience delays between the time we incur expenditures for research and development, sales and marketing and inventory and the time we generate revenue, if any, from these expenditures. Additionally, if actual sales volumes for a particular product are substantially less than originally anticipated, we may experience large write-offs of capitalized license fees, software development tools, product masks, inventories or other capitalized or deferred product-related costs that would negatively affect our operating results. For example, in 2005 and 2006, we invested significant amounts in research and development efforts for projects that were ultimately canceled and for which we will not realize any revenue. In 2007, we wrote off assets with a net book value of $6.9 million, which consisted primarily of engineering software tools that we were no longer using due to reductions in research and development personnel and changes in product development strategy.

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

The year ended December 31, 2004 was our first and only year of profitability since inception. Since then, we have incurred net losses. In addition, the profitability we achieved during the first quarter of 2008 was primarily the result of gain we recognized on the repurchase of certain of our convertible subordinated debentures, and we incurred operating losses during such period. In 2006, we initiated restructuring plans, which we implemented throughout 2007 and the first quarter of 2008, aimed at returning the Company to profitability. We cannot be certain these plans will be successful or 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. If we are not profitable in the future, we may be unable to continue our operations.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The display manufacturing market is highly concentrated and we are, and will continue to be, dependent on a limited number of customers and distributors for a substantial portion of our revenue. Sales to distributors represented 52%, 57% and 52% of revenue for the three month period ended March 31, 2008 and years ended December 31, 2007 and 2006, respectively. Sales to Tokyo Electron Device, or TED, our Japanese distributor, represented 28%, 33% and 26% of revenue for the three month period ended March 31, 2008 and years ended December 31, 2007 and 2006, respectively. Revenue attributable to our top five end customers represented 57%, 47% and 39% of revenue for the three month period ended March 31, 2008 and years ended December 31, 2007 and 2006, respectively. Sales to Seiko Epson Corporation, our top end customer, represented 27%, 21% and 15% of revenue for the three month period ended March 31, 2008 and years ended December 31, 2007 and 2006, respectively. A reduction, delay or cancellation of orders from one or more of our significant customers, or a decision by one or more of our significant customers to select products manufactured by a competitor or to use its own internally-developed semiconductors, would significantly impact our revenue. For example, our loss of a key OEM customer in Europe contributed to a $45.5 million, or 51%, decrease in advanced television revenue from 2005 to 2006.

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

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

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

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

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

Our ability to compete effectively with other companies will depend, in part, on our ability to maintain the proprietary nature of our technology, including our semiconductor designs and software. We provide the computer programming code for our software to customers in connection with their product development efforts, thereby increasing the risk that customers will misappropriate our proprietary software. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to help protect our proprietary technologies. As of December 31, 2007 we held 73 patents and had 80 patent applications pending for protection of our significant technologies. Competitors in both the U.S. and foreign countries, many of whom have substantially greater resources than we do, may apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell our products, or they may develop similar technology independently or design around our patents. Effective copyright, trademark and trade secret protection may be unavailable or limited in foreign countries.

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

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

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

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

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

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

We contract with third-party foundries for wafer fabrication and other manufacturers for packaging, assembly and testing of our products. We do not own or operate a semiconductor fabrication facility and do not have the resources to manufacture our products internally. Our wafers are fabricated by Infineon Technologies AG, Semiconductor Manufacturing International Corporation ("SMIC"), Taiwan Semiconductor Manufacturing Corporation and Toshiba Corporation. Although we have well established relationships with each of these suppliers, including an equity investment in SMIC, the wafers used in each of our products are fabricated by only one of these manufacturers.

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

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

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

Our products require manufacturing with state-of-the-art fabrication equipment and techniques, and the wafers manufactured for any one of our products are not fabricated by more than one supplier. 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 supply source for any specific product. If we have to qualify a new foundry or packaging, assembly and testing supplier for any of our products, we could incur significant delays in shipping products, which may result in lost revenue and damaged customer relationships.

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

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

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

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

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

The manufacture of semiconductors is a complex process and it is often difficult for semiconductor foundries to produce semiconductors free of defects. Because many of our products are more highly integrated than other semiconductors and incorporate mixed analog and digital signal processing and embedded memory technology, they are even more difficult to produce without defects.

Defective products can be caused by design or manufacturing difficulties. Therefore, identifying quality problems can occur only by analyzing and testing our semiconductors in a system after they have been manufactured. The difficulty in identifying defects is compounded because the process technology is unique to each of the multiple semiconductor foundries we contract with to manufacture our products.

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

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

***We use a customer owned tooling process for manufacturing many 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 if we increased our prices or could result in low gross profit margins if we did not increase our prices.

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

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

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

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

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

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

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

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

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

Sales outside the U.S. accounted for approximately 96% of revenue for the three month period ended March 31, 2008 and years ended December 31, 2007 and 2006. We anticipate that sales outside the U.S. will continue to account for a substantial portion of our revenue in future periods. In addition, customers who incorporate our products into their products sell a substantial portion of their products outside of the U.S., and all of our products are manufactured outside of the U.S. We are, therefore, subject to many international risks, including, but not limited to:

- increased difficulties in managing international distributors and manufacturers due to varying time zones, languages and business customs;
- foreign currency exchange fluctuations in the currencies of Japan, the People's Republic of China ("PRC"), Taiwan or Korea that could result in an increase in our operating expenses and cost of procuring our semiconductors;
- potentially adverse tax consequences;
- 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, Japan, Taiwan, or Korea;
- reduced or limited protection of our IP, particularly in software, which is more prone to design piracy;
- increased transaction costs related to sales transactions conducted outside of the U.S., such as charges to secure letters of credit;
- increased risk of internal control weaknesses for key processes transferred to our Asian operations;
- difficulties in maintaining sales representatives outside of the U.S. that are knowledgeable about our industry and products;
- changes in the regulatory environment in the PRC, Japan, Taiwan and Korea that may significantly impact purchases of our products by our customers;
- outbreaks of SARS, bird flu or other pandemics in the PRC or other parts of Asia; and
- difficulties in collecting outstanding accounts receivable balances.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Our acquisition of Equator has not been as successful as we had anticipated. We acquired Equator for an aggregate purchase price of $118.1 million and recorded, among other assets, $57.5 million in goodwill, $36.8 million in acquired developed technology and $4.2 million in other acquired intangible assets. However, the Equator technology has not proven as useful as we had hoped, and thus we have recorded impairment losses on goodwill and intangible assets acquired from Equator. Only $5.1 million of the developed technology and $75,000 of the customer relationship intangible assets acquired from Equator remain on our consolidated balance sheet as of March 31, 2008 and only a few of the Equator employees remain employed by us. Additionally, while we are continuing to provide customers with existing products, we are no longer pursuing stand-alone advanced media processor markets that are not core to our business. We cannot assure you that any future acquisitions we make will be successful or will result in increased revenue or market share.

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

We are subject to numerous environmental laws and regulations. Compliance with current or future environmental laws and regulations could require us to incur substantial expenses which could harm our business, financial condition and results of operations. For example, during 2006 the European Parliament enacted the Restriction of Hazardous Substances Directive, or RoHS, which restricts the sale of new electrical and electronic equipment containing certain hazardous substances, including lead. In 2006, we incurred increased inventory provisions as a result of the enactment of RoHS, which adversely affected our gross profit margin. Additionally during 2006, the European Parliament enacted the Waste Electrical and Electronic Equipment Directive, or WEEE Directive, which makes producers of electrical and electronic equipment financially responsible for specified collection, recycling, treatment and disposal of past and future covered products. Additionally, some jurisdictions have begun to require various levels of Electronic Product Environmental Assessment Tool ("EPEAT") certification, which are based on the Institute of Electrical and Electronics Engineers 1680 standard. The highest levels of EPEAT certification restrict the usage of halogen. Although our older generation products, many of which are still shipping to customers, do contain halogen, our next generation designs do not. We have worked, and will continue to work, with our suppliers and customers to ensure that our products are compliant with enacted laws and regulations. Failure by us or our contract manufacturers to comply with such legislation could result in customers refusing to purchase our products and could subject us to significant monetary penalties in connection with a violation, either of which would have a material adverse effect on our business, financial condition and results of operations. These environmental laws and regulations could become more stringent over time, imposing even greater compliance costs and increasing risks and penalties associated with violations, which could seriously harm our business, financial condition and results of operations. There can be no assurance that violations of environmental laws or regulations will not occur in the future as a result of our inability to obtain permits, human error, equipment failure or other causes.

## Risks Related to Our Industry

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

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

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

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

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

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

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

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

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

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

## Other Risks

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

We have received notice from the NASDAQ Global Market (the "Market") that our stock no longer meets the minimum requirements for continued listing on the Market and that we have until June 23, 2008 to regain compliance with NASDAQ Marketplace Rules. Even if our common stock is not delisted, investors may not be able to sell shares of our common stock at or above the price they paid due to a number of factors, including, but not limited to:

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

The stock prices of technology companies similar to Pixelworks have been highly volatile. Market fluctuations as well as general economic and political conditions, including recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of our common stock. Therefore, the price of our common stock may decline, and the value of your investment may be reduced regardless of our performance. Any scenario in which investors may not be able to realize a gain when they sell our common stock would have an adverse effect on our business, financial condition and results of operations, including our ability to attract and retain qualified employees and to raise capital.

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

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

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

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

As of March 31, 2008, we had $89.8 million of unsecured convertible debentures due 2024 outstanding and $81.4 million in cash and marketable securities, resulting in a net cash deficit position. Although the obligations are due in 2024, the holders of debentures have the right to require us to purchase all or a portion of the $89.8 million debentures outstanding at each of the following dates: May 15, 2011, May 15, 2014 and May 15, 2019. Since the market price of our common stock is significantly below the conversion price of the debentures, the holders of our outstanding debentures are unlikely to convert the debentures to common stock in accordance with the existing terms of the debentures. Accordingly, we expect holders of the debentures to require us to purchase all of the outstanding debentures on May 15, 2011.

On September 25, 2007, we announced a share repurchase program under which the board of directors authorized the repurchase of up to $10.0 million of our common stock over the following twelve months. During 2007, we repurchased 3,782,500 common shares at a cost of $4.3 million. From January 1, 2008 through March 31, 2008, we repurchased 1,593,800 shares for $1.2 million. As of March 31, 2008, $4.5 million remained available for repurchase under the plan.

While we believe that our current cash and marketable securities balances will be sufficient to meet our capital requirements for the next twelve months, we cannot assure you that we will be able to generate sufficient cash flows from operations in the future to refinance or service the potential exercise of the put option on the convertible debentures. We may need, or could elect to seek, additional funding prior to that time through public or private equity or debt financing. Additional funds may not be available on terms favorable to us or our shareholders. Furthermore, if we issue equity securities, our shareholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of our common stock. If we cannot raise funds on acceptable terms, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements.

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

We are spending a significant amount of management time and external resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new Securities and Exchange Commission rules and regulations and NASDAQ Global Market rules. In particular, Section 404 of the Sarbanes-Oxley Act of 2002 requires management's annual review and evaluation of internal control over financial reporting. The process of documenting and testing internal control over financial reporting has required that we hire additional personnel and outside services and has resulted in higher 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. Although the material weakness was remediated in the first quarter of 2005, there are inherent limitations to the effectiveness of any system of internal controls and procedures, including cost limitations, the possibility of human error, judgments and assumptions regarding the likelihood of future events, and the circumvention or overriding of the controls and procedures. Accordingly, even effective controls and procedures can provide only reasonable assurance of achieving their control objectives.

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

The following table sets forth information about shares repurchased during the first quarter of 2008 under the share repurchase program we announced on September 25, 2007 (in thousands except share and per share data):

| Period | Total number of shares purchased(1) | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Approximate dollar value of shares that may yet be purchased under the plans or programs |
|---|---|---|---|---|
| January 1, 2008 - January 31, 2008 | — | $ — | — | $ 5,731 |
| February 1, 2008 - February 29, 2008 | 869,500 | 0.75 | 771,700 | 5,076 |
| March 1, 2008 - March 31, 2008 | 724,300 | 0.75 | 423,000 | 4,533 |
| Total | 1,593,800 | $ 0.75 | 1,194,700 | |

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

**Item 6. Exhibits.**

10.1 Executive Employment Agreement dated and effective March 31, 2008, by and between Bruce Walicek and Pixelworks, 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.

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

## SIGNATURE

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

PIXELWORKS, INC.

Dated: May 8, 2008

/s/ Steven L. Moore

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

**Exhibit 10.1**

**PIXELWORKS, INC.**

**EXECUTIVE EMPLOYMENT AGREEMENT**

This Agreement (the "Agreement") is made and entered into effective as of March 31, 2008 (the "Effective Date"), by and between Bruce Walicek (the "Executive") and Pixelworks, Inc., an Oregon corporation (the "Company").

Executive agreed to serve as Acting CEO of the Company from January 1, 2008. A change in circumstances makes it appropriate to retain Executive as CEO on an ongoing basis, recognize his term in office as that of CEO retroactive to January 1, 2008, and to establish an executive employment agreement with him in connection with his initial employment as CEO.

AGREEMENT

In consideration of the mutual covenants herein contained, the parties agree as follows:

1. Employment. The Company employs Executive as Chief Executive Officer, retroactive to January 1, 2008.

(a) Compensation and Options. Company employs Executive at the base salary defined in Exhibit A, with the bonus plan defined in Exhibit A, and with the option award defined in Exhibit A.

(b) At Will. Executive acknowledge that the Executive's employment is and shall continue to be at-will, as defined under applicable law. Company or Executive may terminate this Agreement by notice pursuant to Section 3(b) hereof. If the Executive's employment terminates for any reason, the Executive shall not be entitled to any payments, benefits, damages, awards or compensation other than as provided by this Agreement, or as may otherwise be established under the Company's then existing employee benefit plans or policies at the time of termination, subject to Section 14(b) hereof.

(c) Duties. Executive shall perform such officer level duties and have such officer level authority and responsibility as is usual and customary for a Chief Executive Officer, plus any additional officer level duties as may reasonably be assigned from time to time by the Board, including but not limited to providing services as an officer and/or as a member of the boards of directors to one or more of the Company's subsidiaries or affiliates. Executive shall perform the duties and carry out the responsibilities assigned to Executive, to the best of his ability, in a trustworthy, businesslike and efficient manner for the purpose of advancing the business of the Company and shall comply with the Company's policies and procedures, as generally in effect from time to time, in all material respects. Except as otherwise approved by the Board in writing, Executive shall devote substantially all of his business time to the performance of his duties under this Agreement.

2. Definition of Terms. The following terms referred to in this Agreement shall have the following meanings:

(a) Cause. “Cause” shall mean Executive engaged in any one or more of the following: (i) a material act of dishonesty, fraud, misconduct , or willful violation of any material law, ethical rule or fiduciary duty that is in connection with Executive’s responsibilities as an Executive of the Company; (ii) acts constituting a felony or moral turpitude which the Board reasonably believes has had or will have a material detrimental effect on the Company’s reputation or business; or (iii) repeated willful failure to perform Executive’s duties as an employee of the Company and the failure to effect such cure within 30 days after written notice of such violation or breach is given to Executive; or (iv) the willful violation of any material Company policy or procedure, or breach of any material provision of this Agreement or other agreement with the Company, and if such violation or breach is susceptible of cure, the failure to effect such cure within 30 days after written notice of such violation or breach is given to Executive.

(b) Change of Control. “Change of Control” shall mean the occurrence of any of the following events, if the occurrence takes place before the Transition End Date:

(i) the approval by shareholders of the Company of a merger or consolidation of the Company with any other corporation, or of a subsidiary of the Company with any other corporation, other than a merger or consolidation which would result in effective voting control over the voting securities of the Company outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity) more than fifty percent (50%) of the total voting power represented by the voting securities of the Company or such surviving entity outstanding immediately after such merger or consolidation;

(ii) the approval by the shareholders of the Company of a plan of complete liquidation of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company’s assets;

(iii) any “person” (as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended) becoming the “beneficial owner” (as defined in Rule 13d-3 under said Act), directly or indirectly, of securities of the Company representing 50% or more of the total voting power represented by the Company’s then outstanding voting securities; or

(iv) a change in the composition of the Board, as a result of which fewer than a majority of the directors are Incumbent Directors. “Incumbent Directors” shall mean directors who either (A) are directors of the Company as of the date hereof, or (B) are elected, or nominated for election, to the Board with the affirmative votes of at least a majority of those directors who are either identified in (A) or identified as their successors elected under this clause (B).

(c) Good Reason Event. A "Good Reason Event" shall be any of the following: (i) without the Executive's express written consent, a material diminution of the Executive's duties, authority or responsibilities; (ii) without the Executive's express written consent, a reduction by the Company of the Executive's base salary; (iii) without the Executive's express written consent, the imposition of a requirement that Executive's primary place of employment be at a facility or a location more than fifty (50) miles from the Executive's current work location, provided that such requirement to relocate materially increases the Executive's commute; or (iv) the failure of the Company to obtain the assumption of this Agreement by any successors contemplated in Section 7 below.

(d) Involuntary Termination. "Involuntary Termination" shall mean (i) any termination of the Executive's employment by the Company which is not effected for valid Cause; or (ii) any termination by the Executive for Good Reason.

(e) Termination Date. "Termination Date" shall mean the effective date of any notice of termination delivered by one party to the other hereunder.

3. Term and Termination of Agreement.

(a) Term. Mr. Walicek's term in office, and measurement of any seniority-dependent benefits the Company may from time to time make available, shall be understood to measure from January 1, 2008. This Agreement shall continue until terminated by either party as provided under this section 3.

(b) Notice of Termination; Effective Date.

(i) By Company. Company may terminate Executive's employment without Cause on 30 days' notice or, at its election, may pay Executive in lieu of any required notice. Company may terminate Executive's employment immediately for Cause. If the Company claims Cause, the Company's notice shall set forth the basis for the "Cause."

(ii) By Executive With Good Reason. Executive may terminate his employment for Good Reason by providing written Notice of Good Reason Termination within thirty days after the initial existence of the Good Reason Event. His Notice of Good Reason Termination must (x) identify the Good Reason Event and the date of its initial existence; (y) invite the Company to remedy the Good Reason Event, and (z) state the Executive's intention to terminate his employment for Good Reason as of a Termination Date no more than ten days following the expiration of the Company's cure period described in the next sentence. Before a Termination for Good Reason shall be effective, the Company shall have a period of thirty days from the date it receives Executive's Notice of Good Reason Termination to remedy the conditions claimed to give rise to a Good Reason Event. If the Company fails to remedy the conditions claimed to give rise to a Good Reason Event by the end of the thirty day cure period. Executive's Termination for Good Reason will be effective on the Termination Date stated in the Notice of Good Reason Termination..

(iii) By Executive, Other than for Good Reason. Executive may voluntarily terminate Executive's employment without Good Reason upon notice of termination to Company, which notice identifies the Termination Date. A voluntary termination will be effective on the identified Termination Date.

4. Termination Benefits on Involuntary Termination. On the Termination Date, provided Executive's employment has ended as a result of an Involuntary Termination and subject to the condition that the Executive signs the release of claims pursuant to Section 8 hereof, and subject to the expiration of any waiver or revocation period applicable to the release of claims without waiver or revocation of the release of claims, Executive shall be entitled to the following Involuntary Termination benefits:

(a) Option Acceleration if on Change of Control. For purposes of this paragraph, "vested" means with respect to a stock option, that it has become exercisable, and with respect to Restricted Stock Units granted subject to a right of repurchase in the Company or its successor, that the right of repurchase has lapsed. If the Termination Date is within a Control Change Window, then half of all Restricted Stock Units or Options that otherwise would not be vested as of the Termination Date, and which were purchased by or granted to Executive prior to the Change of Control, will vest immediately prior to the later of the Change of Control or the Termination Date. The particular half will be the half that, in the ordinary course absent any termination of Executive's employment, would first have become vested. A "Control Change Window" is defined as the period between (x) the earlier of: (i) a Change of Control itself or (ii) the signing of a definitive agreement for a Change of Control that leads to the Change of Control contemplated in that agreement within twelve months, and (y) twelve (12) months after the Change of Control. If the vesting happens under this paragraph as of a Change of Control that occurs after the Termination Date, then (i) Executive shall have three months days from the Change of Control to exercise newly-vested options, and (ii) if Restricted Stock Units have already been repurchased that, under this paragraph, would vest, Executive shall have the right, during that same three month window, to buy back the Restricted Stock Units that would have vested, at the same price the Company purchased them from Executive.

(b) Severance Pay. Company will pay (12) months of base salary, a pro rated portion of target bonus (pro rated according to the portion of the then-current year that has already passed), and any bonus earned with respect to the prior year that has not yet then been paid, in a lump sum on or before the first regularly scheduled pay date following the termination date and Executive's satisfaction of the Release of Claims requirement stated in Section 8 below. All payments to Executive shall be reduced by such amounts as are required to be withheld by law.

(c) COBRA Benefits. Provided Executive is eligible and properly elects coverage, Company will pay all COBRA premiums to extend Executive's group health insurance coverage for twelve months following the Termination Date.

5. Accrued Wages and Vacation, Expenses always payable. Without regard to the reason for, or the timing of, Executive's termination of employment: (i) the Company shall pay the Executive any unpaid base salary due for periods prior to the Termination Date; (ii) the Company shall pay the Executive all of the Executive's accrued and unused vacation through the Termination Date; and (iii) following submission of proper expense reports by the Executive, the Company shall reimburse the Executive for all expenses reasonably and necessarily incurred by

the Executive in connection with the business of the Company prior to the Termination Date. These payments shall be made promptly following termination and within the period of time mandated by law.

6. Limitation on Payments. In the event that the severance and other benefits provided for in this Agreement or otherwise payable to the Executive (i) constitute "parachute payments" within the meaning of Section 280G of the United States Internal Revenue Code (the "Code"), and (ii) would be subject to the excise tax imposed by Section 4999 of the Code (the "Excise Tax"), then Executive's benefits under this Agreement shall be either

(a) delivered in full, or

(b) delivered as to such lesser extent which would result in no portion of such benefits being subject to the Excise Tax,

whichever of the foregoing amounts, taking into account the applicable federal, state and local income taxes and the Excise Tax, results in the receipt by Executive on an after-tax basis, of the greatest amount of benefits, notwithstanding that all or some portion of such benefits may be taxable under Section 4999 of the Code.

Any determination required under this section shall be made in writing by the Company's independent public accountants (the "Accountants"), whose determination shall be conclusive and binding upon the Executive and the Company for all purposes. For purposes of making the calculations required by this section, the Accountants may make reasonable assumptions and approximations concerning applicable taxes and may rely on reasonable, good faith interpretations concerning the application of Sections 280G and 4999 of the Code. The Company and the Executive shall furnish to the Accountants such information and documents as the Accountants may reasonably request in order to make a determination under this section. The Company shall bear all costs the Accountants may reasonably incur in connection with any calculations contemplated by this section.

7. Successors.

(a) Company's Successors. Any successor to the Company (whether direct or indirect and whether by purchase, lease, merger, consolidation, liquidation or otherwise) to all or substantially all of the Company's business and/or assets shall assume the Company's obligations under this Agreement and agree expressly to perform the Company's obligations under this Agreement in the same manner and to the same extent as the Company would be required to perform such obligations in the absence of a succession. For all purposes under this Agreement, the term "Company" shall include any successor to the Company's business and/or assets which executes and delivers the assumption agreement described in this subsection (a) or which becomes bound by the terms of this Agreement by operation of law.

(b) Executive's Successors. Without the written consent of the Company, Executive may not assign or transfer this Agreement or any right or obligation under this Agreement to any other person or entity. Notwithstanding the foregoing, the terms of this Agreement and all rights of Executive hereunder shall inure to the benefit of, and be enforceable by, Executive's personal or legal representatives, executors, administrators, successors, heirs, distributees, devisees and legatees.

8. Execution of Release Agreement upon Termination. As a condition of receiving the benefits under Section 4 of this Agreement, the Executive shall within twenty five days after the Executive's Termination Date, , execute and not revoke a general release of claims against the Company in form satisfactory to the Company.

9. Litigation/Audit Cooperation. Following the termination of Executive's employment for any reason, Executive shall reasonably cooperate with the Company or any of its subsidiaries or affiliates (the "Company Group") in connection with (a) any internal or governmental investigation or administrative, regulatory, arbitral or judicial proceeding involving any member of the Company Group with respect to matters relating to Executive's employment with or service as a member of the board of directors of any member of the Company Group other than a third party proceeding in which Executive is a named party and Executive and the Company (or the applicable member(s) of the Company Group) have not entered into a mutually acceptable joint defense agreement (collectively, "Litigation") or (b) for a two year period following the Termination Date, any audit of the financial statements of any member of the Company Group with respect to the period of time when Executive was employed by any member of the Company Group ("Audit"). Executive acknowledges that such cooperation may include, but shall not be limited to, Executive making himself available to the Company or any other member of the Company Group (or their respective attorneys or auditors) upon reasonable notice for: (i) interviews, factual investigations, and providing declarations or affidavits that provide truthful information in connection with any Litigation or Audit; (ii) appearing at the request of the Company or any member of the Company Group to give testimony without requiring service of a subpoena or other legal process; (iii) volunteering to the Company or any member of the Company Group pertinent information related to any Litigation or Audit; (iv) providing information and legal representations to the auditors of the Company or any member or any member of the Company Group, in a form and within a timeframe requested by the Board, with respect to the Company's or any member of the Company Group's opening balance sheet valuation of intangibles and financial statements for the period in which Executive was employed by the Company or any member of the Company Group; and (v) turning over to the Company or any member of the Company Group any documents relevant to any Litigation or Audit that are or may come into Executive's possession. The Company shall reimburse Executive for reasonable travel expenses incurred in connection with providing the services under this Section 9, including lodging and meals, upon Executive's submission of receipts. The Company shall also compensate Executive for each hour that Executive provides cooperation in connection with this Section 9 at an hourly rate equal to Executive's base salary as of the Termination Date divided by 2080. Executive shall submit invoices for any month in which Executive performs services pursuant to this Section 9 that details the amount of time and a description of the services rendered for each separate day that Executive performed such services. The Company shall reimburse Executive for such services rendered within fifteen (15) days of receiving an invoice from Executive.

10. 409A Savings Clause. If Executive is a "specified employee" within the meaning of Section 409A of the Internal Revenue Code of 1986, as amended by the rules and regulations issued thereunder by the Department of Treasury and the Internal Revenue Service ("409A") as

of the date of the Executive's "separation from service" within the meaning of Section 409A, Executive shall not be entitled to any payment or benefit pursuant to Section 4 until the earlier of (i) the date which is six (6) months after his separation from service for any reason other than death, or (ii) the date of Executive's death. The provisions of this Section 10 shall only apply if, and to the extent, required to avoid the imputation of any tax, penalty or interest pursuant to Section 409A. Any amounts otherwise payable to Executive upon or in the six (6) month period following the Executive's separation from service that are not so paid by reason of this Section 10 shall be paid (without interest) as soon as practicable (and in all events within thirty (30) days) after the date that is six (6) months after Executive's separation from service (or, if earlier, as soon as practicable, and in all events within thirty (30) days, after the date of Executive's death). To the extent that any benefits pursuant to Section 4 or reimbursements pursuant to Section 5 are taxable to the Executive, any reimbursement payment due to the Executive pursuant to any such provision shall be paid to the Executive on or before the last day of the Executive's taxable year following the taxable year in which the related expense was incurred. The benefits and reimbursements pursuant to Section 4 are not subject to liquidation or exchange for another benefit and the amount of such benefits and reimbursements that the Executive receives in one taxable year shall not affect the amount of such benefits or reimbursements that the Executive receives in any other taxable year.

11. Notices. Notices and all other communications contemplated by this Agreement shall be in writing and shall be deemed to have been duly given when personally delivered or when mailed by U.S. registered or certified mail, return receipt requested and postage prepaid. In the case of the Executive, mailed notices shall be addressed to Executive at the home address which Executive most recently communicated to the Company in writing. In the case of the Company, mailed notices shall be addressed to its corporate headquarters, and all notices shall be directed to the attention of its Secretary.

12. Arbitration.

(a) Any dispute or controversy arising out of, relating to, or in connection with this Agreement, or the interpretation, validity, construction, performance, breach, or termination thereof, shall be settled by binding arbitration to be held in Portland, Oregon in accordance with the National Rules for the Resolution of Employment Disputes then in effect of the American Arbitration Association (the "Rules"). The arbitrator may grant injunctions or other relief in such dispute or controversy. The decision of the arbitrator shall be final, conclusive and binding on the parties to the arbitration. Judgment may be entered on the arbitrator's decision in any court having jurisdiction.

(b) The arbitrator(s) shall apply Oregon law to the merits of any dispute or claim, without reference to conflicts of law rules. The arbitration proceedings shall be governed by federal arbitration law and by the Rules, without reference to state arbitration law. Executive hereby consents to the personal jurisdiction of the state and federal courts located in Oregon for any action or proceeding arising from or relating to this Agreement or relating to any arbitration in which the parties are participants.

(c) Executive understands that nothing in this Section modifies Executive's at-will employment status. Either Executive or the Company can terminate the employment relationship at any time, with or without Cause.

(d) EXECUTIVE HAS READ AND UNDERSTANDS THIS SECTION, WHICH DISCUSSES ARBITRATION. EXECUTIVE UNDERSTANDS THAT SUBMITTING ANY CLAIMS ARISING OUT OF, RELATING TO, OR IN CONNECTION WITH THIS AGREEMENT, OR THE INTERPRETATION, VALIDITY, CONSTRUCTION, PERFORMANCE, BREACH OR TERMINATION THEREOF TO BINDING ARBITRATION, CONSTITUTES A WAIVER OF EXECUTIVE'S RIGHT TO A JURY TRIAL AND RELATES TO THE RESOLUTION OF ALL DISPUTES RELATING TO ALL ASPECTS OF THE EMPLOYER/EXECUTIVE RELATIONSHIP, INCLUDING BUT NOT LIMITED TO, THE FOLLOWING CLAIMS:

(i) ANY AND ALL CLAIMS FOR WRONGFUL DISCHARGE OF EMPLOYMENT; BREACH OF CONTRACT, BOTH EXPRESS AND IMPLIED; BREACH OF THE COVENANT OF GOOD FAITH AND FAIR DEALING, BOTH EXPRESS AND IMPLIED; NEGLIGENT OR INTENTIONAL INFLICTION OF EMOTIONAL DISTRESS; NEGLIGENT OR INTENTIONAL MISREPRESENTATION; NEGLIGENT OR INTENTIONAL INTERFERENCE WITH CONTRACT OR PROSPECTIVE ECONOMIC ADVANTAGE; AND DEFAMATION.

(ii) ANY AND ALL CLAIMS FOR VIOLATION OF ANY FEDERAL STATE OR MUNICIPAL CONSTITUTION OR STATUTE, INCLUDING, BUT NOT LIMITED TO, TITLE VII OF THE CIVIL RIGHTS ACT OF 1964, THE CIVIL RIGHTS ACT OF 1991, THE AGE DISCRIMINATION IN EMPLOYMENT ACT OF 1967, THE AMERICANS WITH DISABILITIES ACT OF 1990, THE FAIR LABOR STANDARDS ACT, THE CALIFORNIA FAIR EMPLOYMENT AND HOUSING ACT, AND THE CALIFORNIA LABOR CODE (except for claims for underlying workers' compensation benefits); and

(iii) ANY AND ALL CLAIMS ARISING OUT OF ANY OTHER LAWS AND REGULATIONS RELATING TO EMPLOYMENT OR EMPLOYMENT DISCRIMINATION.

13. Proprietary Information and Inventions Assignment Agreement. Executive shall execute and comply with the terms of the Company's standard Proprietary Information and Inventions Assignment Agreement.

14. Miscellaneous Provisions.

(a) Effect of Any Statutory Benefits. If any severance benefits are required to be paid to the Executive upon termination of employment with the Company as a result of any requirement of law or any governmental entity in any applicable jurisdiction, the aggregate amount payable pursuant to Section 4 hereof shall be reduced by such amount.

(b) Effect of Standard Company Policy. To the extent that any severance benefits are required to be paid to the Executive upon termination of employment with the

Company as a result of any standard Company policy, Executive shall be entitled to the greater of benefits available under such policy or under this Agreement, but not both.

(c) Effect of Standing Severance Agreement. To the extent that any cash severance benefits are provided for the Executive under any agreement between Executive and the Company, those benefits will be paid in addition to the retention benefits payable hereunder.

(d) No Duty to Mitigate. The Executive shall not be required to mitigate the amount of any payment contemplated by this Agreement, nor shall any such payment be reduced by any earnings that the Executive may receive from any other source.

(e) Waiver. No provision of this Agreement may be modified, waived or discharged unless the modification, waiver or discharge is agreed to in writing and signed by the Executive and by an authorized officer of the Company (other than the Executive). No waiver by either party of any breach of, or of compliance with, any condition or provision of this Agreement by the other party shall be considered a waiver of any other condition or provision or of the same condition or provision at another time.

(f) Integration. This Agreement and any agreements referenced herein represent the entire agreement and understanding between the parties as to the subject matter herein and collectively supersede all prior or contemporaneous agreements, whether written or oral, with respect to the same subject matter, *provided that*, for clarification purposes, this Agreement shall not affect any agreements between the Company and Executive regarding intellectual property matters or confidential information of the Company.

(g) Choice of Law. The validity, interpretation, construction and performance of this Agreement shall be governed by the internal substantive laws, but not the conflicts of law rules, of the State of Oregon.

(h) Severability. The invalidity or unenforceability of any provision or provisions of this Agreement shall not affect the validity or enforceability of any other provision hereof, which shall remain in full force and effect.

(i) Employment Taxes. All payments made pursuant to this Agreement shall be subject to withholding of applicable income and employment taxes.

(j) Counterparts. This Agreement may be executed in counterparts, each of which shall be deemed an original, but both of which together will constitute one and the same instrument.

IN WITNESS WHEREOF, each of the parties has executed this Agreement, in the case of the Company by its duly authorized officer, as of the day and year first above written.

**Pixelworks, Inc.**

By: /s/ Allen Alley
Allen Alley, Chair

**Executive**

/s/ Bruce Walicek
Bruce Walicek

EXHIBIT A
Executive: Bruce Walicek

| | |
|---|---|
| Base Salary: | $325,000 annually, payable on standard payroll schedules from March 31, 2008 on. |
| 2008 Bonus Plan: | Target bonus: 100% of salary.<br><br>Bonus cap: 125% of salary.<br><br>The amount of the bonus paid, if any, shall be determined by the Board in its discretion based on the criteria and performance objectives set forth in the company's annual executive bonus plan. The 2008 bonus shall be payable no later than March 15, 2009. |
| Initial Stock Option Award | Executive will have a total option package in connection with his initial employment of 600,000 shares (including the options for 95,000 share originally awarded), to vest according to the Company's standard new hire vesting schedule as applicable to executives, based on the initial employment date (and for vesting purposes, as if awarded on) January 1, 2008, and subject to the following additional modifications:<br><br>1) The vesting for the original 95,000 options granted will not change from the original award made effective January 2, 2008, and this agreement does not change the terms of that award; the vesting of those options will be credited against the standard new hire schedule otherwise applicable for the first year of vesting.<br><br>2) Pricing for the additional 505,000 options to be awarded to reach the intended 600,000 here required, will be determined under the terms of the plan for awards made as of the time and date of the compensation committee action approving this Agreement. The additional options will otherwise be subject to the standard terms and conditions of options issued under the Company's applicable plans. All share references are subject to customary adjustments for stock splits and other events as provided in the applicable plan under which the options are granted. |

| | |
|---|---|
| **Pixelworks, Inc.** | **Executive** |
| By: /s/ Allen Alley | /s/ Bruce Walicek |
| Allen Alley, Chair | Bruce Walicek |

Exhibit 31.1

**CERTIFICATION**

I, Bruce A. Walicek, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Pixelworks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 8, 2008

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

**Exhibit 31.2**

**CERTIFICATION**

I, Steven L. Moore, certify that:

1. I have reviewed this 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: May 8, 2008

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

**Exhibit 32.1**

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

In connection with the Quarterly Report of Pixelworks, Inc. (the "Company") on Form 10-Q for the quarterly period ended March 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bruce A. Walicek, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

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

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

Date: May 8, 2008

**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 March 31, 2008 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Steven L. Moore, Vice President, Chief Financial Officer, Secretary and Treasurer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

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

Date: May 8, 2008