

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

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**FORM 10-Q**

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(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, 2011.

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

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**PIXELWORKS, INC.**

(Exact name of registrant as specified in its charter)

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**OREGON**  
(State or other jurisdiction of incorporation or organization)

**91-1761992**  
(I.R.S. Employer Identification No.)

**224 Airport Parkway, Suite 400**  
**San Jose, California**  
(Address of principal executive offices)

**95110**  
(Zip Code)

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

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

Indicate by check mark 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  (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, 2011: 13,637,225

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PIXELWORKS, INC.  
FORM 10-Q  
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2011  
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**PART I – FINANCIAL INFORMATION****Item 1. Financial Statements.****PIXELWORKS, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands)  
(Unaudited)**

	March 31, 2011	December 31, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 26,704	\$ 16,872
Short-term marketable securities	2,901	12,366
Accounts receivable, net	4,324	4,487
Inventories, net	4,662	4,858
Prepaid expenses and other current assets	2,346	2,337
Total current assets	<u>40,937</u>	<u>40,920</u>
Long-term marketable securities	—	603
Property and equipment, net	8,212	5,830
Other assets, net	4,379	5,061
Total assets	<u>\$ 53,528</u>	<u>\$ 52,414</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 5,059	\$ 4,804
Accrued liabilities and current portion of long-term liabilities	9,352	8,983
Current portion of income taxes payable	201	282
Short-term line of credit	4,000	3,000
Debentures currently payable	15,779	15,779
Total current liabilities	<u>34,391</u>	<u>32,848</u>
Long-term liabilities, net of current portion	3,018	2,061
Income taxes payable, net of current portion	3,256	3,574
Total liabilities	<u>40,665</u>	<u>38,483</u>
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Preferred stock	—	—
Common stock	336,887	336,254
Accumulated other comprehensive income (loss)	(64)	167
Accumulated deficit	(323,960)	(322,490)
Total shareholders' equity	<u>12,863</u>	<u>13,931</u>
Total liabilities and shareholders' equity	<u>\$ 53,528</u>	<u>\$ 52,414</u>

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2011	2010
Revenue, net	\$ 14,700	\$ 18,692
Cost of revenue (1)	8,128	10,036
Gross profit	6,572	8,656
Operating expenses:		
Research and development (2)	5,995	5,340
Selling, general and administrative (3)	3,834	3,793
Restructuring	—	94
Total operating expenses	9,829	9,227
Loss from operations	(3,257)	(571)
Gain on sale of patents	1,600	—
Gain on sale of marketable securities	264	—
Interest expense and other, net	(166)	(128)
Total other income (loss), net	1,698	(128)
Loss before income taxes	(1,559)	(699)
Benefit for income taxes	(91)	(5,301)
Net income (loss)	<u>\$ (1,468)</u>	<u>\$ 4,602</u>
Net income (loss) per share:		
Basic	<u>\$ (0.11)</u>	<u>\$ 0.34</u>
Diluted	<u>\$ (0.11)</u>	<u>\$ 0.32</u>
Weighted average shares outstanding:		
Basic	<u>13,569</u>	<u>13,363</u>
Diluted	<u>13,569</u>	<u>14,220</u>
(1) Includes:		
Additional amortization of non-cancelable prepaid royalty	\$ 86	\$ 2
Stock-based compensation	27	10
Amortization of acquired developed technology	—	573
(2) Includes stock-based compensation	201	96
(3) Includes stock-based compensation	247	117

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended	
	March 31,	
	2011	2010
Cash flows from operating activities:		
Net income (loss)	\$ (1,468)	\$ 4,602
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Gain on sale of patents	(1,600)	—
Depreciation and amortization	1,254	1,114
Stock-based compensation	475	223
Reversal of uncertain tax positions	(331)	(5,284)
Gain on sale of marketable securities	(264)	—
Deferred income tax expense	69	—
Other non-cash tax expense (benefit)	26	(221)
Amortization of acquired intangible assets	—	573
Other	47	43
Changes in operating assets and liabilities:		
Accounts receivable, net	163	(311)
Inventories, net	196	22
Prepaid expenses and other current and long-term assets, net	268	89
Accounts payable	(469)	(1,410)
Accrued current and long-term liabilities	(201)	(122)
Income taxes payable	(68)	141
Net cash used in operating activities	<u>(1,903)</u>	<u>(541)</u>
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	10,061	1,200
Proceeds from sale of patents	1,600	—
Purchases of property and equipment	(159)	(242)
Purchases of marketable securities	—	(6,683)
Net cash provided by (used in) investing activities	<u>11,502</u>	<u>(5,725)</u>
Cash flows from financing activities:		
Net proceeds from line of credit	1,000	—
Payments on asset financings	(922)	(600)
Proceeds from issuances of common stock	155	91
Net cash provided by (used in) financing activities	<u>233</u>	<u>(509)</u>
Net change in cash and cash equivalents	9,832	(6,775)
Cash and cash equivalents, beginning of period	<u>16,872</u>	<u>17,797</u>
Cash and cash equivalents, end of period	<u>\$26,704</u>	<u>\$11,022</u>

See accompanying notes to condensed consolidated financial statements.

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

**NOTE 1: BASIS OF PRESENTATION**

**Nature of Business**

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications and hold 109 patents related to the visual display of digital image data. Our solutions enable manufacturers of digital display and projection devices, such as large-screen flat panel televisions and digital front projectors, to manufacture their products with a consistently high level of video quality, regardless of the content's source or format. Our core technology leverages unique proprietary techniques for intelligently processing video signals from a variety of sources to ensure that all resulting images are optimized. Additionally, our products help our customers reduce costs and differentiate their display and projection devices, an important factor in industries that experience rapid innovation. Pixelworks was founded in 1997 and is incorporated under the laws of the state of Oregon.

**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, 2011 and 2010 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, 2010 is derived from our audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2010, included in Item 8 of our Annual Report on Form 10-K, filed with the SEC on March 9, 2011, and should be read in conjunction with such consolidated financial statements.

The results of operations for the three month period ended March 31, 2011 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2011.

**Reclassifications**

Certain reclassifications have been made to the 2010 condensed consolidated financial statements and notes to conform with the 2011 presentation.

**Use of Estimates**

The preparation of consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and judgments that affect amounts reported in the financial statements and accompanying notes. Our significant estimates and judgments include those related to product returns, warranty obligations,

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bad debts, inventories, property and equipment, impairment of long-lived assets, valuation of investments, amortization of prepaid royalties, valuation of share-based payments, income taxes, litigation and other contingencies. The actual results experienced could differ materially from our estimates.

**NOTE 2: BALANCE SHEET COMPONENTS**

**Marketable Securities – See Note 3**

**Accounts Receivable, Net**

Accounts receivable are recorded at invoiced amount and do not bear interest when recorded or accrue interest when past due. 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 consists of the following:

	March 31, 2011	December 31, 2010
Accounts receivable, gross	\$ 4,715	\$ 4,886
Less: allowance for doubtful accounts	(391)	(399)
Accounts receivable, net	<u>\$ 4,324</u>	<u>\$ 4,487</u>

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

	Three Months Ended March 31,	
	2011	2010
Balance at beginning of period	\$ 399	\$ 428
Reductions credited	(8)	(1)
Balance at end of period	<u>\$ 391</u>	<u>\$ 427</u>

**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.

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Inventories consist of the following:

	March 31, 2011	December 31, 2010
Finished goods	\$ 2,086	\$ 2,961
Work-in-process	3,507	3,232
	5,593	6,193
Less: reserve for slow-moving and obsolete items	(931)	(1,335)
Inventories, net	<u>\$ 4,662</u>	<u>\$ 4,858</u>

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

	Three Months Ended March 31,	
	2011	2010
Balance at beginning of period	\$ 1,335	\$ 2,140
New provision	201	195
Sales of previously reserved inventory	(3)	(32)
Net provision for obsolete inventory	198	163
Final scrap of previously reserved inventory	(602)	(147)
Balance at end of period	<u>\$ 931</u>	<u>\$ 2,156</u>

Based upon our forecast and backlog, we do not currently expect to be able to sell or otherwise use the reserved inventory we have on hand at March 31, 2011. However, it is possible that a customer will decide in the future to purchase a portion of the reserved inventory.

The company recorded lower of cost or market write-downs of \$0 and \$207 for the three months ended March 31, 2011 and 2010, respectively.

**Property and Equipment, Net**

Property and equipment consists of the following:

	March 31, 2011	December 31, 2010
Gross carrying amount	\$ 23,437	\$ 20,406
Less: accumulated depreciation and amortization	(15,225)	(14,576)
Property and equipment, net	<u>\$ 8,212</u>	<u>\$ 5,830</u>



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

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

	March 31, 2011	December 31, 2010
Current portion of accrued liabilities for asset financings	\$ 2,556	\$ 2,601
Accrued payroll and related liabilities	2,250	2,365
Accrued commissions and royalties	1,185	1,139
Reserve for warranty returns	640	723
Accrued interest payable	479	358
Accrued costs related to restructuring	142	172
Other	2,100	1,625
	<u>\$ 9,352</u>	<u>\$ 8,983</u>

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

	Three Months Ended March 31,	
	2011	2010
Reserve for warranty returns:		
Balance at beginning of period	\$ 723	\$ 304
Provision	79	486
Charge-offs	(162)	(312)
Balance at end of period	<u>\$ 640</u>	<u>\$ 478</u>

**Long-Term Liabilities, Net of Current Portion**

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

	March 31, 2011	December 31, 2010
Accrued liabilities for asset financings	\$ 2,432	\$ 1,314
Deferred rent	257	302
Payroll and related liabilities	161	165
Accrued costs related to restructuring	101	119
Other	67	161
	<u>\$ 3,018</u>	<u>\$ 2,061</u>

**Short-Term Line of Credit**

On December 21, 2010, we entered into a Loan and Security Agreement (the "Revolving Loan Agreement") with Silicon Valley Bank (the "Bank"). The Revolving Loan Agreement provides for a secured working capital-based revolving line of credit (the "Revolving Line") in an aggregate amount of up to the lesser of (i) \$10.0 million, or (ii) 80% of eligible domestic accounts receivable and certain foreign accounts receivable. In addition, the Revolving Loan Agreement provides for non-formula advances of up to \$10.0 million which may be made solely during the last five business days of any fiscal

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month or quarter and which must be repaid by the Company on or before the fifth business day after the applicable fiscal month or quarter end. Due to their repayment terms, non-formula advances do not provide the Company with usable liquidity and have been utilized by the Company in order to maintain a \$50.0 million total asset value.

The Revolving Loan Agreement contains customary affirmative and negative covenants as well as customary events of default. The occurrence of an event of default could result in the acceleration of the Company's obligations under the Revolving Loan Agreement and an increase to the applicable interest rate, and would permit the Bank to exercise remedies with respect to its security interest. As of March 31, 2011, we were in compliance with all of the terms of the Revolving Loan Agreement.

Short-term borrowings outstanding under the Revolving Line were non-formula advances of \$4,000 and \$3,000 as of March 31, 2011 and December 31, 2010, respectively and were repaid within required terms. The weighted-average interest rate on short-term borrowings outstanding as of March 31, 2011 was 3.5%.

### **Debentures Currently Payable**

In 2004, we issued \$150,000 of 1.75% convertible subordinated debentures (the "debentures") due 2024. Between 2006 and 2009, we repurchased and retired \$134,221 principal amount of the debentures and as of March 31, 2011, \$15,779 of the debentures are outstanding.

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

On April 13, 2011, we announced an offer to repurchase all of the outstanding debentures, as required under the terms of the indenture governing the debentures. In connection with the offer, we filed a Tender Offer Statement on Schedule TO on that day, including as an exhibit, a notice to holders of the debentures specifying the terms, conditions and procedures of our offer to repurchase. The holders of the debentures' opportunity to tender their debentures terminated on May 11, 2011 and all of the debentures were properly tendered to us at that time. We will redeem all of the debentures for cash on or about May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest.

**NOTE 3: MARKETABLE SECURITIES AND FAIR VALUE MEASUREMENTS**

As of March 31, 2011 and December 31, 2010, all of our marketable securities are classified as available-for-sale and consist of the following:

	Cost	Unrealized Gain (Loss)	Fair Value
<b>Short-term marketable securities:</b>			
As of March 31, 2011:			
US government agencies debt securities	\$ 1,802	\$ (1)	\$ 1,801
Commercial paper	1,100	—	1,100
	<u>\$ 2,902</u>	<u>\$ (1)</u>	<u>\$ 2,901</u>
As of December 31, 2010:			
US government agencies debt securities	\$ 5,513	\$ 3	\$ 5,516
Commercial paper	5,747	—	5,747
Corporate debt security	1,104	(1)	1,103
	<u>\$ 12,364</u>	<u>\$ 2</u>	<u>\$ 12,366</u>
	Cost	Unrealized Gain	Fair Value
<b>Long-term marketable securities:</b>			
As of March 31, 2011:			
Equity securities	\$ —	\$ —	\$ —
As of December 31, 2010:			
Equity securities	\$ 348	\$ 255	\$ 603

Unrealized holding gains and losses are recorded in accumulated other comprehensive income, a component of shareholders' equity, in the condensed consolidated balance sheets. During the quarter ended March 31, 2011, we sold the remaining portion of our long-term equity investment for gross proceeds of \$612 and realized gains of \$264. We determined the cost of the securities sold using specific identification. Net unrealized holding gains of \$255 on available-for-sale securities were reclassified out of accumulated other comprehensive income for the three month period ended March 31, 2011.

**Fair Value Measurements**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Three levels of inputs may be used to measure fair value:

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

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The following tables present information about our assets measured at fair value on a recurring basis in the condensed consolidated balance sheets as of March 31, 2011 and December 31, 2010:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
<b>As of March 31, 2011:</b>				
Money market funds	\$ 14,537	\$ —	\$ —	\$ 14,537
Certificates of deposit	200	—	—	200
US government agencies debt securities	—	1,801	—	1,801
Commercial paper	—	1,700	—	1,700
Total	<u>\$ 14,737</u>	<u>\$ 3,501</u>	<u>\$ —</u>	<u>\$ 18,238</u>
<b>As of December 31, 2010:</b>				
Money market funds	\$ 10,933	\$ —	\$ —	\$ 10,933
Certificates of deposit	200	—	—	200
US government agencies debt securities	—	5,516	—	5,516
Commercial paper	—	6,947	—	6,947
Corporate debt security	—	1,605	—	1,605
Long-term marketable securities	603	—	—	603
Total	<u>\$ 11,736</u>	<u>\$ 14,068</u>	<u>\$ —</u>	<u>\$ 25,804</u>

We have excluded \$3,000 previously included in money market funds as of December 31, 2010, as the amount represents cash not subject to fair value reporting requirements.

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

**NOTE 4: RESTRUCTURINGS**

All actions under our prior restructuring plans were completed in the second quarter of 2009; however, due to decreases in estimated future sublease income and related professional fees, lease termination costs of \$94 were recorded in the first quarter of 2010.

As of March 31, 2011, accrued lease termination costs of \$243 are included in current and non-current accrued liabilities in the condensed consolidated balance sheets and will be paid in cash over the remaining lease terms of approximately two and a half years.

**NOTE 5: INCOME TAXES**

The benefit for income taxes recorded for the first quarter of 2011 was primarily due to a benefit of \$331 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitation, partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions.

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The benefit for income taxes recorded for the first quarter of 2010 was primarily due to a benefit of \$5,284 for the reversal of previously recorded tax contingencies, partially offset by current and deferred tax expense in profitable foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions.

As of March 31, 2011, 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, 2011 and December 31, 2010, the amount of our uncertain tax positions was a liability of \$3,256 and \$3,574, respectively. A number of years may elapse before an uncertain tax position is resolved by settlement or statute of limitation. 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 and interest and penalties of approximately \$1,636 within the next twelve months due to the expiration of statutes of limitation in foreign jurisdictions. We recognize interest and penalties related to uncertain tax positions in income tax expense in our consolidated statements of operations.

**NOTE 6: INTEREST EXPENSE AND OTHER, NET**

Interest expense and other, consists of the following:

	Three Months Ended	
	March 31,	
	2011	2010
Interest income	\$ 10	\$ 13
Interest expense	(157)	(123)
Amortization of debt issuance costs	(19)	(18)
Total interest expense and other, net	<u>\$ (166)</u>	<u>\$ (128)</u>

**NOTE 7: COMPREHENSIVE INCOME (LOSS)**

Total comprehensive income (loss) is as follows:

	Three Months Ended	
	March 31,	
	2011	2010
Net income (loss)	\$ (1,468)	\$ 4,602
Reclassification of unrealized gain upon sale of available-for-sale securities	(255)	—
Unrealized gain (loss) on available-for-sale investments	(1)	3,140
Tax effect of unrealized gain (loss) on available-for-sale investments	26	(221)
Total comprehensive income (loss)	<u>\$ (1,698)</u>	<u>\$ 7,521</u>

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**NOTE 8: EARNINGS PER SHARE**

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

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

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

	Three Months Ended	
	March 31,	
	2011	2010
Net income (loss) used in basic net income (loss) per share	\$ (1,468)	\$ 4,602
Basic weighted average shares outstanding	13,569	13,363
Dilutive effect of employee equity incentive plans	—	857
Diluted weighted average shares outstanding	<u>13,569</u>	<u>14,220</u>
Net income (loss) per common share:		
Basic	<u>\$ (0.11)</u>	<u>\$ 0.34</u>
Diluted	<u>\$ (0.11)</u>	<u>\$ 0.32</u>

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,	
	2011	2010
Employee equity incentive plans	3,434	1,404
Conversion of debentures	216	216

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**NOTE 9: SUPPLEMENTAL CASH FLOW INFORMATION**

Supplemental disclosure of cash flow information is as follows:

	Three Months Ended	
	March 31,	
	2011	2010
Cash paid during the period for:		
Interest	\$ 36	\$ 17
Income taxes	194	66
Non-cash investing and financing activities:		
Acquisitions of property and equipment and other assets under extended payment terms	\$ 2,226	\$ 131

**NOTE 10: SEGMENT 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 end customer, is as follows:

	Three Months Ended	
	March 31,	
	2011	2010
Japan	\$ 9,741	\$ 11,105
Taiwan	2,113	4,232
Europe	682	845
Korea	559	641
U.S.	524	532
China	461	489
Other	620	848
	<u>\$ 14,700</u>	<u>\$ 18,692</u>

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**Significant Customers**

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

	Three Months Ended	
	March 31,	
	2011	2010
Distributors:		
All distributors	64%	55%
Distributor A	46%	37%
End Customers: <sup>(1)</sup>		
Top five end customers	57%	62%
End customer A	20%	22%
End customer B	11%	0%
End customer C	9%	13%
End customer D	8%	10%

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

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

	March 31,	December 31,
	2011	2010
Account A	27%	25%
Account B	24%	45%

**NOTE 11: 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. Additionally, the concentration of these vendors within the People's Republic of China and Taiwan increases our risk of supply disruption due to natural disasters, economic instability, political unrest or other regional disturbances. The recent earthquake and tsunami in Japan has resulted in limited availability of certain component parts that are used in the production of our products. Our contract manufacturers may be required to source these components from alternate vendors, which would require us to re-qualify our parts with customers, which could cause delays in shipments. Although these risks have not materially adversely affected our business, financial condition, results of operations or cash flows to date we cannot assure you that such risks will not do so in the future.

**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.



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**Concentrations of Credit Risk**

Financial instruments that potentially subject us to concentrations of credit risk consist of cash equivalents, short-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 12: COMMITMENTS AND CONTINGENCIES**

**Indemnifications**

Certain of our agreements include indemnification provisions for claims from third-parties relating to our intellectual property. It is not possible for us to predict the maximum potential amount of future payments or indemnification costs under these or similar agreements due to the conditional nature of our obligations and the unique facts and circumstances involved in each particular agreement. We have not made any payments under these agreements in the past, and as of March 31, 2011, we have not incurred any material liabilities arising from these indemnification obligations. In the future, however, such obligations could impact our results of operations.

**Legal Proceedings**

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

**NOTE 13: SUBSEQUENT EVENTS**

On May 11, 2011, we sold 3,650,000 shares of common stock at a price of \$2.24 per share in an underwritten registered offering. Net proceeds to the Company, after deducting underwriting discounts and commissions and other estimated offering expenses, were approximately \$7,288. We intend to use our net proceeds from the offering for general corporate purposes, which may include, among other things, increasing our working capital, the funding of ongoing operating expenses and overhead, repayment of debt and funding capital expenditures. The offering was made pursuant to a shelf registration statement on Form S-3 filed with the Securities and Exchange Commission on November 22, 2010, which became effective on December 2, 2010.

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

**Forward-looking Statements**

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

**Overview**

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications and hold 109 patents related to the visual display of digital image data. Our solutions enable manufacturers of digital display and projection devices, such as large-screen flat panel televisions and digital front projectors, to manufacture their products with a consistently high level of video quality, regardless of the content’s source or format. Our core technology leverages unique proprietary techniques for intelligently processing video signals from a variety of sources to ensure that all resulting images are optimized. Additionally, our products help our customers reduce costs and differentiate their display and projection devices, an important factor in industries that experience rapid innovation. Pixelworks was founded in 1997 and is incorporated under the laws of the state of Oregon.

**Results of Operations**

Revenue, net

Net revenue was as follows (dollars in thousands):

	Three months ended		2011 v 2010	
	March 31,		\$ change	% change
	2011	2010		
Revenue, net	\$ 14,700	\$ 18,692	\$ (3,992)	(21)%

Net revenue decreased \$3.9 million, or 21%, from the first quarter of 2010 to the first quarter of 2011. The decrease was attributable to a 21% decrease in average selling price (“ASP”) and a 1% decrease in units sold. The decrease in ASP was primarily due to a greater proportion of unit sales of our Motion

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Estimation Motion Compensation (“MEMC”) co-processor ICs, which have a lower price point than our other product lines. The decrease in units sold resulted primarily from decreased sales of our digital projector products due to continuing inventory correction, partially offset by an increase in MEMC co-processor IC sales due to our first volume shipments for a top-tier advanced television market customer during the first quarter of 2011.

### Cost of revenue and gross profit

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

	Three months ended March 31,			
	2011	% of revenue	2010	% of revenue
Direct product costs and related overhead <sup>1</sup>	\$ 7,817	53%	\$ 9,081	49%
Amortization of acquired intangible assets	—	0	573	3
Inventory charges <sup>2</sup>	198	1	370	2
Other cost of revenue <sup>3</sup>	113	1	12	0
<b>Total cost of revenue</b>	<b>\$ 8,128</b>	<b>55%</b>	<b>\$ 10,036</b>	<b>54%</b>
<b>Gross profit</b>	<b>\$ 6,572</b>	<b>45%</b>	<b>\$ 8,656</b>	<b>46%</b>

<sup>1</sup> Includes purchased materials, assembly, test, labor, employee benefits, warranty expense and royalties.

<sup>2</sup> Includes the net provision for inventory reserves and lower of cost or market write-downs.

<sup>3</sup> Includes stock based compensation and additional amortization of non-cancelable prepaid royalty.

Cost of revenue increased to 55% of total revenue in the first quarter of 2011, up from 54% of total revenue in the first quarter of 2010. The increase resulted primarily from an increase in direct product costs as a percentage of revenue, partially offset by a decrease in amortization expense for acquired intangible assets that were fully amortized as of the second quarter of 2010. The increase in direct product costs as a percentage of revenue in the first quarter of 2011, compared to the first quarter of 2010, is primarily due to customer transition to our next generation digital projector products and increased sales of our MEMC products both of which have higher material costs than our historical product offerings.

### 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,		2011 v 2010	
	2011	2010	\$ change	% change
Research and development	\$ 5,995	\$ 5,340	\$ 655	12%

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Research and development expense increased \$0.7 million, or 12%, from the first quarter of 2010 to the first quarter of 2011. The increase is primarily attributable to the following:

- Compensation expense increased \$0.3 million as a result of increased headcount and annual merit and cost of living salary increases; and
- Depreciation and amortization expense increased \$0.3 million primarily due to intellectual property additions during the second and third quarters of 2010 and engineering software tool additions during the first quarter of 2011.

### 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,		2011 v 2010	
	2011	2010	\$ change	% change
Selling, general and administrative	\$ 3,834	\$ 3,793	\$ 41	1%

Selling, general and administrative expense were relatively unchanged from the first quarter of 2010 to the first quarter of 2011, reflecting the stable nature of our selling, general and administrative activities over this time period.

### Restructuring

All actions under our prior restructuring plans were completed in the second quarter of 2009; however, due to decreases in estimated future sublease income and related professional fees, lease termination costs of \$0.1 million were recorded in the first quarter of 2010. As of March 31, 2011, accrued lease termination costs of \$0.2 million are included in current and non-current accrued liabilities in the condensed consolidated balance sheets and will be paid in cash over the remaining lease terms of approximately two and a half years.

### Other income, net

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

	Three months ended March 31,	
	2011	2010
Gain on sale of patents <sup>1</sup>	\$ 1,600	\$ —
Gain on sale of marketable securities <sup>2</sup>	264	—
Interest expense and other, net <sup>3</sup>	(166)	(128)
Total other income (expense), net	\$ 1,698	\$ (128)

<sup>1</sup> In the first quarter of 2011, we sold certain patents and related rights and materials for proceeds and a net gain of \$1.6 million. All of the patents were originally obtained by us during our June 2005 acquisition of Equator Technologies, Inc., and the underlying technologies pertain to markets that we no longer pursue.

<sup>2</sup> In the first quarter of 2011, we realized a gain of \$0.3 million on the sale of available-for-sale marketable securities.

<sup>3</sup> Interest expense and other, net consists of interest expense related to interest payable on our convertible subordinated debentures (the "debentures"); imputed interest expense on asset financings and accrued interest under other contractual agreements; interest income earned on cash equivalents and short-term marketable securities; and amortization of debt issuance costs.

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### Benefit for income taxes

The benefit for income taxes recorded for the first quarter of 2011 was primarily due to a benefit of \$0.3 million for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitation, partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions.

The benefit for income taxes recorded for the first quarter of 2010 was primarily due to a benefit of \$5.3 million for the reversal of previously recorded tax contingencies, partially offset by current and deferred tax expense in profitable foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions.

### Business Outlook

On April 20, 2011, we provided an outlook for the second quarter of 2011 in our earnings release, which was furnished on a current report on Form 8-K. The outlook provided the following anticipated financial results prepared in accordance with U.S. generally accepted accounting principles:

- Second quarter revenue of \$14.5 million to \$16.5 million.
- Gross profit margin of approximately 44% to 48%.
- Operating expenses of \$10 million to \$11 million.

The recent earthquake and tsunami in Japan has created uncertainty regarding our supply chain and general economic and market conditions. Please also refer to the discussion of risks related to the Japan earthquake and tsunami in Part II, Item 1A, "Risk Factors," which is incorporated herein by reference. Although this recent natural disaster has not materially adversely affected our business, financial condition, results of operations or cash flows to date we cannot assure you that it will not do so in the future.

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### **Liquidity and Capital Resources**

#### Cash and short- and long-term marketable securities

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

	<u>March 31,</u> <u>2011</u>	<u>December 31,</u> <u>2010</u>	<u>\$ change</u>	<u>% change</u>
Cash and cash equivalents	\$ 26,704	\$ 16,872	\$ 9,832	58%
Short-term marketable securities	2,901	12,366	(9,465)	(77)
Long-term marketable securities	—	603	(603)	(100)
Total cash and marketable securities	<u>\$ 29,605</u>	<u>\$ 29,841</u>	<u>\$ (236)</u>	<u>(1)%</u>

Total cash and marketable securities decreased \$0.2 million from December 31, 2010 to March 31, 2011. The net decrease in the first quarter of 2011 resulted primarily from \$1.9 million used in operating activities and \$0.9 million in payments on property and equipment and other asset financing, partially offset by \$1.6 million in proceeds from the sale of patents and \$1.0 million in net proceeds from our short-term line of credit, as discussed below under Capital Resources. Excluding non-formula advances, our cash and marketable securities would have decreased \$1.2 million from December 31, 2010 to March 31, 2011.

As of March 31, 2011, cash equivalents and short-term marketable securities included \$14.7 million in money market funds and certificates of deposit, \$1.7 million in commercial paper, and \$1.8 million in U.S. government agencies debt securities. All of our investments were denominated in U.S. dollars, and our portfolio did not contain direct exposure to subprime mortgages or structured vehicles that derive their value from subprime collateral.

The quality of our investment portfolio remains high during this difficult credit environment. Our investment policy requires that our portfolio maintains a weighted average maturity of less than 12 months. Additionally, no maturities can extend beyond 24 months and concentrations with individual securities are limited. Investments must be rated at least A-1 / P-1 by Standard & Poor's / Moody's, and our investment policy is reviewed at least annually by our Audit Committee.

The valuations of our short-term marketable securities are affected by a variety of factors, including changes in interest rates and the actual or perceived financial stability of the issuer. However, due to the high quality of our investments and their short-term nature, there has not been, and we do not expect there to be, a significant fluctuation in the valuation of these investments. Accordingly, we do not expect a materially negative impact on our financial condition from fluctuations in the value of our short-term investments. As of March 31, 2011, we had a nominal unrealized loss on these investments.

#### Accounts receivable, net

Accounts receivable, net decreased to \$4.3 million as of March 31, 2011 from \$4.5 million as of December 31, 2010. The average number of days sales outstanding decreased to 26 days as of March 31, 2011 from 29 days as of December 31, 2010. These changes were primarily due to normal fluctuations in the timing of cash receipts.

#### Inventories, net

Inventories, net decreased to \$4.7 million as of March 31, 2011 from \$4.9 million as of December 31, 2010. Inventory turnover increased to 6.7 as of March 31, 2011 from 5.8 as of December 31, 2010 and is calculated based on annualized operating results and average inventory balances for the respective quarters. Inventory turnover increased primarily due to lower average inventory balances and increased direct material cost from the fourth quarter of 2010 to the first quarter of 2011.

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### Capital resources

#### *Equity offering*

On May 11, 2011, we sold 3,650,000 shares of common stock at a price of \$2.24 per share in an underwritten registered offering. Net proceeds to the Company, after deducting underwriting discounts and commissions and other estimated offering expenses, were approximately \$7.3 million. We intend to use our net proceeds from the offering for general corporate purposes, which may include, among other things, increasing our working capital, the funding of ongoing operating expenses and overhead, repayment of debt and funding capital expenditures.

#### *Short-term line of credit*

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

The Revolving Loan Agreement contains customary affirmative and negative covenants as well as customary events of default. The occurrence of an event of default could result in the acceleration of the Company's obligations under the Revolving Loan Agreement and an increase to the applicable interest rate, and would permit the Bank to exercise remedies with respect to its security interest. As of March 31, 2011, we were in compliance with all of the terms of the Revolving Loan Agreement.

Short-term borrowings outstanding under the Revolving Line were non-formula advances of \$4.0 million and \$3.0 million as of March 31, 2011 and December 31, 2010, respectively and were repaid within required terms.

#### *Debentures currently payable*

In 2004, we issued \$150.0 million of 1.75% convertible subordinated debentures (the "debentures") due 2024. Between 2006 and 2009, we repurchased and retired \$134.2 million principal amount of the debentures and as of March 31, 2011, \$15.8 million of the debentures are outstanding.

On April 13, 2011, we announced an offer to repurchase all of the outstanding debentures, as required under the terms of the indenture governing the debentures. In connection with the offer, we filed a Tender Offer Statement on Schedule TO on that day, including as an exhibit, a notice to holders of the debentures specifying the terms, conditions and procedures of our offer to repurchase. The holders of the debentures' opportunity to tender their debentures terminated on May 11, 2011 and all of the debentures were properly tendered to us at that time. We will redeem all of the debentures for cash on or about May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest.

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Liquidity

Our cash and marketable securities totaling \$29.6 million, are highly liquid with scheduled maturities prior to May 15, 2011, which is on or about the date we will repurchase our debentures. Additionally, on May 11, 2011, we received net proceeds of approximately \$7.3 million in an underwritten registered offering of our common stock. Although the repayment of our debentures will consume a significant portion of our cash and marketable securities, we anticipate that our existing working capital, as well as funds available under our Revolving Line, will be adequate to fund our operating, investing and financing needs for the next twelve months. If necessary, management will pursue financing arrangements including the issuance of debt or equity securities or will reduce expenditures, in order to meet the Company's cash requirements. There is no assurance that, if required, we will be able to raise additional capital or reduce discretionary spending to provide the required liquidity which, in turn, may have an adverse effect on our results of operations and financial position.

From time to time, we may evaluate acquisitions of businesses, products or technologies that complement our business. Any further transactions, if consummated, may consume a material portion of our working capital or require additional financing activities, including the issuance of equity securities that may result in dilution to existing shareholders.

**Contractual Payment Obligations**

Our contractual obligations for 2011 and beyond are included in our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission on March 9, 2011. Our obligations for 2011 and beyond have not changed materially as of March 31, 2011.

**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, results of operations, liquidity, capital expenditures or capital resources.

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

**Interest Rate Risk**

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

During the first three months of 2011 and as of March 31, 2011, substantially all of our cash equivalents and investments were held in high quality securities or money market funds with yields approaching zero, accordingly, a hypothetical decrease in interest rates would not have a significant impact on our results of operations or financial position.

As of March 31, 2011, we had convertible subordinated debentures of \$15.8 million outstanding with a fixed interest rate of 1.75%. Interest rate changes affect the fair value of the debentures, but do not affect our earnings or cash flow.



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**Exchange Rate Risk**

All of our sales and inventory purchases are denominated in U.S. dollars and, as a result, we have relatively little exposure to foreign currency exchange risk with respect to our sales or cost of goods sold. We have employees located in offices in Japan, Taiwan, Korea and the People's Republic of China and as such, a portion of our operating expenses as well as foreign income taxes payable are denominated in foreign currencies. Accordingly, our operating results are affected by changes in the exchange rate between the U.S. dollar and those currencies. Any future strengthening of those currencies against the U.S. dollar could negatively impact our operating results by increasing our operating expenses as measured in U.S. dollars. We analyze our exposure to foreign currency fluctuations and may engage in financial hedging techniques in the future to attempt to minimize the effect of these potential fluctuations; however, foreign currency exchange rate fluctuations may adversely affect our financial results in the future.

**Item 4. Controls and Procedures.**

**Evaluation of Disclosure Controls and Procedures**

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

**Changes in Internal Control over Financial Reporting**

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

**Inherent Limitations on Effectiveness of Controls**

Our management, including the CEO and CFO, does not expect that our Disclosure Controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

## PART II – OTHER INFORMATION

### Item 1. Legal Proceedings.

For a discussion of legal proceedings, see “Note 12: Commitments and Contingencies” in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

### 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, 2010, including our consolidated financial statements and related notes, and our other filings made from time to time with the Securities and Exchange Commission.*

#### **Company Specific Risks**

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

We have adopted a product strategy that focuses on our core competencies in pixel processing and delivering high levels of video and image quality. With this strategy, we continue to make further investments in the development of our ImageProcessor architecture for the digital projector market, with particular focus on adding increased performance and functionality. For the advanced television market, our strategy focuses on implementing our intellectual property (“IP”) to improve the video performance of our customers’ image processors through the use of our Motion Estimation Motion Compensation (“MEMC”) co-processor integrated circuits (“ICs”). This strategy is designed to address the needs of the large-screen, high-resolution, high-quality segment of the television market. Although our product strategy is developed to take advantage of market trends, such markets may not develop or may take longer to develop than we expect. We cannot assure you that the products we are developing will adequately address the demands of our target customers, or that we will be able to produce our new products at costs that enable us to price these products competitively.

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

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***We have incurred indebtedness as a result of the sale of convertible debentures. We will be required to repay the debentures in full on or about May 15, 2011 which will consume a significant portion of our available cash and could reduce our ability to execute our product strategy.***

As of March 31, 2011, \$15.8 million of our 1.75% convertible subordinated debentures (the “debentures”) were outstanding. Although the debentures are not due until 2024, pursuant to the tender offer we filed on April 13, 2011, the holders have exercised their option to require us to purchase all of the debentures on or about May 15, 2011. While we believe that our existing working capital, as well as funds available under our short-term line of credit will be sufficient to meet our capital requirements for the next twelve months, the repurchase of the debentures will require a significant portion of our available cash. The reduction of our financial resources could limit our ability to execute our product strategy, particularly if we are unable to generate cash from operations or obtain additional sources of financing.

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

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

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

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

We do not own or operate a semiconductor fabrication facility and do not have the resources to manufacture our products internally. We rely on four third-party foundries to produce all of our wafers and three assembly and test vendors for completion of finished products. The wafers used in any one of our products are fabricated by only one foundry. Sole sourcing each product increases our dependence on our suppliers.

We have limited control over delivery schedules, quality assurance, manufacturing yields, potential errors in manufacturing and production costs. We do not have long-term supply contracts with our third-party manufacturers, so they are not obligated to supply us with products for any specific period of time, quantity or price, except as may be provided in a particular purchase order. Our suppliers can increase the prices of the products we purchase from them with little notice, which may cause us to increase the prices to our customers and harm our competitiveness. Because our requirements represent only a small portion of the total production capacity of our contract manufacturers, they could reallocate capacity to other customers even during periods of high demand for our products, as they have done in the past. We expect this may occur again in the future.

Establishing a relationship with a new contract manufacturer in the event of delays or increased prices would be costly and burdensome. The lead time to make such a change would be at least nine months, and the estimated time for us to adapt a product’s design to a particular contract manufacturer’s process is at least four months. Additionally, we have, and may continue to choose new foundries to manufacture

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our wafers which may require us to modify our design methodology flow for the process technology and intellectual property cores of the new foundry. If we have to qualify a new foundry or packaging, assembly and testing supplier for any of our products or if we are unable to obtain our products from our contract manufacturers on schedule, at costs that are acceptable to us, or at all, we could incur significant delays in shipping products, our ability to satisfy customer demand could be harmed, our revenue from the sale of products may be lost or delayed and our customer relationships and ability to obtain future design wins could be damaged.

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

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

***The concentration of our employees, manufacturers and customers in Japan, the People's Republic of China ("PRC"), Korea, Taiwan and Singapore increases our risk that a natural disaster, including the recent earthquake and tsunami in Japan, or a work stoppage or economic or political instability in the region could have a material adverse effect on our business, financial condition or results of operations.***

Most of our current manufacturers, customers and employees are located in Japan, the PRC, Korea, Taiwan or Singapore. Disruptions from natural disasters, health epidemics, work stoppages, labor strikes and political, social and economic instability may and have affected this region and could have a negative impact on our business, financial condition or results of operations, including disrupting our supply chain and operations, as well as those of our manufacturers and customers. In particular, the recent earthquake and tsunami in Japan has disrupted our supply chain, particularly in the availability of certain component parts that are used in the production of our products. Our contract manufacturers may be required to source these components from alternate vendors, which would require us to re-qualify our parts with customers, which could cause delays in shipments. Our customers are also currently evaluating whether material shortages will decrease their ability to produce and ship their products and also whether overall consumer demand will be reduced as a result of the earthquake and tsunami. As a result, we currently have less visibility regarding the demand for our products, which makes it more difficult for us to manage our supply chain to ensure that we have sufficient, but not excess, on-hand inventory. Although these risks have not materially adversely affected our business, financial condition, results of operations or cash flows to date we cannot assure you that such risks will not do so in the future. We also cannot assure you that another earthquake, tsunami or other natural disaster will not occur in the Pacific Rim region, where the risk of such an event is significant due to, among other things, the proximity of major earthquake fault lines in the area. Any such future event could include power outages, fires, flooding or other adverse conditions, as well as disruption or impairment of production capacity and the operations of our manufacturers and customers, which could have a material adverse effect on us.

In addition to the risk of natural disaster in the Pacific Rim region, the economy of the PRC, in which certain of our manufacturers, customers and employees are based, differs from the economies of many countries in respects such as structure, government involvement, level of development, growth rate, capital reinvestment, allocation of resources, self-sufficiency, rate of inflation, foreign currency flows and balance of payments position, among others. We cannot be assured that the PRC's economic policies will be consistent or effective. Our business, financial condition and results of operations may be harmed by changes in the PRC's political, economic or social conditions.

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

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

In addition, we may not be able to successfully integrate the businesses, products, technologies or personnel of any entity that we might acquire in the future, and any failure to do so could disrupt our business and seriously harm our financial condition.

***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.

Because of the lengthy development and sales cycles, we will experience delays between the time we incur expenditures for research and development, sales and marketing and inventory and the time we generate revenue, if any, from these expenditures. Additionally, if actual sales volumes for a particular product are substantially less than originally anticipated, we may experience large write-offs of capitalized license fees, software development tools, product masks, inventories or other capitalized or deferred product-related costs, or increased amortization of non-cancelable prepaid royalties, any of which would negatively affect our operating results. For example, our provisions for obsolete inventory and lower of cost or market write-downs were \$1.6 million and \$1.2 million in 2010 and 2009, respectively and \$0.2 million for the three months ended March 31, 2011.

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

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

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

The display manufacturing market is highly concentrated and we are, and will continue to be, dependent on a limited number of customers and distributors for a substantial portion of our revenue. Sales to our top distributor represented 46%, 44% and 35% of revenue for the three month period ended March 31, 2011 and the years ended December 31, 2010 and 2009, respectively. Revenue attributable to our top five end customers represented 57%, 58% and 56% of revenue for the three month period ended March 31, 2011 and the years ended December 31, 2010 and 2009, respectively. As of March 31, 2011 and 2010, we had two and three accounts, respectively, that each represented 10% or more of accounts receivable. All of the orders included in our backlog are cancelable. A reduction, delay or cancellation of orders from one or more of our significant customers, or a decision by one or more of our significant customers to select products manufactured by a competitor or to use its own internally-developed semiconductors, would significantly impact our revenue. Further, the concentration of our accounts receivable with a limited number of customers increases our credit risk. The failure of these customers to pay their balances, or any customer to pay future outstanding balances, would result in an operating expense and reduce our cash flows.

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

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

The estimates we use for our advance orders from contract manufacturers are based, in part, on reports of inventory levels and production forecasts from our distributors and integrators, which act as intermediaries between us and the companies using our products. This process requires us to make numerous assumptions concerning demand and to rely on the accuracy of the reports and forecasts of our distributors and integrators, each of which may introduce error into our estimates of inventory requirements. Our failure to manage this challenge could result in excess inventory or inventory shortages that could materially impact our operating results or limit the ability of companies using our semiconductors to deliver their products. For example, we overestimated demand for certain of our products which led to significant charges for obsolete inventory in 2010, 2009 and 2008. On the other hand, if we underestimate demand, we would forego revenue opportunities, lose market share and damage our customer relationships.

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

Sales outside the U.S. accounted for approximately 96%, 96% and 97% of revenue for the three month period ended March 31, 2011 and the years ended December 31, 2010 and 2009, respectively. We anticipate that sales outside the U.S. will continue to account for a substantial portion of our revenue in future periods. In addition, customers who incorporate our products into their products sell a substantial portion of their products outside of the U.S., and all of our products are manufactured outside of the U.S. We are, therefore, subject to many international risks, including, but not limited to:

- increased difficulties in managing international distributors and manufacturers due to varying time zones, languages and business customs;

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- compliance with U.S. laws affecting operations outside of the U.S., such as the Foreign Corrupt Practices Act;
- foreign currency exchange fluctuations in the currencies of Japan, the PRC, Taiwan or Korea;
- reduced or limited protection of our IP, particularly in software, which is more prone to design piracy;
- difficulties in collecting outstanding accounts receivable balances;
- changes in tax laws and the interpretation of those laws;
- difficulties regarding timing and availability of export and import licenses;
- political and economic instability, particularly in the PRC, Japan, Taiwan, or Korea;
- difficulties in maintaining sales representatives outside of the U.S. that are knowledgeable about our industry and products;
- changes in the regulatory environment in the PRC, Japan, Taiwan and Korea that may significantly impact purchases of our products by our customers;
- outbreaks of health epidemics in the PRC or other parts of Asia;
- imposition of new tariffs, quotas, trade barriers and similar trade restrictions on our sales; and
- greater vulnerability to infrastructure and labor disruptions than established markets.

All of these factors could result in increased costs or decreased revenues, and could materially affect our product sales, financial condition and results of operations.

Additionally, we have employees located in offices in Japan, Taiwan, Korea and the PRC and as such, a portion of our operating expenses as well as foreign income taxes payable are denominated in foreign currencies. Accordingly, our operating results are affected by changes in the exchange rate between the U.S. dollar and those currencies. Any future strengthening of those currencies against the U.S. dollar could negatively impact our operating results by increasing our operating expenses as measured in U.S. dollars. We analyze our exposure to foreign currency fluctuations and may engage in financial hedging techniques in the future to attempt to minimize the effect of these potential fluctuations; however, foreign currency exchange rate fluctuations may adversely affect our financial results in the future.

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

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

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

We spend a significant amount of management time and external resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including evolving Securities and Exchange Commission rules and regulations, NASDAQ Global Market rules, the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Sarbanes-Oxley Act of 2002 which requires management's annual review and evaluation of internal control over financial reporting. If we are unable to maintain an effective system of internal controls, our shareholders could lose confidence in the accuracy and completeness of our financial reports which in turn could cause our stock price to decline.

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

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

As of December 31, 2010, we had federal, state and foreign net operating loss carryforwards of approximately \$173.1 million, \$73.5 million and \$0.4 million, respectively, which expire between 2011 and 2027. These net operating loss carryforwards may be used to offset future taxable income and thereby reduce our U.S. federal income taxes otherwise payable. Section 382 of the Internal Revenue Code of 1986, as amended (the "Code"), imposes an annual limit on the ability of a corporation that undergoes an "ownership change" to use its net operating loss carry forwards to reduce its tax liability. In the event of certain changes in our shareholder base, we may at some point in the future experience an "ownership change" as defined in Section 382 of the Code. Accordingly, our use of the net operating loss carryforwards may be limited by the annual limitations described in Section 382 of the Code. In addition, all or a portion of these net operating loss carryforwards may expire unutilized.

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

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

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



**Company Risks Related to the Semiconductor Industry and Our Markets**

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

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

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

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

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

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

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

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

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

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

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

Many of our competitors have longer operating histories and greater resources to support development and marketing efforts than we do. Some of our competitors operate their own fabrication facilities. These competitors may be able to react more quickly and devote more resources to efforts that compete directly with our own. Our current or potential customers have developed, and may continue to develop, their own proprietary technologies and become our competitors. Increased competition from both competitors and our customers' internal development efforts could harm our business, financial condition and results of operations by, for example, increasing pressure on our profit margin or causing us to lose sales opportunities. In 2010 and 2011, for example, frame rate conversion technology similar to that used in our line of MEMC co-processors continued to be integrated into the SoC products of our competitors, particularly in lower refresh rate television products. We cannot assure you that we can compete successfully against current or potential competitors.

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

The markets in which we compete or seek to compete are subject to rapid technological change and miniaturization capabilities, frequent new product introductions, changing customer requirements for new products and features and evolving industry standards. The introduction of new technologies and emergence of new industry standards could render our products less desirable or obsolete, which could harm our business and significantly decrease our revenue. Examples of changing industry standards include the growing use of broadband to deliver video content, increased display resolution and size, faster screen refresh rates, video capability such as high definition and 3D, the proliferation of new display devices and the drive to network display devices together. Our products are incorporated into our customers' products, which have different parts and specifications and utilize multiple protocols that allow them to be compatible with specific computers, video standards and other devices. If our customers' products are not compatible with these protocols and standards, consumers will return, or not purchase, these products and the markets for our customers' products could be significantly reduced. Additionally, if the technology used by our customers becomes less competitive due to cost, customer preferences or other factors relative to alternative technologies, sales of our products could decline.

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

From time to time, shortages of components and materials that are critical to the manufacture of our products and our customers' products may occur. Such critical components and materials include semiconductor wafers and packages, double data rate memory die, display components, analog-to-digital converters, digital receivers, video decoders and voltage regulators. If material shortages occur, we may incur additional costs or be unable to ship our products to our customers in a timely fashion, both of which could harm our business and adversely affect our results of operations.

For example, the recent earthquake and tsunami in Japan has limited the availability of certain component parts that are used in the production of our products. Our contract manufacturers may be required to source these components from alternate vendors, which would require us to re-qualify our parts with customers, which could cause delays in shipments. Our customers are also currently evaluating whether material shortages will decrease their ability to produce and ship their products. Although these risks have not materially adversely affected our business, financial condition or results of operations to date we cannot assure you that such risks will not do so in the future.

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

We provide our customers with software development tools and with software that provides basic functionality for our ICs and enables enhanced connectivity of our customers' products. Software development is a complex process and we are dependent on software development languages and operating systems from vendors that may limit our ability to design software in a timely manner. Also, as software tools and interfaces change rapidly, new software languages introduced to the market may be incompatible with our existing systems and tools, requiring significant engineering efforts to migrate our existing systems in order to be compatible with those new languages. Software development disruptions could slow our product development or cause us to lose customers and design wins. The integration of software with our products adds complexity, may extend our internal development programs and could impact our customers' development schedules. This complexity requires increased coordination between hardware and software development schedules and increases our operating expenses without a corresponding increase in product revenue. This additional level of complexity lengthens the sales cycle and may result in customers selecting competitive products requiring less software integration.

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

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

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

Our ability to compete effectively with other companies will depend, in part, on our ability to maintain the proprietary nature of our technology, including our semiconductor designs and software code. We provide the computer programming code for our software to customers in connection with their product development efforts, thereby increasing the risk that customers will misappropriate our proprietary software. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to help protect our proprietary technologies. We hold 109 patents and have 28 patent applications pending for protection of our significant technologies. Competitors in both the U.S. and foreign countries, many of whom have substantially greater resources than we do, may apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell our products, or they may develop similar technology independently or design around our patents. Effective patent, copyright, trademark and trade secret protection may be unavailable or limited in foreign countries.

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

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

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

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

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

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

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

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

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

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

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

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

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***Environmental laws and regulations have caused us to incur, and may again cause us to incur, significant expenditures to comply with applicable laws and regulations, and we may be assessed considerable penalties for noncompliance.***

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

### **Other Risks**

***The current adverse global economic environment and volatility in global credit and financial markets could materially and adversely affect our business and results of operations.***

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

***Future sales of our equity could result in significant dilution to our existing shareholders and depress the market price of our common stock.***

We may need to seek additional capital from time to time. If this financing is obtained through the issuance of equity securities, debt convertible into equity securities, options or warrants to acquire equity securities or similar instruments or securities, our existing shareholders will experience dilution in their ownership percentage upon the issuance, conversion or exercise of such securities and such dilution could be significant. For example, on May 11, 2011, we issued 3.65 million shares of our common stock in an underwritten registered offering. Further, new equity securities issued by us could have rights, preferences or privileges senior to those of our common stock.

In addition, any such issuance by us or sales of our securities by our security holders, or the perception that such issuances or sales could occur, could negatively impact the market price of our securities. For example, we have a number of institutional shareholders that own significant blocks of our common stock. If one or more of these shareholders were to sell large portions of their holdings in a relatively short time, for liquidity or other reasons, the prevailing market price of our common stock could be negatively affected. This could result in further potential dilution to our existing shareholders and the impairment of our ability to raise capital through the sale of equity, debt or other securities.

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

Our stock price and the stock prices of technology companies similar to Pixelworks have been highly volatile. The price of our common stock may decline and the value of your investment may be reduced regardless of our performance. Market fluctuations, as well as general economic and political conditions, including recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of our common stock. Additional factors that could negatively impact our stock price include:

- actual or anticipated fluctuations in our operating results;

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- changes in expectations as to our future financial performance;
- changes in financial estimates of securities analysts;
- announcements by us or our competitors of technological innovations, design wins, contracts, standards, acquisitions or divestitures;
- the operating and stock price performance of other comparable companies;
- issuances or proposed issuances of equity, debt or other securities by us, or sales of securities by our security holders;
- inconsistent trading volume levels of our common stock; and
- changes in market valuations of other technology companies.

Any inability or perceived inability of investors to realize a gain on an investment in our common stock could have an adverse effect on our business, financial condition and results of operations by potentially limiting our ability to retain our customers, to attract and retain qualified employees and to raise capital.

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

On June 4, 2008, we effected a one-for-three reverse split of our common stock. We effected the reverse split to regain compliance with NASDAQ Marketplace Rules, particularly the minimum \$1.00 per share requirement for continued inclusion on the NASDAQ Global Market. The per share price of our common stock has fluctuated significantly and was below \$1.00 as recently as May 6, 2009. We cannot guarantee that it will remain at or above \$1.00 per share and if the price again drops below \$1.00 per share, the stock could become subject to delisting again, and we may seek shareholder approval for an additional reverse split. A second reverse split could produce adverse effects and may not result in a long-term or permanent increase in the price of our common stock. In addition to the minimum \$1.00 per share requirement, NASDAQ Global Market also requires satisfaction of one of the following in addition to certain other requirements: (i) a minimum of \$50.0 million in total asset value and \$50.0 million in revenues (in the latest fiscal year or in two of the last three fiscal years), (ii) a minimum of \$50.0 million in market value of listed securities, or (iii) a minimum of \$10.0 million in stockholders' equity. As of March 31, 2011, we achieved a \$50.0 million total asset value by making a non-formula advance on our short-term line of credit and as recently as December 31, 2008, our shareholders' equity was below \$10.0 million. In the future, we may be unable to meet these continued listing requirements and our stock could become subject to delisting.

If our common stock is delisted, trading of the stock will most likely take place on an over-the-counter market established for unlisted securities. An investor is likely to find it less convenient to sell, or to obtain accurate quotations in seeking to buy, our common stock on an over-the-counter market, and many investors may not buy or sell our common stock due to difficulty in accessing over-the-counter markets, or due to policies preventing them from trading in securities not listed on a national exchange or other reasons. For these reasons and others, delisting would adversely affect the liquidity, trading volume and price of our common stock, causing the value of an investment in us to decrease and having an adverse effect on our business, financial condition and results of operations by limiting our ability to attract and retain qualified executives and employees and limiting our ability to raise capital.

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*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, including by preventing a sale or takeover of us at a price or prices favorable to the holders of our common stock.*

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

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

### **Item 6. Exhibits.**

- 10.1 Pixelworks, Inc. Amended and Restated 2010 Employee Stock Purchase Plan. +
- 31.1 Certification of Chief Executive Officer.
- 31.2 Certification of Chief Financial Officer.
- 32.1\* Certification of Chief Executive Officer.
- 32.2\* Certification of Chief Financial Officer.

+ Indicates a management contract or compensation arrangement.

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



**SIGNATURE**

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

Dated: May 12, 2011

PIXELWORKS, INC.

/s/ Steven L. Moore

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

## PIXELWORKS, INC.

## AMENDED AND RESTATED 2010 EMPLOYEE STOCK PURCHASE PLAN

**1. PURPOSE**

The purpose of this Plan is to assist Eligible Employees in acquiring a stock ownership interest in the Corporation, at a favorable price and upon favorable terms, pursuant to a plan which is intended to qualify as an "employee stock purchase plan" under Section 423 of the Code. This Plan is also intended to encourage Eligible Employees to remain in the employ of the Corporation or a Participating Subsidiary and to provide them with an additional incentive to advance the best interests of the Corporation.

**2. DEFINITIONS**

Capitalized terms used herein which are not otherwise defined shall have the following meanings.

**"Account"** means the bookkeeping account maintained by the Corporation, or by a recordkeeper on behalf of the Corporation, for a Participant pursuant to Section 7(a).

**"Board"** means the Board of Directors of the Corporation.

**"Code"** means the U.S. Internal Revenue Code of 1986, as amended from time to time.

**"Commission"** means the U.S. Securities and Exchange Commission.

**"Committee"** means the committee appointed by the Board to administer this Plan pursuant to Section 12.

**"Common Stock"** means the common stock, par value \$0.001 per share, of the Corporation, and such other securities or property as may become the subject of Options pursuant to an adjustment made under Section 17.

**"Compensation"** means an Eligible Employee's regular earnings and shall not include any overtime pay, sick pay, shift differential, shift premium, vacation pay, cash incentive compensation, commissions or cash bonuses. Compensation also includes any amounts contributed as salary reduction contributions to a plan qualifying under Section 401(k), 125 or 129 of the Code. Any other form of remuneration is excluded from Compensation, including (but not limited to) the following: prizes, awards, relocation or housing allowances, stock option exercises, stock appreciation right payments, the vesting or grant of restricted stock, the payment of stock units, performance awards, auto allowances, tuition reimbursement, perquisites, non-cash compensation and other forms of imputed income. Notwithstanding the foregoing, Compensation shall not include any amounts deferred under or paid from any nonqualified deferred compensation plan maintained by the Corporation or any Subsidiary.

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“**Contributions**” means the bookkeeping amounts credited to the Account of a Participant pursuant to this Plan, equal in amount to the amount of Compensation that the Participant has elected to contribute for the purchase of Common Stock under and in accordance with this Plan.

“**Corporation**” means Pixelworks, Inc., an Oregon corporation, and its successors.

“**Effective Date**” means the date on which this Plan is initially approved by the shareholders of the Corporation.

“**Eligible Employee**” means any employee of the Corporation, or of any Subsidiary which has been designated in writing by the Committee as a “Participating Subsidiary.” Notwithstanding the foregoing, “Eligible Employee” shall not include any employee whose customary employment is twenty (20) hours or less per week.

“**Exchange Act**” means the U.S. Securities Exchange Act of 1934, as amended from time to time.

“**Fair Market Value**” on any date means:

- (a) if the Common Stock is listed or admitted to trade on a national securities exchange, the closing price of a share of Common Stock on such date on the principal national securities exchange on which the Common Stock is so listed or admitted to trade, or, if there is no trading of the Common Stock on such date, then the closing price of a share of Common Stock on such exchange on the next preceding date on which there was trading in the shares of Common Stock;
- (b) in the absence of exchange data required to determine Fair Market Value pursuant to the foregoing, the value as established by the Committee as of the relevant time for purposes of this Plan.

“**Grant Date**” means, with respect to an Offering Period, the first day of that Offering Period.

“**Individual Limit**” has the meaning given to such term in Section 4(b).

“**Offering Period**” means the period of eighteen (18) consecutive months commencing on each Grant Date as provided in Section 5; provided, however, that the Committee may declare, as it deems appropriate and in advance of the applicable Offering Period, a shorter (not to be less than three months) Offering Period or a longer (not to exceed 27 months) Offering Period.

“**Option**” means the stock option to acquire shares of Common Stock granted to a Participant pursuant to Section 8.

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“**Option Price**” means the per share exercise price of an Option as determined in accordance with Section 8(b).

“**Parent**” means any corporation (other than the Corporation) in an unbroken chain of corporations ending with the Corporation in which each corporation (other than the Corporation) owns stock possessing 50% or more of the total combined voting power of all classes of stock in one or more of the other corporations in the chain.

“**Participant**” means an Eligible Employee who has elected to participate in this Plan and who has filed a valid and effective Subscription Agreement to make Contributions pursuant to Section 6.

“**Participating Subsidiary**” shall have the meaning given to such term in Section 19(c).

“**Plan**” means this Pixelworks, Inc. Employee Stock Purchase Plan, as it may be amended or restated from time to time.

“**Purchase Date**” means, with respect to a Purchase Period, the last day of that Purchase Period.

“**Purchase Period**” has the meaning set forth in Section 5.

“**Subscription Agreement**” means the written agreement filed by an Eligible Employee with the Corporation pursuant to Section 6 to participate in this Plan.

“**Subsidiary**” means any corporation (other than the Corporation) in an unbroken chain of corporations (beginning with the Corporation) in which each corporation (other than the last corporation) owns stock possessing 50% or more of the total combined voting power of all classes of stock in one or more of the other corporations in the chain.

### 3. ELIGIBILITY

Any person employed as an Eligible Employee as of the beginning of any given Offering Period (and who is not a Participant in any Offering Period then in effect) shall be eligible to participate in such Offering Period, subject to the Eligible Employee satisfying the requirements of Section 6.

### 4. STOCK SUBJECT TO THIS PLAN; SHARE LIMITATIONS

- (a) *Aggregate Share Limit.* Subject to the provisions of Section 17, the capital stock that may be delivered under this Plan will be shares of the Corporation’s authorized but unissued Common Stock. The maximum number of shares of Common Stock that may be delivered pursuant to Options granted under this Plan is 1,300,000 shares, subject to adjustments pursuant to Section 17.

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- (b) *Individual Share Limit.* The maximum number of shares of Common Stock that any one individual may acquire upon exercise of his or her Option with respect to any one Purchase Period is 3,000, subject to adjustments pursuant to Section 17 (the “**Individual Limit**”). The Committee may amend the Individual Limit in effect for any particular Offering Period, any such amendment to be made prior to the first day of such Offering Period, without stockholder approval.
  - (c) *Shares Not Actually Delivered.* Shares that are subject to or underlie Options, which for any reason are cancelled or terminated, are forfeited, fail to vest, or for any other reason are not paid or delivered under this Plan shall again, except to the extent prohibited by law, be available for subsequent Options under this Plan.

## 5. OFFERING AND PURCHASE PERIODS

- (a) *Offering Periods.* During the term of this Plan, the Corporation will grant Options to purchase shares of Common Stock in each Offering Period to all Participants in that Offering Period. Unless otherwise specified by the Committee in advance of a particular Offering Period, each Offering Period will be of eighteen (18) months duration, with the first such Offering Period to commence on August 1, 2010, and a new Offering Period shall commence on each February 1 or August 1 thereafter such that more than one Offering Period may be in effect at any one time; provided, however, that no Eligible Employee may be a Participant in, or hold an outstanding Option with respect to, more than one Offering Period at any one time. In the event that the Fair Market Value of the Common Stock on any Purchase Date during an Offering Period is lower than the Fair Market Value of the Common Stock on the Grant Date of that Offering Period, that Offering Period will terminate on such Purchase Date, and each Participant in such terminated Offering Period will be automatically enrolled in the new Offering Period that commences on the February 1 or August 1, as applicable, that immediately follows such Purchase Date. Each Option shall become effective on the Grant Date of the Offering Period with respect to which the Option is granted. The term of each Option shall be the duration of the related Offering Period and shall end on the Purchase Date for the third and final Purchase Period of that Offering Period. Offering Periods shall continue until this Plan is terminated in accordance with Section 18 or 19, or, if earlier, until no shares of Common Stock remain available for Options pursuant to Section 4.
- (b) *Purchase Periods.* Unless otherwise specified by the Committee in advance of a particular Offering Period, each Offering Period will consist of three (3) Purchase Periods, and each Purchase Period will be of six (6) months duration. Purchase Periods shall commence each February 1 and August 1 and shall end the immediately following July 31 or January 31, respectively.

## 6. PARTICIPATION

- (a) *Enrollment.* An Eligible Employee may become a participant in this Plan by completing a Subscription Agreement on a form approved by and in a manner prescribed by the Committee (or its delegate). To become effective, a Subscription Agreement must be signed by the Eligible Employee and be filed with the Corporation at the time specified by the Committee, but in all cases prior to the start of the Offering Period with respect to which it is to become effective, and must set forth a whole percentage (or, if the Committee so provides, a stated amount) of the Eligible Employee’s Compensation to be credited to the Participant’s Account as Contributions each pay period.

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- (b) *Contribution Limits.* Notwithstanding the foregoing, a Participant may not elect to contribute less than one percent (1%) nor more than ten percent (10%) (or such other limit as the Committee may establish prior to the start of the applicable Offering Period) of his or her Compensation during any one pay period as Plan Contributions. The Committee also may prescribe other limits, rules or procedures for Contributions.
  - (c) *Content and Duration of Subscription Agreements.* Subscription Agreements shall contain the Eligible Employee's authorization and consent to the Corporation's withholding from his or her Compensation the amount of his or her Contributions. An Eligible Employee's Subscription Agreement, and his or her participation election and withholding consent thereon, shall remain valid for all Offering Periods until (1) the Eligible Employee's participation terminates pursuant to the terms hereof, (2) the Eligible Employee files a new Subscription Agreement that becomes effective, or (3) the Committee requires that a new Subscription Agreement be executed and filed with the Corporation.

## 7. METHOD OF PAYMENT OF CONTRIBUTIONS

- (a) *Participation Accounts.* The Corporation shall maintain on its books, or cause to be maintained by a recordkeeper, an Account in the name of each Participant. The percentage of Compensation elected to be applied as Contributions by a Participant shall be deducted from such Participant's Compensation on each payday during the period for payroll deductions set forth below and such payroll deductions shall be credited to that Participant's Account as soon as administratively practicable after such date. A Participant may not make any additional payments to his or her Account. A Participant's Account shall be reduced by any amounts used to pay the Option Price of shares acquired, or by any other amounts distributed pursuant to the terms hereof.
- (b) *Payroll Deductions.* Subject to such other rules as the Committee may adopt, payroll deductions with respect to an Offering Period shall commence as of the first day of the payroll period which coincides with or immediately follows the applicable Grant Date and shall end on the last date of the payroll period which coincides with or immediately precedes the applicable Purchase Date, unless sooner terminated by the Participant as provided in Section 7(d) or until his or her participation terminates pursuant to Section 11.
- (c) *Changes in Contribution Elections for Next Purchase Period.* A Participant may discontinue, increase, or decrease the level of his or her Contributions (within the Plan limits) by completing and filing with the Corporation, on such terms as the Committee (or its delegate) may prescribe, a new Subscription Agreement which indicates such election. Subject to any other timing requirements that the Committee may impose, an election pursuant to this Section 7(c) shall be effective with the first Purchase Period that commences after the Corporation's receipt of such election. Except as contemplated by Section 7(d) and 7(e), changes in Contribution levels may not take effect during a Purchase Period. Other modifications or suspensions of Subscription Agreements are not permitted.

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- (d) *Withdrawal During an Offering Period.* A Participant may terminate his or her Contributions during an Offering Period (and receive a distribution of the balance of his or her Account in accordance with Section 11) by completing and filing with the Corporation, in such form and on such terms as the Committee (or its delegate) may prescribe, a written withdrawal form which shall be signed by the Participant. Such termination shall be effective as soon as administratively practicable after its receipt by the Corporation. A withdrawal election pursuant to this Section 7(d) with respect to an Offering Period shall only be effective for a particular Purchase Period, however, if it is received by the Corporation prior to the Purchase Date of that Purchase Period (or such earlier deadline that the Committee may reasonably require to process the withdrawal prior to the applicable Purchase Date). Partial withdrawals of Accounts are not permitted.
  - (e) *Discontinuance of Contributions During a Purchase Period.* A Participant may discontinue his or her Contributions at any time during a Purchase Period by completing and filing with the Corporation, on such terms as the Committee (or its delegate) may prescribe, a new Subscription Agreement which indicates such election. If a Participant elects to discontinue his or her Contributions pursuant to this Section 7(e), the Contributions previously credited to the Participant's Account for that Purchase Period shall be used to exercise the Participant's Option as of the applicable Purchase Date in accordance with Section 9 (unless the Participant makes a timely withdrawal election in accordance with Section 7(d), in which case such Participant's Account shall be paid to him or her in cash in accordance with Section 11(a)).
  - (f) *Leaves of Absence.* During leaves of absence approved by the Corporation or a Participating Subsidiary and meeting the requirements of Regulation Section 1.421-1(h)(2) under the Code, a Participant may continue participation in this Plan by cash payments to the Corporation on his normal paydays equal to the reduction in his Plan Contributions caused by his leave.

## **8. GRANT OF OPTION**

- (a) *Grant Date; Number of Shares.* On each Grant Date, each Eligible Employee who is a Participant during that Offering Period shall be granted an Option to purchase a number of shares of Common Stock. The Option shall be exercised on each Purchase Date that occurs during that Offering Period. The number of shares of Common Stock to be purchased upon exercise of the Option on each Purchase Date shall be determined by dividing the Participant's Account balance as of that Purchase Date by the Option Price, subject to the limits of Section 8(c).
- (b) *Option Price.* The Option Price per share of the shares subject to an Option for a Purchase Period shall be the lesser of: (i) 85% of the Fair Market Value of a Share on the Grant Date of the Offering Period to which the Purchase Period relates; or (ii) 85% of the Fair Market Value of a Share on the Purchase Date of that Purchase Period; provided, however, that the Committee may provide prior to the start of any Purchase Period that the Option Price for that Purchase Period shall be determined by applying a discount amount (not to exceed 15%) to either

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(1) the Fair Market Value of a share of Common Stock on the Grant Date of the Offering Period to which the Purchase Period relates, or (2) the Fair Market Value of a share of Common Stock on the Purchase Date of that Purchase Period, or (3) the lesser of the Fair Market Value of a share of Common Stock on the Grant Date of the Offering Period to which the Purchase Period relates or the Fair Market Value of a share of Common Stock on the Purchase Date of that Purchase Period. Notwithstanding anything to the contrary in the preceding provisions of this Section 8(b), in no event shall the Option Price per share be less than the par value of a share of Common Stock.

- (c) *Limits on Share Purchases.* Notwithstanding anything else contained herein, the maximum number of shares subject to an Option for an Offering Period shall be subject to the Individual Limit in effect on the Grant Date of that Offering Period (subject to adjustment pursuant to Section 17) and any person who is otherwise an Eligible Employee shall not be granted any Option (or any Option granted shall be subject to compliance with the following limitations) or other right to purchase shares under this Plan to the extent:
- (1) it would, if exercised, cause the person to own stock (within the meaning of Section 423(b)(3) of the Code) possessing 5% or more of the total combined voting power or value of all classes of stock of the Corporation, or of any Parent, or of any Subsidiary; or
  - (2) such Option causes such individual to have rights to purchase stock under this Plan and any other plan of the Corporation, any Parent, or any Subsidiary which is qualified under Section 423 of the Code which accrue at a rate which exceeds \$25,000 of the fair market value of the stock of the Corporation, of any Parent, or of any Subsidiary (determined at the time the right to purchase such stock is granted, before giving effect to any discounted purchase price under any such plan) for each calendar year in which such right is outstanding at any time.

For purposes of the foregoing, a right to purchase stock accrues when it first become exercisable during the calendar year. In determining whether the stock ownership of an Eligible Employee equals or exceeds the 5% limit set forth above, the rules of Section 424(d) of the Code (relating to attribution of stock ownership) shall apply, and stock which the Eligible Employee may purchase under outstanding options shall be treated as stock owned by the Eligible Employee.

## 9. EXERCISE OF OPTION

- (a) *Purchase of Shares.* Unless a Participant withdraws pursuant to Section 7(d) or the Participant's Plan participation is terminated as provided in Section 11, his or her Option for the purchase of shares shall be exercised automatically on each Purchase Date for that Offering Period, without any further action on the Participant's part, and the maximum number of whole shares of Common Stock subject to such Option (subject to the limits of Section 8(c)) shall be purchased at the Option Price with the balance of such Participant's Account.



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- (b) *Account Balance Remaining After Purchase.* If any amount which is not sufficient to purchase a whole share remains in a Participant's Account after the exercise of his or her Option on the Purchase Date: (1) such amount shall be credited to such Participant's Account for the next Purchase Period, if he or she is then a Participant; or (2) if such Participant is not a Participant in the next Purchase Period, or if the Committee so elects, such amount shall be refunded to such Participant as soon as administratively practicable after such date. If the share limit of Section 4(a) is reached, any amount that remains in a Participant's Account after the exercise of his or her Option on the Purchase Date to purchase the number of shares that he or she is allocated shall be refunded to the Participant as soon as administratively practicable after such date. If any amount which exceeds the limits of Section 8(c)(1) remains in a Participant's Account after the exercise of his or her Option on the Purchase Date, such amount shall be refunded to the Participant as soon as administratively practicable after such date. The Participant's Account shall be reduced on a dollar-for-dollar basis by any amount used to purchase shares hereunder or any amount refunded to the Participant.

#### **10. DELIVERY OF SHARES**

As soon as administratively practicable after the Purchase Date, the Corporation shall, in its discretion, either deliver to each Participant a certificate representing the shares of Common Stock purchased upon exercise of his or her Option, provide for the crediting of such shares in book entry form in the name of the Participant, or provide for an alternative arrangement for the delivery of such shares to a broker or recordkeeping service for the benefit of the Participant. In the event the Corporation is required to obtain from any commission or agency authority to issue any such certificate or otherwise deliver such shares, the Corporation will seek to obtain such authority. If the Corporation is unable to obtain from any such commission or agency authority which counsel for the Corporation deems necessary for the lawful issuance of any such certificate or other delivery of such shares, or if for any other reason the Corporation cannot issue or deliver shares of Common Stock and satisfy Section 21, the Corporation shall be relieved from liability to any Participant except that the Corporation shall return to each Participant to whom such shares cannot be issued or delivered the amount of the balance credited to his or her Account that would have otherwise been used for the purchase of such shares.

#### **11. TERMINATION OF EMPLOYMENT; CHANGE IN ELIGIBLE STATUS**

- (a) *General.* Except as provided in Section 11(b) below, if a Participant ceases to be an Eligible Employee for any reason (including, without limitation, due to the Participant's death, disability, quit, resignation or retirement, or due to a layoff or other termination of employment with or without cause), or if the Participant elects to withdraw from the Plan pursuant to Section 7(d), at any time prior to the last day of an Offering Period in which he or she participates, such Participant's Account shall be paid to him or her (or, in the event of the Participant's death, to the person or persons entitled thereto under Section 13) in cash, and such Participant's Option and participation in the Plan shall automatically terminate as of the time that the Participant ceased to be an Eligible Employee.

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- (b) *Change in Eligible Status; Leave.* If a Participant (1) ceases to be an Eligible Employee during a Purchase Period but remains an employee of the Corporation or a Subsidiary through the Purchase Date for that Purchase Period (for example, and without limitation, due to a change in the Participant's employer from the Corporation or a Participating Subsidiary to a non-Participating Subsidiary, if the Participant's employer ceases to maintain the Plan as a Participating Subsidiary but otherwise continues as a Subsidiary, or if the Participant's customary level of employment no longer satisfies the requirements set forth in the definition of Eligible Employee), or (2) during a Purchase Period commences a sick leave, military leave, or other leave of absence approved by the Corporation or a Participating Subsidiary, and the leave meets the requirements of Treasury Regulation Section 1.421-1(h)(2) and the Participant is an employee of the Corporation or a Subsidiary or on such leave as of the applicable Purchase Date, such Participant's Contributions shall cease (subject to Section 7(d) and Section 7(f)), and the Contributions previously credited to the Participant's Account for that Purchase Period shall be used to exercise the Participant's Option as of the applicable Purchase Date in accordance with Section 9 (unless the Participant makes a timely withdrawal election in accordance with Section 7(d), in which case such Participant's Account shall be paid to him or her in cash in accordance with Section 11(a)).
- (c) *Re-Enrollment.* A Participant's termination from Plan participation precludes the Participant from again participating in this Plan during that Offering Period. However, such termination shall not have any effect upon his or her ability to participate in any succeeding Offering Period, provided that the applicable eligibility and participation requirements are again then met. A Participant's termination from Plan participation shall be deemed to be a revocation of that Participant's Subscription Agreement and such Participant must file a new Subscription Agreement to resume Plan participation in any succeeding Offering Period.
- (d) *Change in Subsidiary Status.* For purposes of this Plan, if a Subsidiary ceases to be a Subsidiary, each person employed by that Subsidiary will be deemed to have terminated employment for purposes of this Plan, unless the person continues as an employee of the Corporation or another Subsidiary.

## 12. ADMINISTRATION

- (a) *The Committee.* The Board shall appoint the Committee, which shall be composed of not less than two members of the Board. The Board may, at any time, increase or decrease the number of members of the Committee, may remove from membership on the Committee all or any portion of its members, and may appoint such person or persons as it desires to fill any vacancy existing on the Committee, whether caused by removal, resignation, or otherwise. The Board may also, at any time, assume the administration of all or a part of this Plan, in which case references (or relevant references in the event the Board assumes the administration of only certain aspects of this Plan) to the "Committee" shall be deemed to be references to the Board. Action of the Committee with respect to this Plan shall be taken pursuant to a majority vote or by the unanimous written consent of its members. No member of the Committee shall be entitled to act on or decide any matter relating solely to himself or herself or solely to any of his or her rights or benefits under this Plan.

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- (b) *Powers and Duties of the Committee.* Subject to the express provisions of this Plan, the Committee shall supervise and administer this Plan and shall have the full authority and discretion: (1) to construe and interpret this Plan and any agreements defining the rights and obligations of the Corporation, any Subsidiary, and Participants under this Plan; (2) to further define the terms used in this Plan; (3) to prescribe, amend and rescind rules and regulations relating to the administration of this Plan (including, without limitation, deadlines for making elections or for providing any notices contemplated by this Plan, which deadlines may be more restrictive than any deadlines otherwise contemplated by this Plan); and (4) to make all other determinations and take such other action as contemplated by this Plan or as may be necessary or advisable for the administration of this Plan or the effectuation of its purposes. Notwithstanding anything else contained in this Plan to the contrary, the Committee may also adopt rules, procedures or sub-plans applicable to particular Subsidiaries or locations, which sub-plans may be designed to be outside the scope of Section 423 of the Code and need not comply with the otherwise applicable provisions of this Plan.
- (c) *Decisions of the Committee are Binding.* Any action taken by, or inaction of, the Corporation, any Subsidiary, the Board or the Committee relating or pursuant to this Plan and within its authority hereunder or under applicable law shall be within the absolute discretion of that entity or body and shall be conclusive and binding upon all persons.
- (d) *Indemnification.* Neither the Board nor any Committee, nor any member thereof or person acting at the direction thereof, shall be liable for any act, omission, interpretation, construction or determination made in good faith in connection with this Plan, and all such persons shall be entitled to indemnification and reimbursement by the Corporation in respect of any claim, loss, damage or expense (including, without limitation, attorneys' fees) arising or resulting therefrom to the fullest extent permitted by law and/or under any directors and officers liability insurance coverage that may be in effect from time to time.
- (e) *Reliance on Experts.* In making any determination or in taking or not taking any action under this Plan, the Committee or the Board, as the case may be, may obtain and may rely upon the advice of experts, including professional advisors to the Corporation. No director, officer or agent of the Corporation or any Participating Subsidiary shall be liable for any such action or determination taken or made or omitted in good faith.
- (f) *Delegation.* The Committee may delegate ministerial, non-discretionary functions to individuals who are officers or employees of the Corporation or a Subsidiary.

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**13. DESIGNATION OF BENEFICIARY**

If the Committee permits beneficiary designations with respect to this Plan, then each Participant may file, on a form and in a manner prescribed by the Committee (or its delegate), a written designation of a beneficiary who is to receive any shares or cash from or with respect to such Participant's Account under this Plan in the event of such Participant's death. If a Participant is married and the designated beneficiary is not solely his or her spouse, spousal consent shall be required for such designation to be effective unless it is established (to the satisfaction of the Committee or its delegate) that there is no spouse or that the spouse cannot be located. The Committee may rely on the last designation of a beneficiary filed by a Participant in accordance with this Plan. Beneficiary designations may be changed by the Participant (and his or her spouse, if required) at any time on forms provided and in the manner prescribed by the Committee (or its delegate).

If a Participant dies with no validly designated beneficiary under this Plan who is living at the time of such Participant's death (or in the event the Committee does not permit beneficiary designations under this Plan), the Corporation shall deliver all shares and/or cash payable pursuant to the terms hereof to the executor or administrator of the estate of the Participant, or if no such executor or administrator has been appointed, the Corporation, in its discretion, may deliver such shares and/or cash to the spouse or to any one or more dependents or relatives of the Participant, or if no spouse, dependent or relative is known to the Corporation, then to such other person as the Corporation may designate.

If a Participant's death occurs before the end of an Offering Period or subsequent to the end of an Offering Period but prior to the delivery to him or her or for his or her benefit of any shares deliverable under the terms of this Plan, and the Corporation has notice of the Participant's death, then any shares purchased for that Offering Period and any remaining balance of such Participant's Account shall be paid to such beneficiary (or such other person entitled to such payment pursuant to this Section 13). If the Committee permits beneficiary designations with respect to this Plan, any such designation shall have no effect with respect to shares purchased and actually delivered (or credited, as the case may be) to or for the benefit of the Participant.

**14. TRANSFERABILITY**

Neither Contributions credited to a Participant's Account nor any Options or rights with respect to the exercise of Options or right to receive shares under this Plan may be anticipated, alienated, encumbered, assigned, transferred, pledged or otherwise disposed of in any way (other than by will, the laws of descent and distribution, or as provided in Section 13) by the Participant. Any such attempt at anticipation, alienation, encumbrance, assignment, transfer, pledge or other disposition shall be without effect and all amounts shall be paid and all shares shall be delivered in accordance with the provisions of this Plan. Amounts payable or shares deliverable pursuant to this Plan shall be paid or delivered only to (or credited in the name of, as the case may be) the Participant or, in the event of the Participant's death, the Participant's beneficiary pursuant to Section 13.

**15. USE OF FUNDS; INTEREST**

All Contributions received or held by the Corporation under this Plan will be included in the general assets of the Corporation and may be used for any corporate purpose. Notwithstanding anything else contained herein to the contrary, no interest will be paid to any Participant or credited to his or her Account under this Plan (in respect of Account

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balances, refunds of Account balances, or otherwise). Amounts payable under this Plan shall be payable in shares of Common Stock or from the general assets of the Corporation and, except for any shares that may be reserved on the books of the Corporation for issuance with respect to this Plan, no special or separate reserve, fund or deposit shall be made to assure payment of amounts that may be due with respect to this Plan.

## **16. REPORTS**

Statements shall be provided (either electronically or in written form, as the Committee may provide from time to time) to Participants as soon as administratively practicable following each Purchase Date. Each Participant's statement shall set forth, as of such Purchase Date, that Participant's Account balance immediately prior to the exercise of his or her Option, the Option Price, the number of whole shares purchased and his or her remaining Account balance, if any.

## **17. ADJUSTMENTS OF AND CHANGES IN THE STOCK**

Upon or in contemplation of any reclassification, recapitalization, stock split (including a stock split in the form of a stock dividend), or reverse stock split; any merger, combination, consolidation, or other reorganization; split-up, spin-off, or any similar extraordinary dividend distribution in respect of the Common Stock (whether in the form of securities or property); any exchange of Common Stock or other securities of the Corporation, or any similar, unusual or extraordinary corporate transaction in respect of the Common Stock; or a sale of substantially all the assets of the Corporation as an entirety occurs; then the Committee shall equitably and proportionately adjust (1) the number and type of shares or the number and type of other securities that thereafter may be made the subject of Options (including the specific maxima and numbers of shares set forth elsewhere in this Plan), (2) the number, amount and type of shares (or other securities or property) subject to any or all outstanding Options, (3) the Option Price of any or all outstanding Options, and/or (4) the securities, cash or other property deliverable upon exercise of any outstanding Options, in each case to the extent necessary to preserve (but not increase) the level of incentives intended by this Plan and the then-outstanding Options.

Upon the occurrence of any event described in the preceding paragraph, or any other event in which the Corporation does not survive (or does not survive as a public company in respect of its Common Stock); then the Committee may make provision for a cash payment or for the substitution or exchange of any or all outstanding Options for cash, securities or property to be delivered to the holders of any or all outstanding Options based upon the distribution or consideration payable to holders of the Common Stock upon or in respect of such event.

The Committee may adopt such valuation methodologies for outstanding Options as it deems reasonable in the event of a cash or property settlement and, without limitation on other methodologies, may base such settlement solely upon the excess (if any) of the amount payable upon or in respect of such event over the Option Price of the Option.

In any of such events, the Committee may take such action sufficiently prior to such event to the extent that the Committee deems the action necessary to permit the Participant to realize the benefits intended to be conveyed with respect to the underlying shares in the same manner as is or will be available to shareholders generally.

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## 18. POSSIBLE EARLY TERMINATION OF PLAN AND OPTIONS

Upon a dissolution or liquidation of the Corporation, or any other event described in Section 17 that the Corporation does not survive or does not survive as a publicly-traded company in respect of its Common Stock, as the case may be, this Plan and, if prior to the last day of an Offering Period, any outstanding Option granted with respect to that Offering Period shall terminate, subject to any provision that has been expressly made by the Board for the survival, substitution, assumption, exchange or other settlement of this Plan and Options. In the event a Participant's Option is terminated pursuant to this Section 18 without a provision having been made by the Board for a substitution, exchange or other settlement of the Option, such Participant's Account shall be paid to him or her in cash without interest.

## 19. TERM OF PLAN; AMENDMENT OR TERMINATION

- (a) *Effective Date; Termination.* Subject to Section 19(b), this Plan shall become effective as of the Effective Date. No new Offering Periods shall commence on or after the tenth anniversary of the Effective Date, and this Plan shall terminate as of the Purchase Date on or immediately following such date unless sooner terminated pursuant to Section 18 or this Section 19. In the event that during a particular Purchase Period all of the shares of Common Stock made available under this Plan are subscribed prior to the expiration of this Plan, this Plan and all outstanding Options hereunder shall terminate at the end of that Purchase Period and the shares available shall be allocated for purchase by Participants in that Purchase Period on a pro-rata basis determined with respect to Participants' Account balances.
- (b) *Board Amendment Authority.* The Board may, at any time, terminate or, from time to time, amend, modify or suspend this Plan, in whole or in part and without notice. Shareholder approval for any amendment or modification shall not be required, except to the extent required by law or applicable stock exchange rules, or required under Section 423 of the Code in order to preserve the intended tax consequences of this Plan. No Options may be granted during any suspension of this Plan or after the termination of this Plan, but the Committee will retain jurisdiction as to Options then outstanding in accordance with the terms of this Plan. No amendment, modification, or termination pursuant to this Section 19(b) shall, without written consent of the Participant, affect in any manner materially adverse to the Participant any rights or benefits of such Participant or obligations of the Corporation under any Option granted under this Plan prior to the effective date of such change. Changes contemplated by Section 17 or Section 18 shall not be deemed to constitute changes or amendments requiring Participant consent.
- (c) *Certain Additional Committee Authority.* Notwithstanding the amendment provisions of Section 19(b) and without limiting the Board's authority thereunder and without limiting the Committee's authority pursuant to any other provision of this Plan, the Committee shall have the right (1) to designate from time to time the Subsidiaries whose employees may be eligible to participate in this Plan (including, without limitation, any Subsidiary that may first become such after the date shareholders first approve this Plan) (each a "**Participating Subsidiary**"), and (2) to change the service and other qualification requirements

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set forth under the definition of Eligible Employee in Section 2 (subject to the requirements of Section 423(b) of the Code and applicable rules and regulations thereunder). Any such change shall not take effect earlier than the first Purchase Period that starts on or after the effective date of such change. Any such change shall not require shareholder approval.

## 20. NOTICES

All notices or other communications by a Participant to the Corporation contemplated by this Plan shall be deemed to have been duly given when received in the form and manner specified by the Committee (or its delegate) at the location, or by the person, designated by the Committee (or its delegate) for that purpose.

## 21. CONDITIONS UPON ISSUANCE OF SHARES

This Plan, the granting of Options under this Plan and the offer, issuance and delivery of shares of Common Stock are subject to compliance with all applicable federal and state laws, rules and regulations (including but not limited to state and federal securities laws) and to such approvals by any listing, regulatory or governmental authority as may, in the opinion of counsel for the Corporation, be necessary or advisable in connection therewith. The person acquiring any securities under this Plan will, if requested by the Corporation and as a condition precedent to the exercise of his or her Option, provide such assurances and representations to the Corporation as the Committee may deem necessary or desirable to assure compliance with all applicable legal requirements.

## 22. PLAN CONSTRUCTION

- (a) *Section 16.* It is the intent of the Corporation that transactions involving Options under this Plan (other than “Discretionary Transactions” as that term is defined in Rule 16b-3(b)(1) promulgated by the Commission under Section 16 of the Exchange Act, to the extent there are any Discretionary Transactions under this Plan), in the case of Participants who are or may be subject to the prohibitions of Section 16 of the Exchange Act, satisfy the requirements for exemption under Rule 16b-3(c) promulgated by the Commission under Section 16 of the Exchange Act to the maximum extent possible. Notwithstanding the foregoing, the Corporation shall have no liability to any Participant for Section 16 consequences of Options or other events with respect to this Plan.
- (b) *Section 423.* Except as the Committee may expressly provide in the case of one or more sub-plans adopted pursuant to Section 12(b), this Plan and Options are intended to qualify under Section 423 of the Code. Accordingly, all Participants are to have the same rights and privileges (within the meaning of Section 423(b)(5) of the Code and except as not required thereunder to qualify this Plan under Section 423) under this Plan, subject to differences in Compensation among Participants and subject to the Contribution and share limits of this Plan.
- (c) *Interpretation.* If any provision of this Plan or of any Option would otherwise frustrate or conflict with the intents expressed above, that provision to the extent possible shall be interpreted so as to avoid such conflict. If the conflict remains irreconcilable, the Committee may disregard the provision if it concludes that to do so furthers the interest of the Corporation and is consistent with the purposes of this Plan as to such persons in the circumstances.

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### 23. EMPLOYEES' RIGHTS

- (a) *No Employment Rights.* Nothing in this Plan (or in any Subscription Agreement or other document related to this Plan) will confer upon any Eligible Employee or Participant any right to continue in the employ or other service of the Corporation or any Subsidiary, constitute any contract or agreement of employment or other service or effect an employee's status as an employee at will, nor shall interfere in any way with the right of the Corporation or any Subsidiary to change such person's compensation or other benefits or to terminate his or her employment or other service, with or without cause. Nothing contained in this Section 23(a), however, is intended to adversely affect any express independent right of any such person under a separate employment or service contract other than a Subscription Agreement.
- (b) *No Rights to Assets of the Company.* No Participant or other person will have any right, title or interest in any fund or in any specific asset (including shares of Common Stock) of the Corporation or any Subsidiary by reason of any Option hereunder. Neither the provisions of this Plan (or of any Subscription Agreement or other document related to this Plan), nor the creation or adoption of this Plan, nor any action taken pursuant to the provisions of this Plan will create, or be construed to create, a trust of any kind or a fiduciary relationship between the Corporation or any Subsidiary and any Participant, Beneficiary or other person. To the extent that a Participant, Beneficiary or other person acquires a right to receive payment pursuant to this Plan, such right will be no greater than the right of any unsecured general creditor of the Corporation.
- (c) *No Shareholder Rights.* A Participant will not be entitled to any privilege of stock ownership as to any shares of Common Stock not actually delivered to and held of record by the Participant. No adjustment will be made for dividends or other rights as a shareholder for which a record date is prior to such date of delivery.

### 24. MISCELLANEOUS

- (a) *Governing Law.* This Plan, the Options, Subscription Agreements and other documents related to this Plan shall be governed by, and construed in accordance with, the laws of the State of Oregon.
- (b) *Severability.* If any provision shall be held by a court of competent jurisdiction to be invalid and unenforceable, the remaining provisions of this Plan shall continue in effect.
- (c) *Captions and Headings.* Captions and headings are given to the sections of this Plan solely as a convenience to facilitate reference. Such captions and headings shall not be deemed in any way material or relevant to the construction of interpretation of this Plan or any provision hereof.



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(d) *No Effect on Other Plans or Corporate Authority.* The adoption of this Plan shall not affect any other Corporation or Subsidiary compensation or incentive plans in effect. Nothing in this Plan will limit or be deemed to limit the authority of the Board or Committee (1) to establish any other forms of incentives or compensation for employees of the Corporation or any Subsidiary (with or without reference to the Common Stock), or (2) to grant or assume options (outside the scope of and in addition to those contemplated by this Plan) in connection with any proper corporate purpose; to the extent consistent with any other plan or authority. Benefits received by a Participant under an Option granted pursuant to this Plan shall not be deemed a part of the Participant's compensation for purposes of the determination of benefits under any other employee welfare or benefit plans or arrangements, if any, provided by the Corporation or any Subsidiary, except where the Committee or the Board (or the Board of Directors of the Subsidiary that sponsors such plan or arrangement, as applicable) expressly otherwise provides or authorizes in writing.

## **25. TAX WITHHOLDING**

Notwithstanding anything else contained in this Plan herein to the contrary, the Corporation may deduct from a Participant's Account balance as of a Purchase Date, before the exercise of the Participant's Option is given effect on such date, the amount of taxes (if any) which the Corporation reasonably determines it or any Subsidiary may be required to withhold with respect to such exercise. In such event, the maximum number of whole shares subject to such Option (subject to the other limits set forth in this Plan) shall be purchased at the Option Price with the balance of the Participant's Account (after reduction for the tax withholding amount).

Should the Corporation for any reason be unable, or elect not to, satisfy its or any Subsidiary's tax withholding obligations in the manner described in the preceding paragraph with respect to a Participant's exercise of an Option, or should the Corporation or any Subsidiary reasonably determine that it or an affiliated entity has a tax withholding obligation with respect to a disposition of shares acquired pursuant to the exercise of an Option prior to satisfaction of the holding period requirements of Section 423 of the Code, the Corporation or Subsidiary, as the case may be, shall have the right at its option to (1) require the Participant to pay or provide for payment of the amount of any taxes which the Corporation or Subsidiary reasonably determines that it or any affiliate is required to withhold with respect to such event or (2) deduct from any amount otherwise payable to or for the account of the Participant the amount of any taxes which the Corporation or Subsidiary reasonably determines that it or any affiliate is required to withhold with respect to such event.

## **26. NOTICE OF SALE**

Any person who has acquired shares under this Plan shall give prompt written notice to the Corporation of any sale or other transfer of the shares if such sale or transfer occurs (1) within the two-year period after the Grant Date of the Offering Period with respect to which such shares were acquired, or (2) within the twelve-month period after the Purchase Date of the Purchase Period with respect to which such shares were acquired.

## 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 12, 2011

By: /s/ Bruce A. Walicek

Bruce A. Walicek

*President and Chief Executive Officer*

## CERTIFICATION

I, Steven L. Moore, certify that:

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

Date: May 12, 2011

By: /s/ Steven L. Moore

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

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

In connection with the Quarterly Report of Pixelworks, Inc. (the "Company") on Form 10-Q for the quarterly period ended March 31, 2011 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 12, 2011

**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, 2011 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 12, 2011