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

FORM 10-K

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

For the fiscal year ended December 31, 2005

or

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

For the transition period from _________ to _________

Commission File Number: 000-30269

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

Oregon (State or other jurisdiction of incorporation or organization)		91-1761992 (I.R.S. Employer Identification Number)
8100 SW Nyberg Road, Tualatin, OR (Address of principal executive offices)	97062 (Zip code)	(503) 454-1750 (Registrant's telephone number, including area code)

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

Securities registered pursuant to Section 12(g) of the Act:
Common Stock

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ☐ Accelerated filer ☑ Non-accelerated filer ☐

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

Aggregate market value of voting Common Stock held by non-affiliates of the Registrant at June 30, 2005: $386,843,732. For purposes of this calculation, executive officers and directors are considered affiliates.

Number of shares of Common Stock outstanding at February 28, 2006: 47,494,809.

Documents Incorporated by Reference

Portions of the registrant's definitive proxy statement relating to its 2006 Annual Meeting of Shareholders, to be filed subsequently — Part III.

PIXELWORKS, INC.
FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2005

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PART I

Item 1. Business.

Overview

We are a leading designer, developer and marketer of semiconductors and software for the advanced display industry, including advanced televisions, multimedia projectors, digital streaming media devices and liquid crystal display panels. Our system-on-chip semiconductors provide the ‘intelligence’ for these new types of displays and devices by processing and optimizing video and computer graphic signals to produce high-quality images. Many of the world’s leading manufacturers of consumer electronics and computer display products utilize our technology to enhance image quality and ease of use of their products. Our goal is to provide all of the electronics necessary to process the signal along its entire path through the system in order to provide a turnkey solution for our customers.

The display industry is undergoing a transformation from displays using cathode ray tubes, or CRTs, which have been the predominant display technology for more than 60 years and operate using analog, or waveform, signals. A new generation of technologies are now available that utilize display screens comprised of a grid of thousands of tiny picture elements, or pixels, and operate digitally. Examples of these new types of displays include liquid crystal displays, plasma displays, micro-mirror devices and other advanced display technologies.

During the transition to digital display technology, the way signal processing integrated circuits, or ICs, are developed is shifting away from development by vertically integrated manufacturers toward development by third-party companies like Pixelworks. We provide our customers, including manufacturers, original equipment manufacturers, or OEMs, and systems integrators, with video and graphics processing solutions that enable them to deliver to market rapidly an advanced display system with industry-leading performance and features. By choosing this product development strategy, our customers reduce their research and development costs, thereby reducing the cost of the overall system. In addition, our customers can utilize a consistent design environment across multiple product lines.

Concurrent with the move to new pixilated displays, broadcasters and consumer electronics manufacturers are moving ahead with the introduction of video in digital formats, including the much-anticipated high-definition television, or HDTV. Current broadcast standards were also developed in the middle of the last century and were optimized for display on CRT televisions. The signals are formatted in low resolutions that do not provide sufficient visual information and do not look crisp when displayed on larger screens. The new digital television standards promise cleaner broadcast signals that can transmit a high-definition signal in widescreen format for a cinema-quality viewing experience.

More recently, a new technology is emerging to deliver video content over broadband networks using Internet Protocol standards which is creating an entirely new delivery methodology of video to consumers. Internet Protocol television, or IPTV, can stream live multicasts or stored content for video-on-demand applications in formats that efficiently compress video data so that it can be sent across networks. In order to access content currently, a set-top box is commonly needed since most televisions do not have the capability to decode IPTV content.

We have a broad product line that uses proprietary technologies and advanced designs to address the requirements of the industry we serve. Our products range from single-purpose discrete ICs to system-on-chip ICs integrating a microprocessor, memory and image processing circuits that function as a computer on a single chip. Pixelworks has expanded its technology portfolio through internal developments, acquisitions and co-developments with business partners. In the future, we plan to introduce products that continue to integrate additional functionality and utilize more advanced processes in order to improve performance and lower product costs.

Advanced Display Industry

Pixelworks serves four fast-growing markets in the advanced display industry that are reshaping how business users and consumers interact with information and entertainment, including advanced televisions, multimedia projectors, LCD panels and digital streaming media devices. The display industry’s shift toward digital, fixed-pixel display technologies is creating a need for video signal processing electronics that achieve the necessary performance, in terms of image quality, ease of use and cost, to spur the transition to mainstream market adoption. These four markets are in different stages of maturity and each have unique requirements and dynamics.

Advanced Television Market

While the CRT television is a widely accepted technology worldwide, the transition to digital-based television is gaining momentum in the market. According to a display industry analyst, in 2005 non-CRT televisions using digital display technologies, referred to as advanced televisions, comprised more than 15 percent of the 177 million television units sold worldwide. Advanced televisions totaled 27.2 million units which marked an annual increase of 115 percent while the total market grew by only 6 percent which illustrates the acceleration of adoption of advanced television technologies.

Based on current analyst projections, advanced televisions using digital display technology that would require digital video signal processing ICs is accelerating and will collectively overtake CRT technology in 2009. The display technologies include liquid crystal displays, or LCDs, plasma display panels, or PDPs, and rear-projection televisions using LCDs, digital micro-mirror devices, or DMDs, and newer technology such as liquid crystal on silicon, or LCoS. While the entire television market is forecast to grow from 177 million units in 2005 to more than 200 million units in 2009, a compound annual growth rate of 3 percent, the advanced television portion of the market is forecast to grow to 99.8 million units in 2009 for a compound annual growth rate of 38 percent.

Looking more closely at the growth forecasted, two sub-categories will drive the adoption of advanced televisions as consumers choose thin-screen televisions for their homes. LCD televisions are expected to lead the transition among advanced televisions rising from 19.6 million units in 2005 to 76.7 million units in 2009, a compound annual growth rate of 41 percent. Plasma display televisions are expected to grow at nearly the rate of LCD televisions, although at approximately one fifth of the overall unit volume due to their higher average selling price based on their larger form factor. Plasma display televisions are estimated to grow from 4.9 million units in 2005 to 16.2 million units in 2009, a compound annual growth rate of 35 percent.

Rear-projection television, or RPTV, growth is projected to be modest between 2005 and 2009, growing from 5.9 million units to 7.2 million units for a compound annual growth rate of 5 percent. However, the underlying architecture of RPTV is shifting from older projection TVs using analog CRT technology to newer digital technologies. In 2005, approximately 47 percent of RPTVs were based on digital display technologies. That is expected to exceed 96 percent in 2009 with 6.9 million units, comprised of DMD, LCD and LCoS, for a combined compound annual growth rate of 26 percent.

Another sector of the advanced television market that has emerged for Pixelworks is CRT televisions which utilize our discrete semiconductors for advanced video signal processing to enhance the picture quality. A key component of this image enhancement is to de-interlace incoming television signals for

CRTs using progressive scanning. These types of televisions are referred to as advanced CRT televisions and the market for these totaled 20.4 million units in 2005 and is expected to grow to 28.8 million in 2008 for a 12 percent annual growth rate.

Market forecasts indicate that the advanced television market is poised for robust growth over the next several years. In addition to the introduction of new display technologies into the consumer electronics marketplace, two major trends are driving the growth of advanced televisions worldwide: the introduction of digital television standards and new entrants among television manufacturers.

The introduction of a new broadcast standard requiring the use of digital transmission rather than analog methods is an important transition in the industry. Digital television offers a clearer image than analog and enables the transmission of high-definition standards, a wide-screen format, less interference and new types of applications such as interactivity and data transmission. In the United States, the digital television standard is referred to as the ATSC format with similar broadcast standards being developed in Europe and in Japan called DVB and ARIB, respectively.

The United States government is driving adoption of ATSC technology with a number of mandates. A recent development in the United States is that the U.S. Congress declared in January 2006 that analog television signal transmissions will cease on February 17, 2009. In order to facilitate this transition, the U.S. Federal Communication Commission is mandating that televisions sold in the United States include circuitry for receiving ATSC signals. Beginning in March 2007, all televisions with a tuner and at least a 13-inch diagonal screen must include an ATSC receiver.

The second trend, the growth of new entrants into the television market, illustrates the shift in the supply chain from electronics developed by vertically integrated manufacturers toward those provided by third-party companies such as Pixelworks. With strong growth expected in advanced televisions, consumer electronics and PC manufacturers are converging on the television as the information and entertainment gateway. In addition, regional manufacturers in Asia are attempting to gain a position in the market that further increases the competitive landscape.

Multimedia Projector Market

The multimedia projector market is maturing with steady growth as prices continue to decline and manufacturers are introducing models for more targeted segments, including an emerging consumer segment. In 2005, 4.1 million units were sold worldwide. A display industry analyst is forecasting that in 2009 the multimedia projector market will expand to 13.1 million units, for a compound annual growth rate of 33 percent. For the overall multimedia projector market, the average selling price is expected to decrease from $1,578 in 2005 to $996 in 2009.

Two digital display technologies are currently used in multimedia projectors. In 2005, approximately 51 percent of the market was using liquid crystal displays while the remainder was utilizing digital micro-mirror devices, according to a display industry analyst. Models range from larger units designed for installation, to ultra-portable devices weighing less than two and a half pounds for maximum portability.

The largest segment of the market serves professional users who use multimedia projectors to display presentation materials from PCs and for showing video presentations. Requirements for the professional market include portability, compatibility with multiple sources and features that ensure simple operation. While businesses will continue to purchase projectors, we expect the growth in the professional segment to come mainly from the education and government sectors.

The emerging market for consumer projectors for home entertainment continues to expand and open a new opportunity for projector manufacturers. Consumers are discovering that they can have a satisfying home cinema experience by investing in a sub-$1,000 multimedia projector. In order to achieve attractive price targets, manufacturers are developing models using lower resolution displays, often with 800-by-600 pixel resolution, also known as SVGA which is an acronym for Super Video Graphics Array, and using lower cost liquid crystal displays. According to a display industry analyst, the consumer market for multimedia projectors was 562,000 units in 2005 with the segment growing to 2.5 million units in 2009 for a compound annual growth rate of 46 percent.

LCD Panel Market

We are entering the market to supply timing controller circuits for liquid crystal display panels which are a key component in a number of consumer products, including flat-screen computer monitors, flat-screen televisions and notebook computers. LCD panels are the primary technology driving the conversion to digital display technologies due to their cost efficiency, performance and manufacturability. The most advanced LCD manufacturers are using equipment capable of handling glass substrates, the fundamental component in liquid crystal displays, exceeding 4 square meters from which 12 32-inch diagonal displays can be yielded.

The total available market for the timing controller circuits consists of large-area liquid crystal displays which, according to an industry analyst, consists of 217 million units worldwide in 2005, with 47 percent for monitors, 36 percent for notebook computers and the remaining 17 percent for televisions. By 2008, the market opportunity grows to 280 million units, for an annual growth rate of 9 percent, and a slight increase in the share for monitors to 54 percent, with 30 percent and 16 percent to the notebook and television markets, respectively.

The end market for LCD panels is continuing to create demand for these products. LCD monitors comprised 69 percent of the desktop monitor market, according to a display industry analyst, with 108 million units sold in 2005. By 2009, the desktop monitor market is forecast to exceed 93 percent of the total desktop monitors sold with more than 171 million units. The transition to LCD displays in the television market is also underway with 11 percent of the total television units sold worldwide in 2005 using LCD technology and nearly tripling the number of units in 2009 to capture 38 percent of the total television market.

Digital Streaming Media Devices Market

Digital streaming media devices, formerly discussed as our advanced media processors market, is an emerging class of electronics that deliver advanced video and audio content to displays over broadband networks using Internet Protocol standards which have previously only been used for data and graphic information. With the higher bandwidth capacities available on broadband networks, advanced encoding and decoding compression standards are now able to transmit full-motion, standard and high resolution video directly over the Internet.

Digital streaming devices range from mass-market applications for IPTV set-top boxes for receiving and decoding video to products that serve specialized niches. IPTV can stream live multicasts or stored content for video-on-demand applications in formats that are more efficient than standard broadcast television. In order to access IPTV content currently, a set-top box is commonly needed since most televisions do not have the capability to decode IPTV content. The market for IPTV set-top boxes, according to industry analysts, exceeded 4 million units in 2005 and will approach 15 million units by 2008.

A digital media adapter, or DMA, is a dedicated device for enabling viewing and listening of content stored on a local computer over a network. DMAs connect via an Ethernet or wireless connection and are able to search the host computer for digital video, digital photos and music and accesses them remotely through an user-interface displayed on a television or monitor. Digital streaming media devices also serve niche markets by enabling video conferencing, IP-based security and surveillance, and professional broadcast encoders for converting and delivering video content over a broadband network.

Our Products and Technologies

We design, develop and market ICs and software that optimize video and computer graphic signals for a wide variety of displays used in business and consumer markets, including advanced televisions, multimedia projectors, LCD panels and digital media streaming devices. We have a broad product line that uses proprietary and licensed technologies and advanced designs to address the requirements of the industry we serve. Our products range from single-purpose discrete ICs to system-on-chip ICs integrating a microprocessor, memory and image processing circuits that function as a computer on a single IC.

As the advanced display industry has grown rapidly, we have expanded and adapted our products to meet the needs of manufacturers in terms of performance, cost and functionality. Our product development strategy is to take a systems-level approach, which means we design products from the manufacturers' viewpoint in terms of analyzing how we can integrate maximum functionality at a reasonable cost. We believe that by developing parts that anticipate the requirements of our target markets, we will help accelerate the adoption of advanced display technologies.

Products

We currently have the following product categories in our portfolio:

ImageProcessor ICs. System-on-chip ICs include embedded microprocessors and digital signal processing circuitry that control the operations and signal processing within the advanced display system. ImageProcessor ICs are used in advanced televisions, multimedia projectors and LCD monitors. Semiconductors in this category include circuitry for advanced image scaling, aspect ratio conversion, color compensation, customizable on-screen display, automatic image optimization and control of the operating system. ImageProcessor ICs can also include the following additional functions: advanced de-interlacing circuitry; digital keystone correction; an analog-to-digital controller, or ADC; a Digital Visual Interface, or DVI, receiver; and a High-Definition Multimedia Interface, or HDMI, receiver.

ImageProcessor ICs were our first product offerings and continue to form the core of our business in the advanced television and multimedia projector markets. We have continued to design the architecture for optimal performance and manufactured the ICs on processes that align with our customers' requirements. Additionally, since our ImageProcessor ICs include the microprocessor for the entire system, we provide a complete software development environment and operating system that enables our customers to rapidly develop their products, customize the "look and feel" of their products, and provide a consistent software architecture across product lines and product categories. Our latest ImageProcessor IC, codename Pearl, targets the advanced television and multimedia projector markets. Pearl products integrate our most advanced de-interlacing, video decoding, HDMI and video enhancement processing technologies.

Video SignalProcessor ICs. Integrated circuits in this category are discrete semiconductors that are companion chips for our ImageProcessor ICs and offer manufacturers more flexibility in their multimedia projection and advanced television system architectures. Video SignalProcessor ICs are used to pre- and post-process video signals in conjunction with an ImageProcessor IC. By offering these ICs, we can target specific needs in our markets and can perfect our technology developments prior to integrating the technology into our ImageProcessor ICs.

We currently produce two classes of Video SignalProcessor ICs. The first category is the IC family that performs de-interlacing. Currently, many video signals are delivered in an interlaced format which means that each frame of video is sent in two sequential fields comprised of first the odd-numbered rows and then the even-numbered. However, most advanced display technologies show fields in a single frame so the two separate fields must be reconstituted into a single frame of video information. This process presents many challenges and can introduce visual artifacts into the image, but our Video SignalProcessor ICs use patented de-interlacing technology to maximize video quality. We currently sell our de-interlacing Video SignalProcessor family into the advanced television market, including the advanced CRT segment, as well as the multimedia projector market.

Our second class of Video SignalProcessor ICs are signal interface chips that combine a multi-standard video decoder and analog-to-digital converter for processing current television formats and new digital television standards. Certain versions also include a DVI receiver. We currently offer our signal interfacing Video SignalProcessor family in the multimedia projector and advanced television markets.

MediaProcessor ICs. We have developed a new class of products to support the display of new digital television formats, including HDTV. The digital broadcast standards transmit data encoded using a signal compression format known as “MPEG”, named for the Motion Picture Experts Group which established it. Our MediaProcessor ICs decode MPEG video streams and are central to building televisions to display the new digital standards. Our products, the PWM20XX family of MediaProcessor ICs, resulted from our partnership with Toshiba. The MediaProcessor chip provides a cost-effective, high-quality integrated solution for customers developing high definition televisions.

Broadband Signal Processor ICs. Our Broadband Signal Processor ICs are programmable system-on-chip ICs for handling IPTV video using multiple industry-standard compression decoding schemes. Broadband Signal Processor ICs use a VLIW, or Very Long Instruction Word, microprocessor that offers the flexibility and power to be customized for a variety of applications, including for handling IPTV and digital media adapter encoding and decoding, videoconferencing and other specialized applications.

Audio Processing and Video Demodulator ICs. We have developed a new line of discrete chips for processing audio and video broadcast signals by serving as the IF, or Intermediate Frequency, demodulator. The IF signal is the signal format isolated by the tuner and it combines all of the video and audio information. A demodulator separates the various signal information and then routes them to the proper circuitry within the system. Some of the chips in this category only separate audio signals while others also serve as video IF demodulators for added functionality and reduced costs in analog and digital advanced televisions.

Smart TCON ICs. The timing controller, or TCON, is a discrete semiconductor that is integrated into a liquid crystal display panel. The TCON translates a signal from the image processing electronics into a format which instructs each sub-pixel in the display as to the amount of light it should emit during each screen refresh, which is usually 60 times per second. We have developed a programmable timing controller technology that improves LCD performance by increasing response speed and contrast while also lowering system costs by replacing the purpose-built discrete ICs that are in use today.

Technologies

In order to offer targeted products, our semiconductors are designed with a flexible chip architecture that allows us to combine functional blocks of digital and mixed signal circuitry. Accordingly, we develop technologies that can be implemented across multiple product lines. Following is a description of selected technologies by target market.

Core Technologies for Advanced Displays

- *Advanced Image Scaling and Shaping*. Since advanced displays are typically fixed-pixel, digital display technologies, a constant challenge is to reconfigure incoming content in video or PC formats that does not match the display resolution. Pixelworks has developed innovative, industry-leading image scaling technologies that intelligently enlarge or compress images for display in different resolutions or aspect ratios, which is the ratio of width to height of display screens. This technology is essential for interfacing fixed resolution digital displays to the wide range of inputs that are present in today's marketplace, including HDTV. In addition, our image processing technology incorporates proprietary programmable image scaling capable of resizing images to fit a wide variety of aspect ratios.
- *Adaptive Image Optimization*. Our products must translate a broad range of signals in standard and non-standard formats. We use a proprietary image processing technique to identify the characteristics of an incoming signal and configure the system to produce the best possible image.
- *Color Compensation Technology*. Our sophisticated custom color compensation technology makes it possible to display consistent color images from video and computer graphics, which use very different color palettes, on different display devices. Our color processing technology compensates for variations in the color performance of a display. Using our approach, any color can be addressed independently and adjusted without impacting other colors.
- *Fully Customizable On-Screen Display.* Our technology couples an integrated on-screen display controller with our industry-first development application. These technologies allow customers who are designing ImageProcessor semiconductors into their display products to quickly develop and implement their own unique user interfaces with up to 256 colors that can incorporate graphics and colorful icons in start-up displays and menus.

Advanced Television Technologies

We have a suite of technologies that are designed to serve the advanced television market which we call DNX — Digital Natural Expression™. Pixelworks' DNX™ video processing technology dramatically improves the quality of video images by combining multiple enhancement techniques to deliver clear, natural-looking standard and high-definition video images. DNX technology utilizes sophisticated digital video processing to deliver a lifelike picture through a combination of techniques.

- *DNX Motion-Adaptive De-Interlacing.* We have developed a proprietary video processing technology to convert interlaced content into progressive content that virtually eliminates image artifacts such as stair-stepping, often referred to as 'jaggies' that can occur with less sophisticated techniques. Our motion-adaptive de-interlacing is able to analyze the content and apply the most appropriate methods for both standard television formats and also high-definition television formats. In addition, DNX Motion-Adaptive De-Interlacing automatically recognizes when incoming signals were originally captured on film so that special methods are employed to display the content.

- *DNX PixelBoost*™. A technology that improves pixel response to eliminate blurring in fast-motion video as seen on some LCD panels. LCD pixels are not able to turn on and off as rapidly as pixels in CRTs, which results in blurry images when content contains quick movements. PixelBoost technology can compensate for this property of LCD panels by manipulating the content in a way that makes it display more crisply on the screen.
- *DNX Rich Color Processing*. A technology that renders more than one billion colors with 10-bit color processing and also optimizes content appearance for various display technologies.
- *DNX Video Enhancement Processing.* Most content has been encoded in order to enhance its appearance on CRT-based televisions which makes it appear unnatural when displayed on LCDs, DMDs or plasma displays. Our DNX Video Enhancement Processing enables manufacturers to apply filters that compensate for the signals in order to produce sharp, rich picture quality.
- *DNX Noise Reduction.* Digital displays often appear to create movement where none exists because pixels flicker in areas where there is no motion, creating a distracting shimmering effect. This is referred to as “noise”. We have developed proprietary technology that minimizes noise for a stable, accurate video image.

Other key video technologies include:

- *Digital Deflection Control.* Digital Deflection Control, or DDC, technology is designed for advanced CRTs by reducing system complexity and cost, providing more control over how the image appears on-screen and improves system reliability. Current digital CRTs use discrete analog chips to manipulate the scanning beam in order to achieve accurate images. DDC digitally pre-processes the video signal in order to achieve the correct screen geometry and image positioning to compensate for geometric distortion inherent in CRT technology.
- *SteadySync™ Weak Signal Compatibility*. In many parts of the world, television viewers still receive their content via over-the-air broadcast. Our SteadySync technology is able to compensate for broadcast signals that are weak by being able to better lock onto a signal and display a picture. This technology helps users in under-served regions to better receive television broadcasts, which is attractive for manufacturers serving developing countries.
- *Intelligent Windowing.* Intelligent windowing offers consumers control over how they view multiple content simultaneously. Our ImageProcessor ICs for advanced televisions are capable of displaying video and computer content in various, user-controlled formats such as side-by-side, Picture-In-Picture, or PIP, and Picture-On-Picture, or POP, where as many as 12 images from various other sources or channels can be monitored while watching a primary viewing window. Our Intelligent Windowing delivers additional flexibility with adjustable transparency and user-controlled resizing of windows.

Multimedia Projector Technologies

- *Digital Keystone Correction.* We pioneered digital keystone correction technology and it is now established as a key feature in multimedia projectors. When projecting an image, if the digital projector is not perpendicular to the surface on which it is projecting the image, the image will be distorted. Our digital keystone correction modifies the geometry of the image in our ImageProcessor IC so that it will appear that the image is "squared up", which allows a projector to be placed virtually anywhere in the room. Our ICs have the ability to adjust the image both vertically and horizontally. With our CornerKlick™ feature, a user can simply correct the image using our unique user interface.

LCD Panel Technologies

- *Smart Timing Controllers.* Typically, every LCD module requires a specific IC called a timing controller, or TCON, that is a purpose-built, discrete component with the function of signaling the LCD module when to turn the pixels on and off. We have led the development of a new type of TCON that is programmable, or "smart", so it is able to work with most LCD modules. LCD manufacturers benefit by no longer having to design and build a unique component for each module. Additionally, we implemented new signal processing techniques that enhance pixel response times and contrast ratios.

Digital Streaming Media Device Technologies

- *DreamStream Application Reference Software* . DreamStream software is a production-ready platform for manufacturers developing digital media streaming devices for displaying video content using our Broadband Signal Processor ICs. DreamStream-enabled devices, including set-top boxes and digital media adapters, support industry-standard encoding and decoding compression schemes, as well as digital rights management, on-screen browser and wireless connectivity.

Future Developments

Pixelworks has continued to expand its technology portfolio through internal developments, acquisitions, co-developments with business partners, licensing and through selling of joint reference designs. In the future, we plan to introduce products and technologies that will enable us to provide the electronics solution for our customers for the entire signal path of an advanced display.

Customers, Sales and Marketing

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

Our global distribution channel is multi-tiered and involves:

- *Distributors.* Distributors are resellers in local markets who provide engineering support and stock our semiconductors in direct relation to specific manufacturing customer orders. Our distributors often have valuable and established relationships with our end customers, and in certain countries it is customary to sell to distributors. While distributor payment to us is not dependent upon the distributor's ability to resell the product or to collect from the end customer, our distributors may provide longer payment terms to end customers than those we would offer. Sales to distributors accounted for 46%, 69% and 69% of total revenue for the years ended December 31, 2005, 2004 and 2003, respectively.

Our largest distributor, Tokyo Electron Device, or TED, is located in Japan. TED represented 22%, 31% and 39% of revenue for the years ended December 31, 2005, 2004 and 2003, respectively, and accounted for 16% and 26% of accounts receivable at December 31, 2005 and 2004, respectively. Revenue through TED to a single end customer, Seiko Epson Corporation, accounted for 10%, 8% and 7% of revenue for the years ended December 31, 2005, 2004 and 2003, respectively. No other single end customer accounted for more than 10% of revenue during the three years ended December 31, 2005.

Neoview, located in Taiwan, was historically our second largest distributor. Neoview represented 13% and 16% of revenue for the years ended December 31, 2004 and 2003, respectively. Effective February 4, 2005, we terminated our distributor relationship with Neoview and we now sell products directly to Taiwanese customers previously served by Neoview, as well as through our other Taiwanese distributors. Neoview represented 1% of revenue for the year ended December 31, 2005.

We also have distributor relationships in China and Europe.

- *Direct Relationships.* We have established direct relationships with companies that manufacture advanced display systems. Some of our direct relationships are supported by manufacturer's representatives, which are independent sales agents that represent us in local markets and provide engineering support but do not carry inventory. Revenue through direct relationships accounted for 54%, 31% and 31% of total revenue for the years ended December 31, 2005, 2004 and 2003, respectively. We have identified three classifications of direct relationships as follows:
  - *Integrators.* Integrators are OEM customers who build display devices based on specifications provided by branded manufacturers.
  - *Branded Manufacturers*. Branded manufacturers are globally recognized manufacturers who develop display device specifications, manufacture, market and distribute display devices either directly or through resellers to end-users.
  - *Branded Suppliers*. Branded suppliers are globally recognized suppliers who develop display device specifications and then source them from integrators, typically in Asia, and distribute them either directly or through resellers to end-users.

Looking ahead, we anticipate an increase in the percentage of revenue through direct relationships. An example of this transition is the termination of our distributor agreement with our former Taiwanese distributor described above. We expect this change to strengthen our relationships with our direct customers and to be cost effective.

Our sales and marketing team included 126 employees as of December 31, 2005. The sales and marketing team includes 72 field application engineers who provide technical expertise and assistance to manufacturing customers on final product development. We have sales, marketing and support personnel in the U.S., China, Taiwan, Japan and Korea.

Seasonality

Historically, our sales have been higher in the second half of the year, primarily due to holiday demand for consumer electronics including advanced televisions and flat panel monitors. Additionally, the multimedia projector market is subject to seasonality with higher shipments typically occurring in the fourth quarter.

Geographic Concerns

Our global operations subject us to risks and difficulties associated with doing business outside the U.S. These risks include foreign currency exchange rate fluctuations, political and economic instability, reduced or limited protection of our intellectual property and increased transaction costs. Our global operations also increase the complexity of our relationship with our distributors and manufacturers due to varying time zones, languages and business customs.

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

Backlog

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

Research and Development

Our internal research and development efforts are focused on the development of our semiconductors for the advanced television, multimedia projector, digital streaming media devices and LCD panel markets. Our development efforts are focused on pursuing higher levels of integration and new features in order to extend our system-on-chip semiconductors and discrete ICs to provide our customers with electronics solutions, including software, service and support, that enable them to introduce market leading products. These higher levels of integration are designed to reduce components on circuit boards and help lower final systems costs for our customers.

In addition to our 72 field applications engineers, on December 31, 2005, we had 254 engineers, technologists and scientists who are organized into the following functional groups: Integrated Circuit Design, Software Engineering, Video and Image Processing Engineering, Display Interface Engineering, Systems Engineering and Product and Test Engineering.

We have invested, and expect that we will continue to invest, significant resources in research and development activities. Our research and development expenses were $51.8 million, $33.0 million and $29.6 million in 2005, 2004, and 2003, respectively.

Manufacturing

Our products require advanced semiconductor processing and packaging technologies. Within the semiconductor industry we are known as a "fabless" company, meaning that we do not fabricate the semiconductors that we design and develop, but instead rely on third parties to manufacture our products. We have IC foundry relationships with Infineon, Semiconductor Manufacturing International Corporation, or SMIC, Taiwan Semiconductor Manufacturing Corporation, or TSMC, and Toshiba. This approach allows us to concentrate our resources on product design and development where we believe we have greater competitive advantages. However, as the estimated time for us to adapt a product's design to a particular contract manufacturer's process is at least four months, there is no readily available alternate supply for any specific product.

Intellectual Property

We rely on a combination of nondisclosure agreements and copyright, trademark and trade secret laws to protect the algorithms, design and architecture of our system-on-chip technology. As of December 31, 2005, we held 36 patents and had 94 patent applications pending, which relate generally to improvements in the visual display of digital image data including, but not limited to, improvements in image scaling, image correction, automatic image optimization and video signal processing for digital displays.

We intend to seek patent protection for other significant technologies that we have already developed and expect to seek patent protection for future products as necessary. Any future patents may not be granted and if granted may be invalidated, circumvented, challenged or licensed to others.

To supplement the technologies that we develop internally, we have licensed rights to use intellectual properties held by third parties, and we may license additional technology rights in the future. If any of these agreements terminate, we would be required to exclude the licensed technology from our existing and future product lines.

The semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. We have indemnification obligations with respect to the infringement of third party intellectual property rights. There is no intellectual property litigation currently pending against us. However, we may, from time to time, receive notifications of claims that we may be infringing patents or other intellectual property rights owned by third parties. If it is necessary or desirable, we may seek licenses under those patents or intellectual property rights. However, we cannot be sure that licenses will be offered or that the terms of any offered licenses would be acceptable to us.

Competition

In general, the market for semiconductors is intensely competitive. Our market is characterized by rapid technological change, evolving industry standards, compressed product life cycles and declining average selling prices. We believe the principal factors impacting competition in our markets are levels of product integration, functional versatility provided by software, compliance with industry standards, time to market, cost, product performance, system design costs, intellectual property, customer relationships and reputation.

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

We compete with specialized and diversified electronics and semiconductor companies that offer display processors or scaling components. Some of these include ATI, Genesis Microchip, I-Chips, ITE, JEPICO Corp., Macronix, Mediatek, Media Reality Technologies, Micronas, MStar Semiconductor, Inc., Realtek, Renesas Technology, Sigma Designs, Silicon Image, Silicon Optix, STMicroelectronics, Sunplus Technology, Techwell, Topro, Trident, Trumpion, Weltrend, Zoran and other companies. Potential competitors may include diversified semiconductor manufacturers and the semiconductor divisions or affiliates of some of our customers, including Intel, Koninlijke Philips Electronics, LG Electronics, Matsushita Electric Industrial, Mitsubishi, National Semiconductor, NEC, nVidia, Samsung Electronics, Sanyo Electric Company, Sharp Corporation, Sony Corporation, Texas Instruments and Toshiba Corporation. In addition, start-up companies may seek to compete in our markets.

Employees

As of December 31, 2005, we had a total of 469 employees – 254 in engineering, 126 in sales and marketing, of which 72 are field application engineers and 54 sales and marketing staff, 23 in operations, and 66 in administration, including finance, information technology, human resources and general administration. Of these employees, 199 are in the United States. None of our employees are represented by a collective bargaining agreement, nor have we experienced any work stoppage. We consider our relationship with our employees to be good. Our future success will depend in large part on our ability to continue to attract, retain, and motivate highly skilled and qualified personnel.

Available Information

We file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 as amended (the “Exchange Act”). You can inspect and copy our reports, proxy statements and other information filed with the SEC at the SEC’s Public Reference Room at 450 Fifth Street, N.W. in Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the Public Reference Room. The SEC maintains an Internet Web site at http://www.sec.gov where you can obtain most of our SEC filings. In addition, you can inspect our reports, proxy materials and other information at the offices of the Nasdaq Stock Market at 1735 K Street NW, Washington D.C. 20006. We also make available free of charge through a link on our website at www.pixelworks.com our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after they are filed electronically with the SEC.

Item 1A. Risk Factors.

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

(Dollars in thousands, except per share data)

RISKS RELATED TO OUR OPERATIONS

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

In June 2005, we completed the acquisition of Equator Technologies, Inc. ("Equator"), a privately held company, for an aggregate purchase price of $118,116. The acquisition of Equator required a substantial expenditure and involves substantial risks on our part. Equator's current product offerings and technological developments relate to internet protocol television ("IPTV") set-top boxes, digital media appliances, videoconferencing devices and security devices. These are emerging technologies and the markets they serve are developing and largely untested, and we do not have direct experience developing and selling products into these markets. In addition, in making the acquisition of Equator we have made certain assumptions and projections with respect to the following: Equator's revenue for future quarters; our expectations regarding the growth of the markets Equator serves; the ability of Equator to develop and introduce new products and software and the risk that customers will not accept those new products and software; and the synergies we believe we can realize from the acquisition. We cannot be sure that such assumptions are correct. For these reasons, we cannot provide assurance that the acquisition of Equator will produce the revenues, earnings or business synergies that we anticipate, or that it will perform as expected.

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

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

To date, we have acquired Panstera, Inc. in January 2001, nDSP in January 2002, Jaldi Semiconductor in September 2002 and Equator in June 2005. In March 2003, we announced the execution of a definitive merger agreement with Genesis Microchip, Inc.; however, the merger was terminated in August of 2003, and we incurred $8,949 of expenses related to the transaction. In the third quarter of 2003, we made an investment of $10,000 in Semiconductor Manufacturing International Corporation (SMIC). We intend to continue to consider investments in or acquisitions of complementary businesses, products or technologies.

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

These and any future acquisitions and investments could result in:

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

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

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

Goodwill represents a significant portion of our total assets.

As of December 31, 2005, goodwill amounted to $133,731 or approximately 32% of our total assets. We are required to review goodwill for possible impairment on an annual basis or when events and circumstances arise which indicate a possible impairment. The review of goodwill for impairment may result in large write-offs of goodwill, which could have a material adverse effect on our results of operations. Due to the fact that the market value of our reporting unit is approaching book value, it is at least reasonably possible that we will have an impairment in the near term.

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

While we had net income of $21,781 for the year ended December 31, 2004, we incurred a net loss of $42,610 for the year ended December 31, 2005 and our accumulated deficit is $102,198 through December 31, 2005. The year ended December 31, 2004 was our first year of annual profitability since inception. We expect our research and development and selling, general and administrative expenses to continue to increase. Given expected increases in operating expenses, we must increase revenues and gross profit to become profitable again. We cannot be certain that we will achieve profitability in the future or, if we do, that we can sustain or increase profitability on a quarterly or annual basis. This may in turn cause the price of our common stock to decline. In addition, if we are not profitable in the future we may be unable to continue our operations.

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

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

- our success in integrating the operations of our recently acquired subsidiary, Equator Technologies, Inc.;
- demand for multimedia projectors, advanced televisions, LCD panels, and digital streaming media devices;
- demand for our products and the timing of orders for our products;
- the deferral of customer orders in anticipation of new products or product enhancements from us or our competitors or due to a reduction in our end customers' demand;
- the loss of one or more of our key distributors or customers or a reduction, delay or cancellation of orders from one or more of these parties;
- changes in the available production capacity at the semiconductor fabrication foundries that manufacture our products and changes in the costs of manufacturing;
- our ability to provide adequate supplies of our products to customers and avoid excess inventory;
- the announcement or introduction of products and technologies by our competitors;
- changes in product mix, product costs or pricing, or distribution channels; and
- general economic conditions and economic conditions specific to the advanced display and semiconductor markets.

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

Our operating expenses and inventory levels are based on our expectations of future revenues and our operating expenses are relatively fixed in the short term. Consequently, if anticipated sales and shipments in any quarter do not occur when expected, operating expenses and inventory levels could be disproportionately high, and our operating results for that quarter and, potentially, future quarters may be negatively impacted. Any shortfall in our revenues would have a direct impact on our business. In addition, fluctuations in our quarterly results could adversely affect the price of our common stock in a manner unrelated to our long-term operating performance. Because our operating results are volatile and difficult to predict, you should not rely on the results of one quarter as an indication of our future performance. It is possible that in some future quarter our operating results will fall below the expectations of securities analysts and investors. In this event, the price of our common stock may decline significantly.

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

Average selling prices for our products decline over relatively short time periods while many of our product costs are fixed. When our average selling prices decline, our gross profits decline unless we are able to sell more units or reduce the cost to manufacture our products. Our operating results are negatively affected when revenue or gross profit margins decline. We have experienced these results and expect that we will continue to experience them in the future, although we cannot predict when they may occur or how severe they will be.

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

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

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

If we do not achieve additional design wins in the future, our ability to grow would be seriously limited.

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

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

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

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

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

Successful development and timely introduction of new or enhanced products depends on a number of other factors, including, but not limited to:

- accurate prediction of customer requirements and evolving industry standards, including video decoding, digital interface and content piracy protection standards;
- development of advanced display technologies and capabilities;
- timely completion and introduction of new product designs;
- use of advanced foundry processes and achievement of high manufacturing yields; and
- market acceptance of the new products.

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

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

Our products incorporate software and software development tools. The integration of software adds complexity, may extend our internal development programs and could impact our customers' development schedules. This complexity requires increased coordination between hardware and software development schedules and may increase our operating expenses without a corresponding increase in product revenue. Some customers and potential customers may choose not to use our products because of the additional requirements of implementing our software, preferring to use a product that works with their existing software. This additional level of complexity lengthens the sales cycle and may result in customers selecting competitive products requiring less software integration.

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

We are and will continue to be dependent on a limited number of large distributors and customers for a substantial portion of our revenue. Sales to distributors represented 46%, 69% and 69% of total revenue for the years ended December 31, 2005, 2004 and 2003, respectively. Sales to Tokyo Electron Device, or TED, our Japanese Distributor, represented 22%, 31% and 39% of our total revenue for the years ended December 31, 2005, 2004 and 2003, respectively. Sales to our top five end customers accounted for approximately 34%, 33% and 35% of total revenue for the years ended December 31, 2005, 2004 and 2003, respectively. As a result of this distributor and end customer concentration, any one of the following factors could significantly impact our revenues:

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

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

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

At December 31, 2005, we had three customers that each represented more than 10% of our accounts receivable. At December 31, 2004, we had two customers that each represented more than 10% of our accounts receivable. TED represented 16% and 26% of total accounts receivable at December 31, 2005 and 2004, respectively. The failure to pay this balance by this or any other customer would result in an expense that would increase our operating expenses and would reduce our cash flows.

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

Sales outside the U.S. accounted for approximately 96%, 99% and 99% of total revenue in 2005, 2004 and 2003, respectively. We anticipate that sales outside the U.S. will continue to account for a substantial portion of our revenue in future periods. In addition, customers who incorporate our products into their products sell a substantial portion outside of the U.S., thereby exposing us indirectly to further international risks. In addition, all of our products are manufactured outside of the U.S. We are, therefore, subject to many international risks, including, but not limited to:

- increased difficulties in managing international distributors and manufacturers of our products and components due to varying time zones, languages and business customs;
- foreign currency exchange fluctuations such as the devaluation in the currencies of Japan, People's Republic of China ("PRC"), Taiwan and Korea that could result in an increased cost of procuring our semiconductors;
- potentially adverse tax consequences;

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

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

A substantial and potentially increasing portion of our products are manufactured by foundries located in the PRC and a large number of our customers are geographically concentrated in the PRC. In addition, approximately 45% of our employees are located in this area and we made an investment of $10,000 in SMIC, located in Shanghai, China in the third quarter of 2003. Disruptions from natural disasters, health epidemics (including new outbreaks of SARS or bird flu) and political, social and economic instability may affect the region, and would have a negative impact on our results of operations. In addition, the economy of the PRC differs from the economies of many countries in respects such as structure, government involvement, level of development, growth rate, capital reinvestment, allocation of resources, self-sufficiency, rate of inflation and balance of payments position, among others. In the past, the economy of the PRC has been primarily a planned economy subject to state plans. Since the entry of the PRC into the World Trade Organization in 2002, the PRC government has been reforming its economic and political systems. These reforms have resulted in significant economic growth and social change. We cannot assure, however, that the PRC's policies for economic reforms will be consistent or effective. Our results of operations and financial position may be harmed by changes in the PRC's political, economic or social conditions.

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

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

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

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

If we are unable to obtain our products from manufacturers on schedule, our ability to satisfy customer demand will be harmed, and revenue from the sale of products may be lost or delayed. If orders for our products are cancelled, expected revenues would not be realized. In addition, if the price charged by our third-party manufacturers increases we will be required to increase our prices, which could harm our competitiveness. For example, in the fourth quarter of 2005, one of our third-party manufacturers experienced temporary manufacturing delays due to unexpected process problems, which caused delays in delivery of our products making it difficult for us to satisfy our customer demand.

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

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

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

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

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

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

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

Semiconductor manufacturing technologies change rapidly and manufacturers typically discontinue older manufacturing processes in favor of newer ones. Once a manufacturer makes the decision to retire a manufacturing process, notice is generally given to its customers. Customers will then either retire the affected part or develop a new version of the part that can be manufactured on the newer process. In the event that a manufacturing process is discontinued, our products could become unavailable from our current suppliers. Additionally, migrating to a new, more advanced process requires significant expenditures for research and development. A significant portion of our products use embedded DRAM technology and the required manufacturing process for this technology may only be available for the next two years. We also utilize 0.18um, 0.15um and 0.13um standard logic processes, which may only be available for the next five to seven years. We have commitments from our suppliers to notify us in the event of a discontinuance of a manufacturing process in order to assist us with product transitions.

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

None of our products are fabricated by more than one supplier. Additionally, our products require manufacturing with state-of-the-art fabrication equipment and techniques. Because the lead-time needed to establish a relationship with a new contract manufacturer is at least nine months, and the estimated time for us to adapt a product’s design to a particular contract manufacturer’s process is at least four months, there is no readily available alternative source of supply for any specific product. This could cause significant delays in shipping products, which may result in lost revenues and damaged customer relationships.

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

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

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

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

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

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

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

We develop products based on anticipated market and customer requirements and incur substantial product development expenditures, which can include the payment of large up-front, third-party license fees and royalties, prior to generating associated revenues. Because the development of our products incorporates not only our complex and evolving technology, but also our customers' specific requirements, a lengthy sales process is often required before potential customers begin the technical evaluation of our products. Our customers typically perform numerous tests and extensively evaluate our products before incorporating them into their systems. The time required for testing, evaluation and design of our products into a customer's equipment can take up to nine months or more. It can take an additional nine months before a customer commences volume shipments of systems that incorporate our products. Even when we achieve a design win, the customer may never ship systems incorporating our products. We cannot assure that the time required for the testing, evaluation and design of our products by our customers would not exceed nine months. Because of this lengthy development cycle, we will experience delays between the time we incur expenditures for research and development, sales and marketing, inventory levels and the time we generate revenues, if any, from these expenditures. Additionally, if actual sales volumes for a particular product are substantially less than originally forecasted, we may experience large write-offs of capitalized license fees, product masks and prepaid royalties that would negatively affect our operating results.

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

Shortages of components and other materials that are critical to the design and manufacture of our customers' products could limit our sales. These components include liquid crystal display panels and other display components, analog-to-digital converters, digital receivers and video decoders. During 2000, some of our customers experienced delays in the availability of key components from other suppliers, which, in turn, caused a delay in demand for the products that we supplied to our customers.

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

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

Our products could become obsolete if necessary licenses of third-party technology are not available to us or are only available on terms that are not commercially viable.

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

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

The markets in which we compete or seek to compete are subject to rapid technological change, frequent new product introductions, changing customer requirements for new products and features, and evolving industry standards. The introduction of new technologies and the emergence of new industry standards could render our products less desirable or obsolete, which could harm our business. Examples of changing industry standards include the introduction of high-definition television (ATSC and DVB), or HDTV, new video decoding technology (such as H.264 or Windows Media 9), new digital receivers and displays with resolutions that have required us to accelerate development of new products to meet these new standards.

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

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

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

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

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

We may become subject to claims involving patents or other intellectual property rights. For example, in early 2000, we were notified by InFocus Corporation ("InFocus") that we were infringing on patents held by InFocus. In February 2000, we entered into a license agreement with InFocus granting us the right to use the technology covered by those InFocus patents. As a result, we recorded a charge of $4,078 for patent settlement expense in the first quarter of 2000. Intellectual property claims could subject us to significant liability for damages and invalidate our proprietary rights. In addition, intellectual property claims may be brought against customers that incorporate our products in the design of their own products. These claims, regardless of their success or merit and regardless of whether we are named as defendants in a lawsuit, would likely be time consuming and expensive to resolve and would divert the time and attention of management and technical personnel. Any future intellectual property litigation or claims also could force us to do one or more of the following:

- stop selling products using technology that contains the allegedly infringing intellectual property;
- attempt to obtain a license to the relevant intellectual property, which may not be available on reasonable terms or at all;

- attempt to redesign those products that contain the allegedly infringing intellectual property; and
- pay damages for past infringement claims that are determined to be valid or which are arrived at in settlement of such litigation or threatened litigation.

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

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

Our ability to compete effectively with other companies will depend, in part, on our ability to maintain the proprietary nature of our technology, including our semiconductor designs and software. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to protect our proprietary technologies. We hold 36 patents and have 94 patent applications pending for protection of our significant technologies. We cannot assure you that the degree of protection offered by patents or trade secret laws will be sufficient. Furthermore, we cannot assure you that any patents will be issued as a result of any pending applications, or that, if issued, any claims allowed will be sufficiently broad to protect our technology. In addition, it is possible that existing or future patents may be challenged, invalidated or circumvented. Competitors in both the U.S. and foreign countries, many of whom have substantially greater resources, may apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell our products, or develop similar technology independently or design around our patents. Effective copyright, trademark and trade secret protection may be unavailable or limited in foreign countries. In addition, we provide the computer programming code for our software to selected customers in connection with their product development efforts, thereby increasing the risk that customers will misappropriate our proprietary software.

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

In the second quarter of 2004, we issued $150,000 of 1.75% convertible debentures due 2024 in a private placement pursuant to Rule 144A and Regulation S under the Securities Act of 1933. As a result of this indebtedness, our principal obligations increased substantially. These debt obligations could materially and adversely affect our ability to obtain debt financing for working capital, acquisitions or other purposes, limit our flexibility in planning for or reacting to changes in our business, reduce funds available for use in our operations and could make us more vulnerable to industry downturns and competitive pressures. Our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, many of which are beyond our control.

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

Our ability to successfully market and sell our products in a rapidly evolving market requires effective planning and management processes. We continue to increase the scope of our operations and have increased our headcount from 349 employees at the end of 2004 to 469 at December 31, 2005. Our past growth, and our expected future growth, places a significant strain on our management systems and resources including our financial and managerial controls, reporting systems and procedures. To manage our growth effectively, we must implement and improve operational and financial systems, train and manage our employee base and attract and retain qualified personnel with relevant experience. We must also manage multiple relationships with customers, business partners, contract manufacturers, suppliers and other third parties. Moreover, we could spend substantial amounts of time and money in connection with our rapid growth and may have unexpected costs. Our systems, procedures or controls may not be adequate to support our operations and we may not be able to expand quickly enough to exploit potential market opportunities. While we have not, to date, suffered any significant adverse consequences due to our growth, if we do not continue to manage growth effectively our operating expenses could increase more rapidly than our revenue, adversely affecting our statement of operations.

Risks Related to Our Industry

Failure of consumer demand for advanced displays and other digital display technologies to increase would impede our growth and adversely affect our business.

Our product development strategies anticipate that consumer demand for advanced televisions, multimedia projectors, liquid crystal display panels, digital streaming media devices and other emerging display technologies will increase in the future. The success of our products is dependent on increased demand for these display technologies. The potential size of the market for products incorporating these display technologies and the timing of its development are uncertain and will depend upon a number of factors, all of which are beyond our control. In order for the market in which we participate to grow, advanced display products must be widely available and affordable to consumers. In the past, the supply of advanced display products has been cyclical. We expect this pattern to continue. Undercapacity in the advanced display market may limit our ability to increase our revenues because our customers may limit their purchases of our products if they cannot obtain sufficient supplies of LCD panels or other advanced display components. In addition, advanced display prices may remain high because of limited supply, and consumer demand may not grow.

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

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

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

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

We compete with specialized and diversified electronics and semiconductor companies that offer advanced display, digital TV and IPTV semiconductor products. Some of these include ATI, Genesis Microchip, I-Chips, ITE, JEPICO Corp., Macronix, Mediatek, Media Reality Technologies, Micronas, MStar Semiconductor, Inc., Realtek, Renesas Technology, Sigma Designs, Silicon Image, Silicon Optix, STMicroelectronics, Sunplus Technology, Techwell, Topro, Trident, Trumpion, Weltrend, Zoran and other companies. Potential competitors may include diversified semiconductor manufacturers and the semiconductor divisions or affiliates of some of our customers, including Intel, Koninlijke Philips Electronics, LG Electronics, Matsushita Electric Industrial, Mitsubishi, National Semiconductor, NEC, nVidia, Samsung Electronics, Sanyo Electric Company, Sharp Corporation, Sony Corporation, Texas Instruments and Toshiba Corporation. In addition, start-up companies may seek to compete in our markets. Many of our competitors have longer operating histories and greater resources to support development and marketing efforts. Some of our competitors may operate their own fabrication facilities. These competitors may be able to react more quickly and devote more resources to efforts that compete directly with our own. In the future, our current or potential customers may also develop their own proprietary technologies and become our competitors. Our competitors may develop advanced technologies enabling them to offer more cost-effective and higher quality semiconductors to our customers than those offered by us. Increased competition could harm our business, financial condition and results of operations by, for example, increasing pressure on our profit margin or causing us to lose sales opportunities. We cannot assure you that we can compete successfully against current or potential competitors.

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

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

Other Risks

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

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

- our board of directors is authorized, without prior shareholder approval, to increase the size of the board. Our articles of incorporation provide that if the board is increased to eight or more members, the board will 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 change our control, commonly referred to as “blank check” preferred stock;
- members of our board of directors can only be removed for cause;

- the board of directors may alter our bylaws without obtaining shareholder approval; and
- shareholders are required to provide advance notice for nominations for election to the board of directors or for proposing matters to be acted upon at a shareholder meeting.

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

Our executive officers, directors and other principal shareholders, in the aggregate, beneficially own 23,222,641 shares or approximately 48% of our outstanding common stock and exchangeable shares as of February 28, 2006. These shareholders currently have, and will continue to have, significant influence with respect to the election of our directors and approval or disapproval of our significant corporate actions. This influence over our affairs might be adverse to the interest of our other shareholders. In addition, the voting power of these shareholders could have the effect of delaying or preventing a change in control of our business or otherwise discouraging a potential acquirer from attempting to obtain control of us, which could prevent our other shareholders from realizing a premium over the market price for their common stock.

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

Investors may not be able to sell shares of our common stock at or above the price they paid due to a number of factors, including, but not limited to:

- actual or anticipated fluctuations in our operating results;
- actual reduction in our operating results due solely to the adoption of Statement of Financial Accounting Standards No. 123R, which requires, among other things, the expensing of stock options beginning in 2006;
- changes in expectations as to our future financial performance;
- changes in financial estimates of securities analysts;
- announcements by us or our competitors of technological innovations, design wins, contracts, standards or acquisitions;
- the operating and stock price performance of other comparable companies;
- announcements of future expectations by our customers;
- changes in market valuations of other technology companies; and
- inconsistent trading volume levels of our common stock.

In particular, the stock prices of technology companies similar to us have been highly volatile. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. Market fluctuations as well as general economic, political and market conditions including recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of our common stock. Therefore, the price of our common stock may decline, and the value of your investment may be reduced regardless of our performance.

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

We believe our current cash and marketable security balances will be sufficient to meet our capital requirements for the next twelve months. However, we may need, or could elect to seek, additional funding prior to that time. To the extent that currently available funds are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. Additional funds may not be available on terms favorable to us or our shareholders. Further, if we issue equity securities, our shareholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of our common stock. If we cannot raise funds on acceptable terms, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements.

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

We are spending an increasing amount of management time and external resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and NASDAQ Stock Market rules. In particular, Section 404 of the Sarbanes-Oxley Act of 2002 requires management's annual review and evaluation of our internal control systems, and attestations of the effectiveness of these systems by our independent registered public accounting firm. The process of documenting and testing our controls has required that we hire additional personnel and outside advisory services and has resulted in additional accounting and legal expenses. While we invested significant time and money in our effort to evaluate and test our internal control over financial reporting, a material weakness was identified in our internal control over financial reporting in 2004. In addition, there are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including cost limitations, the possibility of human error, judgments and assumptions regarding the likelihood of future events, and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can provide only reasonable assurance of achieving their control objectives.

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We lease approximately 80,000 square feet in two buildings in Tualatin, Oregon, which house our corporate headquarters and include engineering, operations, sales and marketing and administrative facilities. These leases expire at various dates through February 2009.

We lease approximately 39,000 square feet in two buildings in Campbell, California. These leases expire in May and October of 2006, and we have entered into a lease agreement for approximately 37,000 square feet of replacement space commencing June of 2006. We lease approximately 18,000 square feet in Ontario, Canada and 8,000 square feet in Seattle, Washington. Our Ontario lease expires in August 2008 and our Seattle lease expires in October 2011. The facilities in California, Canada and Washington house engineering and sales and marketing facilities.

We lease approximately 57,000 square feet in three cities in China for purposes of engineering and sales and customer support. Our China leases expire at various dates through December 2006. We also lease approximately 26,000 square feet in two cities in Taiwan for purposes of sales and customer support and operations and logistics, and 4,000 square feet in two cities in Japan for purposes of sales and customer support. Our Taiwan and Japan leases expire at various dates through November 2008 and March of 2007, respectively.

Item 3. Legal Proceedings.

We are involved in litigation from time to time that is routine in nature and incidental to our business. We believe that the outcome of any such current litigation would not have a material adverse effect on our financial condition, results of operations or cash flows.

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

No matters were submitted to a vote of our security holders during the fourth quarter of the fiscal year ended December 31, 2005.

PART II

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

Our Common Stock is listed for trading on the Nasdaq National Market under the symbol "PXLW". The stock began trading on May 19, 2000. The following table sets forth, for the periods indicated, the highest and lowest sales prices of the Common Stock.

Fiscal 2005	High	Low
Fourth Quarter	$ 6.74	$4.97
Third Quarter	$11.78	$6.25
Second Quarter	$ 9.32	$6.90
First Quarter	$12.44	$7.55

Fiscal 2004	High	Low
Fourth Quarter	$12.80	$10.11
Third Quarter	$15.32	$ 7.50
Second Quarter	$20.74	$14.61
First Quarter	$17.93	$10.95

As of February 28, 2006, there were 222 shareholders of record (excluding individual participants in securities positions listings), and the last per share sales price of the Common Stock on that date was $4.51.

The payment of dividends is within the discretion of our Board of Directors and will depend on our earnings, capital requirements and operating and financial condition, among other factors. To date, we have not declared any cash dividends and we currently expect to retain any earnings to finance the expansion and development of our business.

Information with respect to equity compensation plans is included in the 2006 Proxy Statement and is incorporated herein by reference.

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Item 6. Selected Financial Data.

The following selected financial data should be read in conjunction with Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operation" and Item 8. "Financial Statements and Supplementary Data".

Statement of Operations Data

	Year Ended December 31,				
	2005	2004	2003	2002	2001
	(In thousands, except per share data)				
Revenue, net	$171,704	$176,211	$140,921	$102,641	$ 90,808
Cost of revenue	108,748	90,991	78,674	52,545	47,167
Gross profit	62,956	85,220	62,247	50,096	43,641
Operating expenses:					
Research and development	51,814	32,969	29,580	31,182	24,875
Selling, general and administrative	30,616	23,736	20,797	16,576	17,387
Restructuring	1,162	—	5,049	—	—
Amortization of goodwill and acquired intangible assets	1,084	486	486	242	15,982
Merger-related expenses	—	—	8,949	—	—
In-process research and development	—	—	—	24,342	32,400
Total operating expenses	84,676	57,191	64,861	72,342	90,644
Income (loss) from operations	(21,720)	28,029	(2,614)	(22,246)	(47,003)
Interest and other income, net	1,532	1,742	1,177	2,275	4,444
Income (loss) before income taxes	(20,188)	29,771	(1,437)	(19,971)	(42,559)
Provision for (recovery of) income taxes	22,422	7,990	(907)	880	—
Net income (loss)	$ (42,610)	$ 21,781	$ (530)	$ (20,851)	$(42,559)
Net income (loss) per share:					
Basic	$ (0.90)	$ 0.47	$ (0.01)	$ (0.48)	$ (1.05)
Diluted	$ (0.90)	$ 0.45	$ (0.01)	$ (0.48)	$ (1.05)
Weighted average shares outstanding:					
Basic	47,337	46,673	45,337	43,397	40,662
Diluted	47,337	52,062	45,337	43,397	40,662

Balance Sheet Data

	December 31,				
	2005	2004	2003	2002	2001
			(In thousands)		
Cash and cash equivalents	$ 68,604	$ 32,585	$ 16,490	$ 17,577	$ 43,288
Working capital	139,291	209,653	91,681	95,776	98,820
Total assets	421,556	423,569	233,317	227,212	202,839
Long-term liabilities, net of current portion	163,357	150,365	100	—	—
Total shareholders' equity	215,217	252,023	220,305	214,816	193,633

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

Forward-looking Statements

This Management's Discussion and Analysis of Financial Condition and Results of Operation and other sections of this Report contain "forward-looking statements" within the meaning of the Securities Litigation Reform Act of 1995 that are based on current expectations, estimates, beliefs, assumptions and projections about our business. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict. Actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements due to numerous factors. Such factors include, but are not limited to, increased competition, continued adverse economic conditions in the U.S. and internationally, including adverse economic conditions in the specific markets for our products, adverse business conditions, failure to design, develop and manufacture new products, lack of success in technological advancements, lack of acceptance of new products, unexpected changes in the demand for our products and services, the inability to successfully manage inventory pricing pressures, failure to reduce costs or improve operating efficiencies, changes to and compliance with international laws and regulations, currency fluctuations and our ability to attract, hire and retain key and qualified employees. These forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Annual Report on Form 10-K. If we do update or correct one or more forward-looking statements, you should not conclude that we will make additional updates or corrections with respect thereto or with respect to other forward-looking statements.

(Dollars in thousands, except per share data)

Overview

We are a leading designer, developer and marketer of semiconductors and software for use in advanced televisions, multimedia projectors, digital streaming media devices and liquid crystal display ("LCD") panel products. Our system-on-chip and discrete semiconductors provide the 'intelligence' for these new types of displays and devices by processing and optimizing video and computer graphic signals to produce high-quality images. Many of the world's leading manufacturers of consumer electronics and computer display products utilize our technology to enhance image quality and ease of use of their products. Our goal is to provide all of the electronics necessary to process the signal along its entire path through the system in order to provide a turnkey solution for our customers.

We sell our products worldwide through a direct sales force and indirectly through distributors and manufacturers' representatives. We sell to distributors in Japan, Taiwan, China and Europe, and our manufacturers' representatives support some of our European and Korean sales. Sales to distributors represented 46%, 69% and 69% of total revenue for the years ended December 31, 2005, 2004 and 2003, respectively. Our distributors typically provide engineering support to our end customers and often have valuable and established relationships with our end customers. In certain countries it is customary to sell to distributors. While distributor payment to us is not dependent upon the distributor's ability to resell the product or to collect from the end customer, the distributors may provide longer payment terms to end customers than those we would offer.

Historically, significant portions of our revenue have been generated by sales to a relatively small number of end customers and distributors. Our top five end customers accounted for 34%, 33% and 35% of our total revenue for the years ended December 31, 2005, 2004 and 2003, respectively.

Significant portions of our products are sold overseas. Sales outside the U.S. accounted for approximately 96%, 99% and 99% of total revenue for the years ended December 31, 2005, 2004 and 2003, respectively. Our integrators, branded manufacturers and branded suppliers incorporate our products into systems that are sold worldwide. All of our revenue to date has been denominated in U.S. dollars.

On June 14, 2005, we acquired all of the outstanding shares of Equator Technologies, Inc. ("Equator") for $118,116, which consisted of cash of $107,854, the value of 1,263,417 options exchanged of $8,336, plus acquisition costs of $1,926. The acquisition was accounted for using the purchase method of accounting and the results of Equator's operations are included in our financial statements beginning on June 14, 2005.

Critical Accounting Policies and Estimates

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

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

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

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

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

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

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

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

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

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

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

Goodwill. Goodwill represents the excess of cost over the fair value of net assets acquired in business combinations and is not amortized. We test goodwill annually for impairment, and more frequently if events and circumstances indicate that it might be impaired. The impairment tests are performed in accordance with SFAS 142, *Goodwill and Other Intangible Assets.* Accordingly, an impairment loss is recognized to the extent that the carrying amount of goodwill exceeds its implied fair value. This determination is made at the reporting unit level. We have assigned all goodwill to a single, enterprise-level reporting unit. The impairment test consists of two steps. First, we determine the fair value of the reporting unit. The fair value is then compared to its carrying amount. Second, if the carrying amount of the reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation in accordance with SFAS 141, *Business Combinations*. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. We perform our annual impairment test in the first quarter of each year. We did not record any goodwill impairment charges in 2005, 2004 or 2003 as a result of the impairment tests performed. We performed our 2006 annual impairment test on January 1, 2006 and determined no impairment existed. Due to the fact that the market value of our reporting unit is approaching book value, it is at least reasonably possible that we will have an impairment in the near term and, therefore, we may be required to perform the impairment test at additional times during the year.

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

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

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Results of Operations

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

	Year Ended December 31, 2005 Dollars	2005 % of sales	2004 Dollars	2004 % of sales	2003 Dollars	2003 % of sales
Revenue, net	$171,704	100.0%	$176,211	100.0%	$140,921	100.0%
Cost of revenue	108,748	63.3	90,991	51.6	78,674	55.8
Gross profit	62,956	36.7	85,220	48.4	62,247	44.2
Operating expenses:						
Research and development	51,814	30.2	32,969	18.7	29,580	21.0
Selling, general and administrative	30,616	17.8	23,736	13.5	20,797	14.8
Restructuring	1,162	0.7	—	0.0	5,049	3.6
Amortization of acquired intangible assets	1,084	0.6	486	0.3	486	0.3
Merger-related expenses	—	0.0	—	0.0	8,949	6.4
Total operating expenses	84,676	49.3	57,191	32.5	64,861	46.0
Income (loss) from operations	(21,720)	(12.6)	28,029	15.9	(2,614)	(1.9)
Interest income	5,658	3.3	3,823	2.2	1,188	0.8
Interest expense	(2,637)	(1.5)	(1,609)	(0.9)	(11)	(0.0)
Realized loss on sale of marketable securities	(779)	(0.5)	—	0.0	—	0.0
Amortization of debt issuance costs	(710)	(0.4)	(472)	(0.3)	—	0.0
Interest and other income, net	1,532	0.9	1,742	1.0	1,177	0.8
Income (loss) before income taxes	(20,188)	(11.8)	29,771	16.9	(1,437)	(1.0)
Provision for (recovery of) income taxes	22,422	13.1	7,990	4.5	(907)	(0.6)
Net income (loss)	$ (42,610)	(24.8)%	$ 21,781	12.4%	$ (530)	(0.4)%

Percentages may not add due to rounding.

Revenue, net

Revenue, net decreased $4,507, or 3%, in 2005 compared to 2004, and increased $35,290, or 25%, in 2004 compared to 2003. The decrease in 2005 from 2004 is attributable to a decrease in average selling prices of 10%, partially offset by an increase in units sold of 9%. Additionally, we experienced a reduction in revenue from the multimedia projector market as a result of a shift in the projection display technology from high temperature polysilicon displays to digital light processing (DLP) displays for end user products. DLP display based products grew in market share compared to high temperature polysilicon based products in 2005 and DLP products do not incorporate our technology. The loss of revenue from the multimedia projector market was partially offset by growth in the advanced television market and our entry into digital streaming media devices market. The increase in 2004 from 2003 resulted from an increase in units sold of 38%, partially offset by a decrease in average selling prices of 9%. Average selling prices for our products decline over relatively short periods of time due to aggressive pricing competition, and we expect to continue to experience downward pressure on our selling prices in future periods.

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

	Year Ended December 31,		
	2005	2004	2003
Advanced television	52%	43%	27%
Multimedia projector	31%	45%	53%
Digital streaming media devices	8%	0%	0%
LCD monitor	7%	10%	18%
Other	2%	2%	2%

Advanced Television

Revenue in the advanced television market has increased as a percent of total revenue from 2003 through 2005. The increase is primarily attributable to growth in overall consumer demand for increasingly feature-rich LCD televisions, progressive scan televisions, plasma displays and digital rear projection televisions. Units sold to the advanced television market increased 28% from 2004 to 2005, and 121% from 2003 to 2004. These increases included increases in units sold to LCD television, advanced CRT television, and plasma display panel manufacturers.

Multimedia Projector

Multimedia projector revenue as a percent of total revenue decreased in part due to the increase in advanced television revenue. The 2005 decrease in multimedia projector revenue is also attributable to market share lost in the DLP sector of the market. In 2004, total multimedia projector revenue increased as a result of market growth driven by the introduction of "sub-$1,000" projectors. Units sold to the multimedia projector market decreased 16% from 2004 to 2005, but increased 25% from 2003 to 2004.

Digital Streaming Media Devices

Revenue in the digital streaming media devices market resulted from our acquisition of Equator in June 2005. This market includes videoconferencing, set-top box, and other miscellaneous applications, which include broadcasting, coding and imaging.

LCD Monitor

Revenue in the LCD monitor market has decreased as a percent of revenue from 2003 to 2005. This is primarily attributable to our decision to focus on higher end products and discontinued development of mainstream products for this market, rather than any particular industry dynamics. We expect LCD monitor revenue to continue to decrease as we pursue opportunities in the LCD panel market.

Other

During the fourth quarter of 2005, we had nominal LCD panel revenue. In the future, we expect revenue from this developing market to grow as we are able to secure design wins. Revenue from sources other than those identified above is not expected to be significant in the near future.

Cost of sales and gross profit

Cost of sales includes purchased materials, assembly, test, labor and overhead, warranty expense, royalties, provisions for slow moving and obsolete inventory, amortization of the fair value adjustment on acquired inventory, amortization of acquired developed technology, amortization of acquired backlog, and stock-based compensation. Gross profit decreased to 36.7% in 2005 from 48.4% in 2004, and increased in 2004 from 44.2% in 2003.

The decrease in gross profit in 2005 compared to 2004 is partially due to an increase in acquisition-related amortization in 2005. In 2005, amortization of the inventory fair value adjustment, amortization of acquired developed technology, and amortization of acquired backlog was $10,332, or 6% of revenue. In 2004, amortization of developed technology was $529, or 0.3% of revenue, and there was no amortization of inventory fair value adjustment or amortization of acquired backlog. Future amortization expense of acquired developed technology will be approximately $7,889, $7,889, $7,889, $7,404 and $3,373 for the years ending December 31, 2006, 2007, 2008, 2009 and 2010.

In addition to the acquisition-related amortization, our gross profit decreased in 2005 from 2004 as a result of average selling prices in the multimedia projector market and advanced television market declining at a more rapid rate than average product costs, and to higher warranty and royalty costs.

The increase in gross profit in 2004 compared to 2003 resulted from higher material margin in the advanced television, multimedia projector and LCD monitor markets. The increases in material margin resulted from a decrease in our average material costs and a shift in the mix of products sold. The most significant margin improvement came in our LCD monitor market, where we focused on higher margin business.

Declines in gross profit margin are characteristic of our industry and the markets we serve, and we expect declines to occur again in the future, however we cannot predict when or how severe they will be. As a result, we actively seek ways to reduce the cost to manufacture our products and introduce new products with higher margins.

Research and development

Research and development expense includes compensation and related costs for personnel, depreciation and amortization, fees for outside services, expensed equipment, and allocations for facilities and information technology expenses.

Research and development expense increased $18,845, or 57.2%, to $51,814 in 2005 from $32,969 in 2004. This increase is primarily due to the following:

- Compensation expense increased $6,850, due to an increase in headcount in research and development cost centers to 254 at December 31, 2005 from 164 at December 31, 2004. This increase includes 49 in our Shanghai design center, and 41 that resulted from our acquisition of Equator. These increases were partially offset by a decrease in Tualatin headcount, which was primarily attributable to the restructuring we initiated in October of 2005.
- Development related expenses, including non-recurring engineering and outside services, increased $4,415.
- Depreciation and amortization expense increased $3,875, primarily due to increased licensed technology and software asset purchases.

- Facilities and information technology expenses allocated to research and development increased $3,293. The increase in facilities and information technology expenses was driven by increases in headcount in information technology departments, increases in rent expense, which were in part attributable to the addition of Equator, increases in depreciation and amortization expense, increases in expensed equipment and software, and increases in telephone and other communications charges.
- Stock-based compensation increased $536 due to the assumption of Equator outstanding stock options.

Research and development expense increased $3,389, or 11.5%, to $32,969 in 2004 from $29,580 in 2003. This increase is primarily due to the following:

- Depreciation and amortization expense increased $1,642 due to higher licensed technology and software purchases in 2004.
- Non-recurring engineering and outside services expenses increased $1,233.
- Compensation expense increased $409 due to an increase in headcount in research and development cost centers to 164 at December 31, 2004 from 121 at December 31, 2003.
- Travel-related expenses increased $387.
- Facilities and information technology expenses allocated to research and development increased $310. The increase in facilities and information technology expenses was driven primarily by increases in headcount in information technology departments and increased telephone and other communications charges.
- Loss on asset disposals increased $303 due to write offs of licensed technology, software and tooling in 2004.
- Expensed equipment and software increased $183.
- Stock-based compensation expense decreased $1,146, which is primarily attributable to our use of the accelerated method of expense recognition, under which more expense is recognized in earlier periods.

We expect to make significant investments in research and development in support of our new product development programs.

Selling, general and administrative

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

Selling, general and administrative expense increased $6,880, or 29.0%, to $30,616 in 2005 from $23,736 in 2004. This increase is primarily due to the following:

- Compensation expense increased $3,963, due to an increase in headcount in selling, general and administrative cost centers to 172 at December 31, 2005 from 153 as of December 31, 2004. This increase includes 10 that resulted from our acquisition of Equator.
- Facilities and information technology expenses allocated to selling, general and administrative increased $1,562. The increase in facilities and information technology expenses was driven by increases in headcount in information technology departments, increases in rent expense, which were in part attributable to the addition of Equator, increases in depreciation and amortization expense, increases in expensed equipment and software, and increases in telephone and other communications charges.

- Sales commission expense increased $908, primarily due to our acquisition of Equator.
- Travel-related expenses increased $727.

Selling, general and administrative expense increased $2,939, or 14.1%, to $23,736 in 2004 compared to $20,797 in 2003. This increase is primarily due to the following:

- Compensation expense increased $1,610 due to an increase in sales and marketing and administrative personnel to 153 as of December 31, 2004 from 96 as of December 31, 2003.
- Outside services increased $783 and includes accounting and legal fees related to patent applications, restructuring corporate subsidiaries in China, and consulting fees related to Sarbanes-Oxley compliance.
- Travel-related expenses increased $393, primarily due to the increase in headcount and an increase in customer visits.
- Sales commission expense increased $299 due to higher revenue.
- Expensed equipment increased $171.
- Depreciation and amortization expense increased $262, due to increased purchases of property and equipment.
- Recruiting expenses increased $161, which is related to the increase in headcount.
- Investor relations expense increased $123.
- Stock-based compensation expense decreased $1,545, which is attributable to our use of the accelerated method of expense recognition.

We expect to make significant investments in our selling, general and administrative infrastructure to support the global expansion and scalability of our business systems and increased sales-related costs.

Restructuring

In October 2005, we initiated a restructuring plan to improve the effectiveness and timeliness of our product development efforts in order to reduce our overall development costs. The restructuring resulted in a reduction-in-force of 36 employees during the fourth quarter of 2005. These employees were given severance benefits, which were expensed and paid in the fourth quarter of 2005. The total amount of these benefits was approximately $1,162. As of December 31, 2005, we had a nominal amount accrued related to this restructuring, which was paid in January 2006.

In September 2003, we initiated a restructuring to better position the Company to compete in the advanced television market. The restructuring included the discontinuation of all research and development efforts related to two products. As a result of these actions, we determined that certain tangible and intangible assets related to the discontinued development efforts were permanently impaired. The net book value of the impaired assets totaled $3,927 at the discontinuation date, and this amount was recognized as a restructuring expense in the third quarter of 2003. In addition, we implemented a reduction-in-force in the fourth quarter of 2003. The terminated employees were granted termination benefits. The total amount of these benefits was approximately $916 and was expensed in the fourth quarter of 2003. We also subleased approximately 4,000 square feet of our California office as a result of the restructuring. We included the present value of the difference between the future minimum lease payments and the non-cancelable sublease rentals in restructuring expense during the fourth quarter of 2003. This amount totaled $188. We did not incur any amounts related to this restructuring in 2004 or 2005. We did not have any material amounts accrued related to this restructuring at December 31, 2004.

Amortization of acquired intangible assets

We recorded customer relationships and trademark assets in connection with the acquisition of Equator in June 2005, and an assembled workforce asset as a result of the Jaldi asset acquisition in September 2002. These acquired intangible assets are amortized on a straight line basis over the following useful lives: customer relationships, 3 years; trademark, 1 year; and assembled workforce, 3 years. At December 31, 2005, the assembled workforce asset is fully amortized. Future amortization expense of the customer relationships and trademark assets will be approximately $1,225, $1,133 and $519 in the years ending December 31, 2006, 2007 and 2008, respectively.

Merger-related expenses

Merger-related expenses totaling $8,949 in 2003, represent costs related to our proposed merger with Genesis Microchip. The proposed merger was terminated August 5, 2003, and in the termination agreement, we agreed to pay a $5,500 termination fee to Genesis Microchip. The fee was payable immediately and was expensed in the third quarter of 2003. Additional merger-related expenses incurred consisted primarily of legal fees.

Interest and other income, net

Interest and other income, net consists of the following:

	Year Ended December 31,		
	2005	2004	2003
Interest income	$ 5,658	$ 3,823	$ 1,188
Interest expense	(2,637)	(1,609)	(11)
Realized loss on sale of marketable securities	(779)	—	—
Amortization of debt issuance costs	(710)	(472)	—
	$ 1,532	$ 1,742	$ 1,177

Interest income includes interest earned on cash equivalents and short- and long-term marketable securities. Interest income increased $1,835, or 48.0%, from 2004 to 2005 and increased $2,635, or 222%, from 2003 to 2004. The increase in interest income from 2003 to 2005 is attributable to the investment of the proceeds from the issuance of our 1.75% convertible subordinated debentures, which were issued in May and June 2004.

Interest expense consists of interest payable on the debentures. Interest expense increased $1,028 from 2004 to 2005 and $1,598 from 2003 to 2004. The increase in interest expense from 2003 to 2005 is due to the issuance of the debentures in May and June 2004.

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

Debt issuance costs related to the debentures have been capitalized and are included in long-term assets in our consolidated balance sheets. The debt issuance costs are being amortized over seven years.

Provision for (recovery of) income taxes

We recorded income tax expense of $22,422 for the year ended December 31, 2005 despite the recognition of a pre-tax book loss. This was attributable primarily to the fourth quarter addition of approximately $31,900 of valuation allowance against essentially all net deferred tax assets and contingent amounts relating to permanent establishment in foreign jurisdictions. The tax detriment of these items was partially offset by federal, state and foreign tax credits and tax-exempt interest generated during the year, and a refund relating to Jaldi's foreign research and experimentation credits. SFAS 109 requires that a valuation allowance be recorded when it is more likely than not that some portion of the deferred tax assets will not be realized. We considered future taxable income by jurisdiction, the scheduled reversal of deferred tax liabilities and tax planning strategies when making this assessment. As of December 31, 2005, we have approximately $72,540 of valuation allowance recorded on the consolidated balance sheet. Should the valuation allowance be released in future periods, approximately $31,298 will be recognized as a reduction of goodwill.

We recorded income tax expense of $7,990 for the year ended December 31, 2004. Tax expense was lower than the expected expense based on the statutory rates due to several permanent differences, primarily relating to federal and state research and experimentation tax credits. The tax benefit of these items is partially offset by an increase in the federal tax rate from 34% to 35%, along with contingent amounts established for penalties and interest associated with additional tax potentially due in foreign jurisdictions.

We recorded an income tax benefit of $907 for the year ended December 31, 2003. The tax benefit exceeded the expected benefit based on the statutory rates due to several permanent differences including, but not limited to, federal and state research and experimentation tax credits, stock-based compensation expense and amortization of acquired developed technology. The tax benefit of these items is partially offset by an increase in the valuation allowance against net operating loss carryforwards at Jaldi, due to the implementation of a research and development contract between Pixelworks and the subsidiary.

As of December 31, 2005, we have generated deductible temporary differences along with net operating loss and tax credit carryforwards. We have approximately $146,320, $77,910 and $6,432 of net operating loss carryforwards to offset future taxable income and approximately $13,550, $5,824 and $2,754 of tax credit carryforwards to offset future tax for federal, state and foreign purposes, respectively. The carryforwards begin expiring in 2006 if not used. Utilization of a portion of the net operating loss and credit carryforwards is subject to an annual limitation due to the ownership change provisions of the Internal Revenue Code of 1986 and similar state provisions.

Liquidity and Capital Resources

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

At December 31, 2005 we had cash and cash equivalents of $68,604, short- and long-term marketable securities of $77,033 and working capital of $139,291. Cash provided by operating activities during the year ended December 31, 2005 was $534 compared to $27,685 and $11,029 for the years ended December 31, 2004 and 2003, respectively.

Cash provided by investing activities during the year ended December 31, 2005 was $33,506. This compares to cash used in investing activities of $161,745 and $15,053 during the years ended December 31, 2004 and 2003, respectively. Cash provided by investing activities during 2005 consists primarily of cash received from the sales and maturities of marketable securities, offset by cash used to purchase marketable securities, cash used to acquire Equator, cash used for payments on accrued liabilities related to equipment and other asset acquisitions, and cash used to purchase equipment and other assets. Cash used in investing activities during 2004 and 2003 consists primarily of cash used to purchase marketable securities, cash used to purchase property and equipment and other assets and investments, and cash used for payments on accrued liabilities related to equipment and other asset purchases, offset by proceeds from maturities of marketable securities.

Cash provided by financing activities was $1,979 during the year ended December 31, 2005. This compares to cash provided by financing activities of $150,155 and $2,937 during the years ended December 31, 2004 and 2003, respectively. Cash provided by financing activities for 2005, 2004, and 2003, consists primarily of proceeds received from the issuance of common stock from the exercise of stock options and purchases of common stock through our employee stock purchase plan. Additionally, cash provided by financing activities during 2004 included net proceeds of $145,500 from the issuance of long-term debt (see capital resources below).

We anticipate that our existing cash and investment balances will be adequate to fund our operating and investing needs for the next twelve months and the foreseeable future. From time to time, we may evaluate acquisitions of businesses, products or technologies that compliment our business. Any such transactions, if consummated, may consume a material portion of our working capital or require the issuance of equity securities that may result in dilution to existing shareholders.

Accounts receivable, net

Accounts receivable, net increased to $19,927 at December 31, 2005 from $14,605 at December 31, 2004. The increase in accounts receivable is primarily due to the acquisition of Equator which contributed $2,066 to the consolidated accounts receivable balance as of December 31, 2005. The increase is also due to higher revenue during the fourth quarter of 2005 compared to the fourth quarter of 2004. Average days sales outstanding increased to 41 days at December 31, 2005 compared to 34 days at December 31, 2004.

Inventories, net

Inventories, net increased to $26,577 at December 31, 2005 from $18,575 at December 31, 2004. The increase in inventory is primarily due to the acquisition of Equator which contributed $6,917 to the net consolidated inventory balance as of December 31, 2005. Inventory turnover on an annualized basis was 4 as of December 31, 2005 and 2004. As of December 31, 2005, this represents approximately thirteen weeks of inventory on hand.

Capital resources

On May 18, 2004, we issued $125,000 of convertible subordinated debentures ("the debentures") due 2024 in a private offering pursuant to Rule 144A under the Securities Act of 1933 ("Securities Act") and outside of the United States in accordance with Regulation S under the Securities Act. On June 4, 2004, we issued an additional $25,000 of debentures pursuant to the exercise of an option granted to the initial purchasers. We intend to use the net proceeds from this offering for general corporate purposes, including potential acquisitions. The debentures have been registered with the SEC for resale under the Securities Act.

The debentures bear interest at a rate of 1.75% per annum and interest is payable on May 15 and November 15 of each year. The debentures are convertible, under certain circumstances, into our common stock at a conversion rate of 41.0627 shares of common stock per $1 principal amount of debentures for a total of 6,159,405 shares. This is equivalent to a conversion price of approximately $24.35 per share. We may redeem some or all of the debentures for cash on or after May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest. The holders of the debentures have the right to require us to purchase all or a portion of their debentures on

May 15, 2011, May 15, 2014 and May 15, 2019 at a price equal to 100% of the principal amount plus accrued and unpaid interest. In addition, we are not precluded from repurchasing outstanding debentures in the open market.

In February 2006, we repurchased $10,000 of our outstanding debentures in cash in the open market, resulting in a gain of approximately $3,000, which will be recorded as other income in the first quarter of 2006.

Contractual Payment Obligations

A summary of our contractual commitments and obligations as of December 31, 2005 is as follows:

	Payments Due By Period				
Contractual Obligation	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-term debt	$150,000	$ —	$ —	$ —	$150,000
Interest on long-term debt	14,109	2,625	5,250	5,250	984
Payments on accrued balances related to asset purchases	24,652	11,940	12,712	—	—
Estimated Q1 2006 purchase commitments to contract manufacturers	18,860	18,860	—	—	—
Operating leases	15,367	4,472	5,972	2,482	2,441

The lease payments above are net of sublease rentals of $40 for the year ending December 31, 2006.

Off-Balance Sheet Arrangements

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

Recent Accounting Pronouncements

In May 2005, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. ("SFAS") 154, *Accounting Changes and Error Corrections-a replacement of APB Opinion No. 20 and FASB Statement No. 3* ("SFAS 154"). SFAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, SFAS 154 requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable, and that a corresponding adjustment be made to the opening balance of retained earnings (or other appropriate components of equity in the statement of financial position) for that period, rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, SFAS 154 requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We will adopt SFAS 154 on January 1, 2006. We do not expect the adoption of SFAS 154 to have a material impact on our consolidated financial statements.

In December 2004, the FASB issued SFAS 123 (Revised), *Share Based Payment* (“SFAS 123R”). SFAS 123R replaced SFAS 123 and no longer allows public companies to apply the intrinsic value based method of accounting for stock compensation described in Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees.* Under SFAS 123R, public entities must measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The cost must be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). SFAS 123R also requires the recognition of compensation expense for the fair value of any unvested stock option awards outstanding at the date of adoption over the remaining vesting period. We will adopt SFAS 123R on January 1, 2006. We believe stock-based compensation will be $2,700 to $3,300 for the first quarter of 2006. We expect the adoption of 123R to have an adverse effect on our consolidated statements of operations and earnings per share in all future periods.

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

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

As of December 31, 2005, we had convertible subordinated debentures of $150 million outstanding with a fixed interest rate of 1.75%. Interest rate changes affect that fair value of these notes, but do not affect our earnings or cash flow. In February 2006, we purchased $10 million of our 1.75% convertible debentures for $6.8 million in cash in the open market.

All of our sales are denominated in U.S. dollars and as a result, we have relatively little exposure to foreign currency exchange risk with respect to our sales. We have employees located in offices in Canada, Japan, Taiwan and the People’s Republic of China and as such, a portion of our operating expenses are denominated in foreign currencies. Accordingly, our operating results are affected by changes in the exchange rate between the U.S. dollar and those currencies. Any future strengthening of those currencies against the U.S. dollar could negatively impact our operating results by increasing our operating expenses as measured in U.S. dollars. While we cannot reasonably estimate the effect that an immediate 10% change in foreign currency exchange rates would have on our operating results or cash flows, we believe that the effect would not be material. We do not currently hedge against foreign currency rate fluctuations.

Item 8. Financial Statements and Supplementary Data.

The financial statements and reports included in Item 8 are as follows:

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Pixelworks, Inc.:

We have audited the accompanying consolidated balance sheets of Pixelworks, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity and comprehensive income (loss) and cash flows for each of the years in the three-year period ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Pixelworks, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Pixelworks, Inc.'s internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*, and our report dated March 13, 2006 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP

Portland, Oregon
March 13, 2006

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

	December 31, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 68,604	$ 32,585
Short-term marketable securities	59,888	160,213
Accounts receivable, net	19,927	14,605
Inventories, net	26,577	18,575
Prepaid expenses and other current assets	7,277	4,856
Total current assets	182,273	230,834
Long-term marketable securities	17,145	79,483
Property and equipment, net	29,029	12,444
Other assets, net	18,277	12,969
Debt issuance costs, net	3,780	4,483
Acquired intangible assets, net	37,321	2,520
Goodwill	133,731	80,836
Total assets	$ 421,556	$423,569
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 7,206	$ 5,946
Accrued liabilities and current portion of long-term liabilities	26,269	12,842
Income taxes payable	9,507	2,393
Total current liabilities	42,982	21,181
Long-term liabilities, net of current portion	13,357	365
Long-term debt	150,000	150,000
Total liabilities	206,339	171,546
Commitments and contingencies		
Shareholders' Equity:		
Preferred stock, $.001 par value; 50,000,000 shares authorized, 1 share issued and outstanding at December 31, 2005 and 2004	—	—
Common stock, $.001 par value; 250,000,000 shares authorized, 47,168,311 and 46,287,752 shares issued and outstanding at December 31, 2005 and 2004, respectively	316,257	304,996
Shares exchangeable into common stock; 1,731,099 shares issued, 574,467 and 649,453 outstanding at December 31, 2005 and 2004, respectively	5,434	6,144
Accumulated other comprehensive income (loss)	(3,503)	531
Deferred stock-based compensation	(773)	(60)
Accumulated deficit	(102,198)	(59,588)
Total shareholders' equity	215,217	252,023
Total liabilities and shareholders' equity	$ 421,556	$423,569

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31, 2005	2004	2003
Revenue, net	$171,704	$176,211	$140,921
Cost of revenue (1)	108,748	90,991	78,674
Gross profit	62,956	85,220	62,247
Operating expenses:			
Research and development (2)	51,814	32,969	29,580
Selling, general and administrative (3)	30,616	23,736	20,797
Restructuring	1,162	—	5,049
Amortization of acquired intangible assets	1,084	486	486
Merger-related expenses	—	—	8,949
Total operating expenses	84,676	57,191	64,861
Income (loss) from operations	(21,720)	28,029	(2,614)
Interest income	5,658	3,823	1,188
Interest expense	(2,637)	(1,609)	(11)
Realized loss on sale of marketable securities	(779)	—	—
Amortization of debt issuance costs	(710)	(472)	—
Interest and other income, net	1,532	1,742	1,177
Income (loss) before income taxes	(20,188)	29,771	(1,437)
Provision for (recovery of) income taxes	22,422	7,990	(907)
Net income (loss)	$ (42,610)	$ 21,781	$ (530)
Net income (loss) per share:			
Basic	$ (0.90)	$ 0.47	$ (0.01)
Diluted	$ (0.90)	$ 0.45	$ (0.01)
Weighted average shares outstanding:			
Basic	47,337	46,673	45,337
Diluted	47,337	52,062	45,337

	2005	2004	2003
(1) Includes amortization of:			
Acquired inventory mark-up	$ 5,217	$ —	$ —
Acquired developed technology	4,515	529	529
Acquired backlog	600	—	—
Stock-based compensation	60	—	8
(2) Includes stock-based compensation of:	758	222	1,368
(3) Includes stock-based compensation of:	307	131	1,676

See accompanying notes to consolidated financial statements.

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

	Year Ended December 31, 2005	2004	2003
Cash flows from operating activities:			
Net income (loss)	$ (42,610)	$ 21,781	$ (530)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Deferred income tax expense (benefit)	13,636	(1,101)	(1,168)
Depreciation and amortization	13,469	8,160	6,119
Amortization of acquired intangible assets	6,199	1,015	1,015
Income tax benefit from stock options	1,421	4,485	—
Stock-based compensation	1,125	353	3,082
Realized loss on sale of marketable securities	779	—	—
Amortization of debt issuance costs	710	472	—
Deferred rent	250	95	—
Loss on asset disposals	180	381	3,927
Lease incentives	95	124	—
Amortization of deferred tax charge	55	55	55
Lease costs related to restructuring	—	—	188
Changes in operating assets and liabilities, net of effects of acquisition:			
Accounts receivable, net	(858)	(6,137)	1,953
Inventories, net	2,806	(8,097)	(3,690)
Prepaid expenses and other current and long-term assets	(2,340)	(43)	(548)
Accounts payable	(554)	1,677	(754)
Accrued current and long-term liabilities	(943)	2,072	1,495
Income taxes payable	7,114	2,393	(115)
Net cash provided by operating activities	534	27,685	11,029
Cash flows from investing activities:			
Proceeds from sales and maturities of available-for-sale marketable securities	263,375	—	—
Proceeds from sales and maturities of held-to-maturity marketable securities	54,928	114,083	135,628
Purchases of available-for-sale marketable securities	(124,108)	—	—
Purchases of held-to-maturities marketable securities	(36,345)	(259,042)	(135,844)
Acquisition of Equator Technologies, Inc., net of cash acquired	(104,736)	—	—
Payments on equipment and other asset financing	(9,825)	(5,106)	(199)
Purchases of property and equipment	(7,915)	(8,471)	(4,385)
Purchases of other assets and investments	(1,929)	(3,221)	(10,253)
Proceeds from sale of assets	61	12	—
Net cash provided by (used in) investing activities	33,506	(161,745)	(15,053)
Cash flows from financing activities:			
Proceeds from issuance of long-term debt	—	145,500	—
Proceeds from issuances of common stock	1,986	5,110	2,937
Debt issuance costs	(7)	(455)	—
Net cash provided by financing activities	1,979	150,155	2,937
Net increase (decrease) in cash and cash equivalents	36,019	16,095	(1,087)
Cash and cash equivalents, beginning of year	32,585	16,490	17,577
Cash and cash equivalents, end of year	$ 68,604	$ 32,585	$ 16,490
Supplemental disclosure of cash flow information:			
Cash paid during the year for:			
Interest	$ 2,638	$ 1,293	$ 11
Income taxes	1,691	530	920
Supplemental disclosure of non-cash investing and financing activities:			
Acquisitions of property and equipment and other assets under extended payment terms	$ 28,820	$ 8,450	$ —
Value of options assumed in the acquisition of Equator Technologies, Inc.	8,336	—	—
Transfer of cost-based investment to available-for-sale marketable security	—	10,000	—
Debt issuance costs withheld from proceeds	—	4,500	—
Release and cancellation of shares held in escrow	—	541	—

See accompanying notes to consolidated financial statements.

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

	Common Stock		Exchangeable Shares		Accumulated Other Comprehensive Income (Loss)	Comprehensive Income (Loss)	Deferred Stock-based Compensation	Accumulated Deficit	Total Shareholders' Equity
	Shares	Amount	Shares	Amount					
Balance at December 31, 2002	43,967,585	$287,566	1,108,969	$10,491	$ —		$ (2,402)	$ (80,839)	$ 214,816
Stock issued under stock option and stock purchase plans	870,969	2,937	—	—	—		—	—	2,937
Stock-based compensation expense due to option modifications and grant to non-employee	—	1,903	—	—	—		—	—	1,903
Reversal of deferred stock-based compensation due to terminations	—	(774)	—	—	—		774	—	—
Amortization of deferred stock-based compensation	—	—	—	—	—		1,179	—	1,179
Conversion of exchangeable shares to common stock	275,108	2,603	(275,108)	(2,603)	—		—	—	—
Net loss	—	—	—	—	—		—	(530)	(530)
Balance at December 31, 2003	45,113,662	294,235	833,861	7,888	—		(449)	(81,369)	220,305
Stock issued under stock option and stock purchase plans and tax benefits associated therewith	1,021,761	9,595	—	—	—		—	—	9,595
Stock-based compensation expense due to option modification	—	65	—	—	—		—	—	65
Reversal of deferred stock-based compensation due to terminations	—	(101)	—	—	—		101	—	—
Amortization of deferred stock-based compensation	—	—	—	—	—		288	—	288
Conversion of exchangeable shares to common stock	184,205	1,743	(184,205)	(1,743)	—		—	—	—
Reversal of exchangeable shares due to termination	—	—	(203)	(1)	—		—	—	(1)
Release and cancellation of shares held in escrow	(31,876)	(541)	—	—	—		—	—	(541)
Net income	—	—	—	—	—	$ 21,781	—	21,781	21,781

Unrealized gain on available-for-sale securities, net of tax of $239	—	—	—	—	531	531	—	—	531
Comprehensive income						$ 22,312			
Balance at December 31, 2004	46,287,752	304,996	649,453	6,144	531		(60)	(59,588)	252,023
Stock issued under stock option and stock purchase plans and tax benefits associated therewith	805,573	2,595	—	—	—		—	—	2,595
Fair value of options assumed in Equator Technologies, Inc. acquisition and deferred stock-based compensation associated therewith	—	8,336	—	—	—		(2,218)	—	6,118
Reversal of deferred stock-based compensation due to terminations	—	(380)	—	—	—		380	—	—
Amortization of deferred stock-based compensation	—	—	—	—	—		1,125	—	1,125
Conversion of exchangeable shares to common stock	74,986	710	(74,986)	(710)	—		—	—	—
Net loss	—	—	—	—	—	$ (42,610)	—	(42,610)	(42,610)
Unrealized loss on available-for-sale securities, net of tax of $0	—	—	—	—	(4,034)	(4,034)	—	—	(4,034)
Comprehensive loss						$ (46,644)			
Balance at December 31, 2005	47,168,311	$316,257	574,467	$ 5,434	$ (3,503)		$ (773)	$ (102,198)	$ 215,217

See accompanying notes to consolidated financial statements.

PIXELWORKS, INC.

Notes to Consolidated Financial Statements

(In thousands, except share and per share data)

NOTE 1. BASIS OF PRESENTATION

Nature of Business

Pixelworks, Inc. ("Pixelworks" or the "Company") is a leading designer, developer and marketer of semiconductors and software for the advanced display industry, including advanced televisions, multimedia projectors, digital streaming media devices and liquid crystal display panels. Our system-on-chip and discrete semiconductors provide the 'intelligence' for these new types of displays and devices by processing and optimizing video and computer graphic signals to produce high-quality images.

Consolidated Financial Statements

Our consolidated financial statements include the accounts of Pixelworks and its wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated. All foreign subsidiaries use the US dollar as the functional currency, and as a result, transaction gains and losses are included in the statement of operations. Transaction gains (losses) were $258, $77 and ($153) for the years ended December 31, 2005, 2004 and 2003, respectively.

Use of Estimates

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

Reclassifications

Certain reclassifications have been made to the 2004 and 2003 financial statements to conform to the 2005 presentation, including the reclassification of stock-based compensation to research and development expense and selling, general and administrative expense and the reclassification of tooling depreciation from research and development expense to cost of revenue. The reclassification of tooling depreciation to cost of revenue decreased gross profit by $1,336 and $1,146 for the years ended December 31, 2004 and 2003, respectively, from previously reported amounts. Additionally, facilities and information technology expenses have been allocated between cost of revenue, research and development expense and selling, general and administrative expense based on employee headcount.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

We consider all highly liquid investments with original maturities of three months or less at the date of purchase to be cash equivalents. Cash equivalents totaled $62,221 and $29,867 at December 31, 2005 and 2004, respectively.

Marketable Securities

Our investments in marketable securities are classified as trading, held-to-maturity or available-for-sale in accordance with Statement of Financial Accounting Standards No. (“SFAS”) 115, *Accounting for Certain Investments in Debt and Equity Securities* (“SFAS 115”). Available-for-sale securities are stated at fair value based on quoted market prices with unrealized holding gains or losses, net of tax, recorded in accumulated other comprehensive income, a component of shareholders’ equity. Held-to-maturity securities are stated at amortized cost. Short-term marketable debt securities have remaining maturities of twelve months or less at December 31, 2005 and 2004, and long-term marketable debt securities have remaining maturities of greater than twelve months.

We periodically evaluate whether declines in fair values of our investments below their cost are other-than-temporary. This evaluation consists of qualitative and quantitative factors regarding the severity and duration of the unrealized loss, as well as our ability and intent to hold the investment until a forecasted recovery occurs.

The cost of securities sold is based on the specific identification method.

Accounts Receivable

Accounts receivable are recorded at invoiced amount and do not bear interest when recorded or accrue interest when past due. We do not have any off balance sheet exposure risk related to customers.

We maintain an allowance for doubtful accounts for estimated losses that may result from the inability of our customers to make required payments. The balance is determined based on our historical write-off experience and the age of outstanding receivables at each reporting date. The determination to write off specific accounts receivable balances is made based on likelihood of collection and past due status. Past due status is based on invoice date and terms specific to each customer.

Inventories

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

Property and Equipment

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

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

Reviews for impairment of property and equipment are performed whenever events or circumstances indicate that the carrying amount of assets may not be recoverable, or that the useful life of assets is shorter than originally estimated. Impairment is assessed in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-lived Assets* (“SFAS 144”), by comparing the projected undiscounted net cash flows associated with the assets over their remaining useful lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of the assets.

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

Acquired Intangible Assets

At December 31, 2005, acquired intangible assets consist of developed technology, customer relationships and trademark assets. At December 31, 2004, acquired intangible assets consisted of developed technology and assembled workforce assets. Intangible assets are amortized on a straight-line basis over their estimated useful lives as follows:

Developed technology	5-7 years
Customer relationships	3 years
Trademark	1 year
Assembled workforce	3 years

Intangible assets are reviewed regularly to determine whether events or circumstances indicate that the carrying amount of the assets may not be recoverable, or that the useful life of an asset is shorter than originally estimated. If such events or circumstances did exist, the assets would be assessed for recoverability in accordance with SFAS 144. To date, we have not recognized any impairment charges against acquired intangible assets.

Licensed Technology

We have capitalized licensed technology assets in other long-term assets. These assets are stated at cost and are amortized on a straight-line basis over the term of the license or the estimated life of the asset, if the license is not contractually limited, which is generally three to five years. These assets are assessed for impairment in accordance with SFAS 144 whenever events or circumstances indicate that their carrying amount may not be recoverable, or that their useful lives may be shorter than originally estimated.

Goodwill

Goodwill represents the excess cost over the fair value of net assets acquired in business combinations. Goodwill is not amortized and is instead tested annually for impairment and more frequently if events and circumstances indicate that it may be impaired. The impairment tests are performed in accordance with SFAS 142, *Goodwill and Other Intangible Assets.* Accordingly, an impairment loss is recognized to the extent that the carrying amount of goodwill exceeds its implied fair value. This determination is made at the reporting unit level. We have assigned all goodwill to a single, enterprise-level reporting unit. The impairment test consists of two steps. First, we determine the fair value of the reporting unit. The fair value is then compared to its carrying amount. Second, if the carrying amount of the reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation in accordance with SFAS 141, *Business Combinations*. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. We perform our annual goodwill impairment test in the first quarter of each year. We did not record any goodwill impairment charges in 2005, 2004 or 2003. We performed our 2006 annual impairment test on January 1, 2006 and determined no impairment existed. Due to the fact that the market value of our reporting unit is approaching book value, it is at least reasonably possible that we will have an impairment in the near term and, therefore, we may be required to perform the impairment test at additional times during the year.

Revenue Recognition

We recognize revenue in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition*. Accordingly, we recognize revenue from product sales to customers and distributors upon shipment provided that:

- an authorized purchase order has been received;
- title and risk of loss have transferred;
- the sales price is fixed or determinable; and
- collectibility of the receivable is reasonably assured.

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

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

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

Warranty Program

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

Stock-Based Compensation

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

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

Deferred stock-based compensation is being amortized on an accelerated basis over the vesting period, generally four years, consistent with the methodology described in FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. Amortization of deferred stock-based compensation was $1,125, $288, and $1,179 for the years ended December 31, 2005, 2004 and 2003, respectively. If employees are terminated, any deferred stock-based compensation related to unvested stock options is reversed. Reversal of deferred stock-based compensation was $380, $101 and $774 for the years ended December 31, 2005, 2004 and 2003, respectively.

During the fourth quarter of 2003, we accelerated the vesting of outstanding stock option awards for employees whose employment was terminated as a result of our restructuring. (See note 9.) We recognized an additional $1,873 of stock-based compensation expense as a result of the modifications.

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

	Year Ended December 31,		
	2005	2004	2003
Net income (loss) as reported	$ (42,610)	$ 21,781	$ (530)
Add: Stock-based compensation included in reported net income (loss), net of related tax effects	1,125	258	1,862
Deduct: Stock-based compensation determined under the fair value based method, net of related tax effects	(14,913)	(11,750)	(10,659)
Pro-forma net income (loss)	$ (56,398)	$ 10,289	$ (9,327)
Reported net income (loss) per share:			
Basic	$ (0.90)	$ 0.47	$ (0.01)
Diluted	$ (0.90)	$ 0.45	$ (0.01)
Pro-forma net income (loss) per share:			
Basic	$ (1.19)	$ 0.22	$ (0.21)
Diluted	$ (1.19)	$ 0.21	$ (0.21)

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

	Year Ended December 31,		
	2005	2004	2003
Stock Option Plans:			
Risk free interest rate	3.95%	3.88%	2.90%
Expected dividend yield	0%	0%	0%
Expected life (in years)	4.7	6.1	5.5
Volatility	90%	100%	109%
Employee Stock Purchase Plan:			
Risk free interest rate	3.13%	1.87%	1.83%
Expected dividend yield	0%	0%	0%
Expected life (in years)	0.5	1.3	1.2
Volatility	68%	103%	104%

Under the Black-Scholes option pricing model the weighted average fair value of options granted during 2005, 2004 and 2003 was approximately $5.91, $11.32 and $6.16, respectively.

We account for equity instruments issued to non-employees in accordance with the provisions of SFAS 123 and Emerging Issues Task Force ("EITF") Issue No. 96-18, *Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services*. During 2003, we issued a stock option to purchase 2,500 shares of Pixelworks stock to a consultant in exchange for past services provided. The fair value of the award was calculated using the Black-Scholes option pricing model and was expensed on the date of grant. The total value of the award of $30 is included in selling, general and administrative expense for the year ended December 31, 2003. There were no other equity instruments issued to non-employees during the periods presented.

In December 2004, SFAS 123 (Revised), *Share Based Payment* ("SFAS 123R"), was issued. SFAS 123R replaced SFAS 123 and no longer allows public companies to apply the intrinsic value based method of accounting for stock compensation described in APB 25. Under SFAS 123R, public entities must measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award and recognize the cost over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). SFAS 123R also requires the recognition of compensation expense for the fair value of any unvested stock option awards outstanding at the date of adoption over the remaining vesting period. We will adopt SFAS 123R beginning January 1, 2006. We believe stock-based compensation will be $2,700 to $3,300 for the first quarter of 2006 and we expect the adoption of 123R to continue to have an adverse effect on our consolidated statements of operations and earnings per share in all future periods.

Research and Development

Amounts paid for research and development activities are charged to expense as incurred.

Income Taxes

We account for income taxes under the asset and liability method. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between financial statement carrying amounts and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years, in which, those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. We establish a valuation allowance in accordance with SFAS 109, *Accounting for Income Taxes* ("SFAS 109"), to reduce deferred tax assets to the amount expected "more likely than not" to be realized in future tax returns.

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

Accumulated Other Comprehensive Income

SFAS 130, *Reporting Comprehensive Income*, establishes standards for the reporting of comprehensive income and its components. Unrealized holding gain (loss), net of tax, related to our available-for-sale investments was ($4,034) and $531 for the years ended December 31, 2005 and 2004, and was the only component of accumulated other comprehensive income (loss). There were no components of comprehensive income (loss) for the year ended December 31, 2003.

Leases

We lease office space and office equipment. We classify our leases as operating or capital in accordance with the criteria of SFAS 13, *Accounting for Leases*. Certain of our operating leases for office space contain provisions under which monthly rent escalates over time, and certain operating leases for office space contain provisions under which, we are reimbursed for leasehold improvements. When leases contain escalating rent clauses, we straight-line rent expense over the term of the lease. When leases provide allowances for leasehold improvements, we capitalize the leasehold improvement assets and amortize them on a straight-line basis over the lesser of the lease term or the estimated useful life of the asset, and reduce rent expense on a straight-line basis over the term of the lease by the amount of the asset capitalized.

Fair Value of Financial Instruments

The fair value of our monetary assets and liabilities, including cash and cash equivalents, marketable securities, accounts receivable and accounts payable, approximates the carrying value due to the short-term nature of these instruments. The fair value of our long-term debt was $100,575 as of December 31, 2005, as compared to its carrying value of $150,000. The fair value of long-term debt was based on the quoted market price of the debt.

Risks and Uncertainties

Concentration of Suppliers

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

Risk of Technological Change

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

Concentrations of Credit Risk

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

NOTE 3. BALANCE SHEET COMPONENTS

Marketable Securities

At December 31, 2004, we classified all of our marketable securities as held-to-maturity, with the exception of auction rate securities and our investment in Semiconductor Manufacturing International Corporation ("SMIC"), a Chinese wafer foundry, which we classified as available-for-sale. On March 31, 2005, we determined that we no longer had the intent to hold any of our securities to maturity based on the potential for future acquisitions, and we reclassified all of our held-to-maturity securities to available-for-sale. The amortized cost of the securities transferred was $159,632 on the transfer date, and the unrealized loss on the securities transferred was $920 on the transfer date. At December 31, 2005, we classified all of our marketable securities as available-for-sale.

Short-term marketable securities consist of the following:

	Amortized Cost	Unrealized Loss	Fair Value
December 31, 2005			
Available-for-sale:			
Auction rate securities	$ 27,800	$ —	$ 27,800
US government agencies	14,814	(103)	14,711
Corporate debentures	4,171	(9)	4,162
Municipal bonds	4,301	(5)	4,296
Commercial paper	5,761	(7)	5,754
Foreign government bonds	3,188	(23)	3,165
	$ 60,035	$ (147)	$ 59,888

	Amortized Cost	Unrealized Loss	Fair Value
December 31, 2004			
Available-for-sale:			
Auction rate securities	$ 77,150	$ —	$ 77,150
Held-to-maturity:			
US government agencies	68,068	(15)	68,053
Municipal bonds	8,265	(21)	8,244
Commercial paper	5,493	(2)	5,491
Foreign government bonds	1,237	(10)	1,227
	$ 83,063	$ (48)	$ 83,015

Long-term marketable securities consist of the following:

	Amortized Cost	Unrealized Gain (Loss)	Fair Value
December 31, 2005			
Available-for-sale:			
Investment in SMIC	$ 10,000	$ (3,240)	$ 6,760
US government agencies	7,872	(69)	7,803
Municipal bonds	1,030	(4)	1,026
Foreign government bonds	990	(30)	960
Corporate debentures	609	(13)	596
	$ 20,501	$ (3,356)	$ 17,145
December 31, 2004			
Available-for-sale:			
Investment in SMIC	$ 10,000	$ 531	$ 10,531
Held-to-maturity:			
US government agencies	52,117	(61)	52,056
US treasury bonds	12,390	29	12,419
Foreign government bonds	2,484	(34)	2,450
Municipal bonds	1,340	(4)	1,336
Corporate debentures	621	2	623
	$ 68,952	$ (68)	$ 68,884

At December 31, 2005, we determined that gross unrealized losses on our marketable securities were temporary based on the duration of the unrealized losses.

During the year ended December 31, 2005, we had sales of marketable securities prior to maturity of $102,576, which is included in proceeds from the sales or maturities of available-for-sale marketable securities in the consolidated statement of cash flows. We did not have any sales of marketable securities prior to maturity during the years ended December 31, 2004 or 2003.

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Maturities of long-term marketable securities range from one to three years at December 31, 2005.

Accounts Receivable, Net

Accounts receivable, net consists of the following:

	December 31,	
	2005	2004
Accounts receivable, gross	$ 20,139	$ 14,817
Allowance for doubtful accounts	(212)	(212)
Accounts receivable, net	$ 19,927	$ 14,605

Bad debt expense was $0 for each of the years ended December 31, 2005, 2004 and 2003.

Inventories, Net

Inventories, net consists of the following:

	December 31,	
	2005	2004
Finished goods	$ 20,623	$ 11,648
Work-in-process	7,350	8,516
	27,973	20,164
Reserve for slow moving and obsolete items	(1,396)	(1,589)
Inventories, net	$ 26,577	$ 18,575

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

	Year Ended December 31,		
	2005	2004	2003
Balance at beginning of year	$ 1,589	$ 1,942	$ 1,377
Usage:			
Inventory scrapped	(730)	(521)	(318)
Inventory utilized	(795)	(735)	—
Subtotal usage	(1,525)	(1,256)	(318)
Provision	1,332	903	883
Balance at end of year	$ 1,396	$ 1,589	$ 1,942

Property and Equipment, Net

Property and equipment, net consists of the following:

	December 31, 2005	December 31, 2004
Software	$ 36,948	$ 16,385
Equipment, furniture and fixtures	15,924	11,681
Tooling	5,000	4,349
Leasehold improvements	2,674	1,778
	60,546	34,193
Accumulated depreciation and amortization	(31,517)	(21,749)
Property and equipment, net	$ 29,029	$ 12,444

Software amortization was $5,781, $3,160 and $2,136 for the years ended December 31, 2005, 2004 and 2003, respectively. Depreciation and amortization expense for equipment, furniture, fixtures, tooling and leasehold improvements was $4,687, $3,479 and $3,083 for the years ended December 31, 2005, 2004 and 2003.

Other Assets, Net

Other assets, net consists primarily of licensed technology as of December 31, 2005 and 2004.

Acquired Intangible Assets, Net

Acquired intangible assets, net consists of the following:

	December 31, 2005	December 31, 2004
Gross carrying amount:		
Developed technology	$ 40,500	$ 3,700
Customer relationships	3,400	—
Assembled workforce	1,577	1,577
Backlog and trademark	800	—
	46,277	5,277
Accumulated amortization:		
Developed technology	(6,057)	(1,543)
Customer relationships	(614)	—
Assembled workforce	(1,577)	(1,214)
Backlog and trademark	(708)	—
	(8,956)	(2,757)
Acquired intangible assets, net	$ 37,321	$ 2,520

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Amortization expense was $6,199, $1,015 and $1,015 for the years ended December 31, 2005, 2004, and 2003. Estimated future amortization expense is as follows:

Year ending December 31:

2006	$ 9,114
2007	9,022
2008	8,408
2009	7,404
2010	3,373
	$ 37,321

Goodwill

Goodwill increased during 2005 due to our acquisition of Equator Technologies, Inc. ("Equator"), offset by the release of valuation allowance established against deferred tax assets acquired from nDSP in 2002 and Panstera in 2001, and certain tax benefits related to stock options. Goodwill decreased during 2004 due to the release of valuation allowance established against deferred tax assets acquired from nDSP in 2002 and Panstera in 2001, and to the release and cancellation of shares held in escrow from the nDSP acquisition.

Accrued Liabilities and Current Portion of Long-Term Liabilities

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

	December 31,	
	2005	2004
Current portion of accrued liabilities for asset purchases	$ 11,940	$ 3,185
Accrued payroll and related liabilities	5,294	4,586
Accrued manufacturing liabilities	3,612	477
Accrued commissions and royalties	1,232	719
Reserve for warranty returns	577	419
Accrued interest payable	335	335
Reserve for sales returns and allowances	237	524
Other	3,042	2,597
	$ 26,269	$ 12,842

During 2005 and 2004, we acquired software and licensed technology assets under purchase agreements that provide extended payment terms. The payment periods vary, but generally extend over a period of one month to two years. We are obligated to make all payments accrued, and there are no contingencies attached to any of the agreements. At December 31, 2005 and 2004, the non-current portion of these obligations is $12,712 and $172, respectively, and is included in long-term liabilities, net of current portion, in the consolidated balance sheets. Future payments due under these obligations are as follows:

Year ending December 31:	
2006	$ 11,940
2007	7,337
2008	5,375
	$ 24,652

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

	Year Ended December 31,		
	2005	2004	2003
Balance at beginning of year	$ 524	$ 202	$ 588
Provision	52	977	1,654
Charge offs	(339)	(655)	(2,040)
Balance at end of year	$ 237	$ 524	$ 202

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

	Year Ended December 31,		
	2005	2004	2003
Balance at beginning of year	$ 419	$ 569	$ 769
Provision	813	241	18
Charge offs	(655)	(391)	(218)
Balance at end of year	$ 577	$ 419	$ 569

Long-Term Debt and Debt Issuance Costs

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

The debentures bear interest at a rate of 1.75% per annum and interest is payable on May 15 and November 15 of each year. The debentures are convertible under certain circumstances into our common stock at a conversion rate of 41.0627 shares of common stock per $1 principal amount of debentures for a total of 6,159,405 shares. This is equivalent to a conversion price of approximately $24.35 per share. The debentures are convertible if (a) our stock trades above 130% of the conversion price for 20 out of 30 consecutive trading days during any calendar quarter, (b) the debentures trade at an amount less than or equal to 98% of the if-converted value of the notes for five consecutive trading days, (c) a call for redemption occurs, or (d) in the event of certain other specified corporate transactions. We may redeem some or all of the debentures for cash on or after May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest. The holders of the debentures have the right to require us to purchase all or a portion of their debentures on May 15, 2011, May 15, 2014 and May 15, 2019 at a price equal to 100% of the principal amount plus accrued and unpaid interest.

The debentures are unsecured obligations and are subordinated in right of payment to all our existing and future senior debt, and are effectively subordinated to all existing and future debt of our subsidiaries. At December 31, 2005, we had no senior debt outstanding and our subsidiaries had approximately $7,314 of liabilities to which the debentures were effectively subordinated.

The debentures meet the definition of conventional convertible debt in EITF Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*. We have evaluated each of the put, call and conversion features of the debentures and concluded that none of these features constitute embedded derivatives under the accounting rules that must be bifurcated from the host contract and accounted for as derivatives in accordance with SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*.

The fees associated with the issuance of the convertible debentures included $4,500 withheld from the proceeds and $462 paid in cash. These debt issuance costs have been capitalized and are included in long-term assets in the consolidated balance sheets. The debt issuance costs are being amortized over 7 years.

NOTE 4. EARNINGS PER SHARE

We calculate earnings per share in accordance with SFAS 128, *Earnings per Share*. Basic earnings per share amounts are computed based on the weighted average number of common shares outstanding, and includes exchangeable shares. These exchangeable shares, which were issued on September 6, 2002 by Jaldi, our Canadian subsidiary, to its shareholders in connection with the Jaldi asset acquisition, have characteristics essentially equivalent to Pixelworks' common stock.

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

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

	Year Ended December 31,		
	2005	2004	2003
Basic weighted average shares outstanding	47,337,122	46,672,766	45,336,670
Incremental shares related to:			
Conversion of debentures	—	3,772,495	—
Stock options	—	1,604,200	—
Restricted stock subject to vesting	—	12,397	—
Diluted weighted average shares outstanding	47,337,122	52,061,858	45,336,670

Due to our net loss position for the years ended December 31, 2005 and 2003, the following weighted average shares were excluded from diluted weighted average shares outstanding, as their effect would have been anti-dilutive:

	Year Ended December 31,	
	2005	2003
Weighted average shares related to:		
Stock options	8,990,140	6,393,851
Conversion of debentures	6,159,405	—
Restricted stock subject to vesting	—	99,001
	15,149,545	6,492,852

Weighted average outstanding stock options of 2,262,702 have been excluded from the computation of diluted net income per share for the year ended December 31, 2004 because the options' exercise prices were greater than the average market value of Pixelworks' common stock, which has the effect of making these potential shares anti-dilutive.

Net loss used in the calculation of basic net loss per share was the same as net loss used in calculating diluted net loss per share for the years ended December 31, 2005 and 2003. The following schedule reconciles net income used in the calculation of basic net income per share to net income used in the calculation of diluted net income per share for the year ended December 31, 2004:

Net income used in calculating basic net income per share	$ 21,781
Add: Interest expense and amortization of debt issuance costs, net of tax	1,522
Net income used in calculating diluted net income per share	$ 23,303

NOTE 5. INCOME TAXES

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

	Year Ended December 31,		
	2005	2004	2003
Domestic	$ (21,482)	$ 28,891	$ (2,166)
Foreign	1,294	880	729
	$ (20,188)	$ 29,771	$ (1,437)

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

	Year Ended December 31,		
	2005	2004	2003
Current:			
Federal	$ 73	$ 8,391	$ 12
State	260	457	8
Foreign	8,453	243	241
Total current	8,786	9,091	261
Deferred:			
Federal	11,754	(161)	(627)
State	1,882	(940)	(541)
Total deferred	13,636	(1,101)	(1,168)
Income tax expense (benefit)	$ 22,422	$ 7,990	$ (907)

The significant components of deferred income tax expense (benefit) are as follows:

	Year Ended December 31,		
	2005	2004	2003
Net change in gross deferred tax assets and liabilities	$ (57,359)	$ 3,362	$ (3,461)
Deferred tax assets reducing (increasing):			
Goodwill	7,445	—	—
Deferred charge and other liabilities	—	—	601
Increase (decrease) in the beginning-of-year balance of the valuation allowance for deferred tax assets	63,550	(4,463)	1,692
	$ 13,636	$ (1,101)	$ (1,168)

A portion of income tax expense (benefit) has been allocated as follows:

	Year Ended December 31,		
	2005	2004	2003
Goodwill	$ (8,257)	$ (1,110)	$ —
Shareholders' equity	(609)	(4,485)	—

Of the $8,257 benefit allocated to goodwill for the year ended December 31, 2005, $812 related to the income tax benefit of stock options.

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

	Year Ended December 31,		
	2005	2004	2003
Expected income tax rate	35%	35%	34%
Increase (decrease) resulting from:			
Change in valuation allowance	(192)	(1)	(81)
Research and experimentation credit	21	(7)	65
Increase in deferred tax rates	13	—	—
Increase in beginning balance of acquired deferred tax assets	11	—	—
Foreign tax refund	3	—	—
Difference between financial and tax reporting for stock option exercises	(2)	—	12
State income taxes, net of federal tax benefit	2	1	8
Amortization of acquired intellectual property, assembled workforce and deferred tax charge	1	(1)	19
Other	(3)	—	6
Actual tax (expense) benefit	(111)%	27%	63%

The tax effects of temporary differences and net operating loss carryforwards which give rise to significant portions of deferred tax assets and deferred tax liabilities are as follows:

	December 31,	
	2005	2004
Deferred tax assets:		
Net operating loss carryforwards	$ 60,439	$ 7,867
Research and experimentation credit carryforwards	14,270	7,020
Foreign tax credit carryforwards	7,598	—
Accrued vacation	599	446
Reserves and accrued expenses	1,456	1,283
Deferred compensation	29	35
Depreciation	1,135	—
Other	1,151	419
Total gross deferred tax assets	86,677	17,070
Deferred tax liabilities:		
Amortization	(13,731)	(919)
Depreciation	—	(563)
Total gross deferred tax liabilities	(13,731)	(1,482)
Less valuation allowance	(72,540)	(8,990)
Net deferred tax assets	$ 406	$ 6,598

The net deferred tax asset balance of $406 as of December 31, 2005, which is included in other assets, net in the consolidated balance sheet, is offset by a contingency reserve of $406, which is included in income taxes payable in the consolidated balance sheet. The current portion of net deferred tax assets of $1,730 as of December 31, 2004 is included in prepaid expenses and other current assets in the consolidated balance sheet. The long-term portion of net deferred tax assets of $4,868 as of December 31, 2004 is included in other assets, net in the consolidated balance sheet.

During the fourth quarter of 2005, we recorded approximately $31,900 of tax expense to place valuation allowance against essentially all our net deferred tax assets as we could not conclude that it was more likely than not that we would be able to realize the benefit of these assets. SFAS 109 requires that a valuation allowance be recorded when it is more likely than not that some portion of the deferred tax assets will not be realized. We considered future taxable income by jurisdiction, the scheduled reversal of deferred tax liabilities and tax planning strategies when making this assessment. The net change in the total valuation allowance for the year ended December 31, 2005 was an increase of $63,550, of which $38,773 was allocated to the income statement. $24,777 related to valuation allowance added in connection with the acquisition of Equator. This amount was added to the balance sheet to reflect assets acquired that the company did not believe they could realize the benefit of. The net change in the total valuation allowance for the years ended December 31, 2004 and 2003 was a decrease and increase of approximately $4,462 and $1,692 respectively.

Certain tax benefits, when recognized, related to the valuation allowance for deferred tax assets as of December 31, 2005 will be allocated as a reduction to goodwill in the amount of approximately $31,298.

As of December 31, 2005, we have federal, state and foreign net operating loss carryforwards of approximately $146,320, $77,910 and $6,432, respectively, which will expire between the years 2007 and 2025. As of December 31, 2005, we had generated federal, state and foreign tax credit carryforwards of approximately $13,550, $5,824 and $2,754, respectively, which begin expiring in 2006. Utilization of a portion of the U.S. net operating loss and credit carryforwards is subject to an annual limitation due to the ownership change provisions of the Internal Revenue Code of 1986 and similar state provisions. An ownership change subject to these provisions occurred with the acquisitions of nDSP during 2002 and Equator during 2005.

We had undistributed earnings of foreign subsidiaries of approximately $4,582 at December 31, 2005, for which deferred taxes have not been provided. Such earnings are considered indefinitely invested outside of the United States. If repatriated, some of these earnings could generate foreign tax credits that may reduce the federal tax liability associated with any future foreign dividend.

We have recorded tax reserves to address potential exposures involving positions that could be challenged by taxing authorities. The tax reserves are reviewed as circumstances warrant and adjusted as events occur that affect our potential liability for additional taxes. While we believe we have adequately provided for potential exposures, the ultimate resolution of these matters may be greater or less than the amount we have accrued.

NOTE 6. COMMITMENTS AND CONTINGENCIES

Royalties

We license technology from third parties and have agreed to pay certain suppliers a per unit royalty based on either the number of chips sold or manufactured, or the net sales price of the chips containing the licensed technology. Royalty expense was $3,056, $2,493 and $1,798 for the years ended December 31, 2005, 2004 and 2003, respectively, which is included in cost of revenue in the consolidated statements of operations.

401(k) Plan

We have a profit-sharing plan for eligible employees under the provisions of Internal Revenue Code Section 401(k). Participants may defer a percentage of their annual compensation on a pre-tax basis, not to exceed the dollar limit that is set by law. A discretionary matching contribution by the Company is allowed and is equal to a uniform percentage of the amount of salary reduction elected to be deferred, which percentage will be determined each year by the Company. The Company made no contributions to the 401(k) plan during 2005, 2004 or 2003.

Leases

At December 31, 2005 and 2004, we had no capital leases. At December 31, 2005, future minimum payments under operating leases are as follows:

Year Ending December 31:	
2006	$ 4,472
2007	3,166
2008	2,806
2009	1,340
2010	1,142
Thereafter	2,441
	$ 15,367

Minimum lease payments above are net of sublease rentals of $40 for the year ended December 31, 2006. Rent expense for the years ended December 31, 2005, 2004 and 2003 was $4,381, $2,942 and $2,817, respectively.

Contract Manufacturers

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

Indemnifications

Certain of our agreements include limited indemnification provisions for claims from third-parties relating to our intellectual property. Such indemnification provisions are accounted for in accordance with Financial Accounting Standards Board Summary of Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others-an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No.34*. The indemnification is limited to the amount paid by the customer. As of December 31, 2005, we have not incurred any material liabilities arising from these indemnification obligations, however in the future, such obligations could immediately impact our results of operations but would not materially affect our business.

Legal Proceedings

We are involved in litigation from time to time that is routine in nature and incidental to our business. We believe that the outcome of any such current litigation would not have a material adverse effect on our financial condition, results of operations or cash flows.

NOTE 7. SHAREHOLDERS' EQUITY

Preferred Stock

The Company is authorized to issue 50,000,000 shares of preferred stock with a par value of $.001 per share. The Board of Directors is authorized to fix or alter the rights, preferences, privileges and restrictions granted to, or imposed on, each series of preferred stock.

As of December 31, 2005 and 2004, there is one series of preferred stock designated as the Special Voting Share Series, of which there is one voting share issued and outstanding. The series was designated and the share was issued in 2002 in connection with our Jaldi asset acquisition. The voting share entitles the holders of exchangeable shares (see below) to vote on any matters that come before the Pixelworks common shareholders.

The holder of the voting share is not entitled to receive dividends. In the event of any dissolution of the Company, the holder of the voting share is entitled to be paid out of the net assets of the Company an amount equal to $.001, before any payment is made to the holders of common stock.

Common Stock

The Company is authorized to issue 250,000,000 shares of common stock with a par value of $.001 per share. Shareholders of common stock have unlimited voting rights and are entitled to receive the net assets of the corporation upon dissolution, subject to the rights of the preferred shareholders.

Exchangeable Shares

In connection with the Jaldi asset acquisition, Jaldi issued 1,731,099 exchangeable shares to its shareholders. The voting share described above is held in trust for the benefit of the holders of the exchangeable shares and provides the holders of the exchangeable shares with dividend, voting and other rights equivalent to those of Pixelworks' common shareholders. These exchangeable shares are the economic equivalent of Pixelworks' common shares, and may be exchanged at any time for Pixelworks common stock on a one-for-one basis.

Stock Option Plans

Under our 1997 Stock Incentive Plan and 2001 Nonqualified Stock Option Plan (the "option plans"), 20,340,116 and 4,000,000 stock options, respectively, may be granted. Options granted under the plans must generally be exercised while the individual is an employee and within ten years of the date of grant. Our new-hire vesting schedule provides that each option becomes exercisable at a rate of 25% on the first anniversary date of the grant, and 2.08% on the last day of every month thereafter for a total of thirty-six additional increments. Our merit vesting schedule provides that options become exercisable monthly for a period of 4 years, with 10% becoming exercisable in the first year, 20% becoming exercisable in the second year, 30% becoming exercisable in the third year and 40% becoming exercisable in the fourth year.

In connection with our acquisition of Equator, we assumed the Equator Technologies, Inc. 1996 Stock Incentive Plan and certain stand-alone Equator stock option plans and issued 1,263,417 options to purchase Pixelworks common stock in exchange for Equator options outstanding thereunder. During 2005, no additional stock option grants were made under this plan.

The following is a summary of stock option activity:

	Number of shares	Weighted average exercise price
Options outstanding as of December 31, 2002	5,814,694	$ 9.74
Granted at market	1,592,099	7.52
Exercised	(650,766)	2.76
Canceled	(484,288)	10.20
Options outstanding as of December 31, 2003	6,271,739	9.86
Granted at market	2,595,005	14.03
Exercised	(809,966)	4.91
Canceled	(531,643)	12.82
Options outstanding as of December 31, 2004	7,525,135	11.63
Granted at market	2,560,030	8.48
Exchanged in acquisition	1,263,417	1.26
Exercised	(608,754)	1.05
Canceled	(1,576,346)	11.21
Options outstanding as of December 31, 2005	9,163,482	$ 10.09

The following table summarizes information about options outstanding at December 31, 2005:

	Options Outstanding			Options Exercisable	
Range of Exercise prices	Number outstanding at December 31, 2005	Weighted average remaining contractual life	Weighted average exercise price	Number exercisable at December 31, 2005	Weighted average exercise price
$ 0.07 — $ 2.43	1,036,237	6.36	$ 0.61	932,616	$ 0.61
3.98 — 6.58	969,173	7.90	6.09	366,785	5.85
6.59 — 7.96	1,270,435	8.53	7.54	394,069	7.40
8.00 — 9.15	1,018,099	7.70	8.47	459,627	8.48
9.22 — 9.48	1,114,228	8.88	9.33	146,997	9.29
9.52 — 11.29	975,097	7.14	10.37	701,738	10.29
11.34 — 14.84	1,034,560	8.07	13.72	390,513	13.33
14.90 — 16.90	1,108,436	7.21	16.19	703,107	16.34
17.05 — 39.00	637,217	5.74	23.70	553,043	24.53
$ 0.07 — $39.00	9,163,482	7.62	$ 10.09	4,648,495	$ 10.41

At December 31, 2004 and 2003, there were 3,159,243 and 2,804,710 options exercisable with weighted average exercise prices of $11.28 and $9.54, respectively.

As of December 31, 2005, 4,325,219 shares were available for grant under the option plans.

Employee Stock Purchase Plan

At December 31, 2005, a total of 1,700,000 shares of common stock have been reserved for issuance under the Employee Stock Purchase Plan (“ESPP”). Beginning in 2005, the number of shares available for issuance under the ESPP increases each year in an amount equal to the lesser of (i) the number of shares of common stock issued pursuant to the ESPP during the immediately preceding fiscal year, (ii) two percent of the outstanding shares of common stock on the first day of the year for which the increase is being made or (iii) a lesser amount determined by the Board of Directors. During the years ended December 31, 2005, 2004 and 2003, the Company issued 196,819, 211,795 and 220,203 shares under the ESPP for proceeds of approximately $1,347, $1,133 and $1,141, respectively. As of December 31, 2005, there were 851,923 shares available for issuance under this plan.

NOTE 8. SEGMENT INFORMATION

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

Geographic Information

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

	Year Ended December 31,		
	2005	2004	2003
Japan	$ 56,770	$ 70,749	$ 58,597
Taiwan	29,752	36,766	33,843
China	23,884	30,587	17,930
Europe	25,861	14,342	8,302
Korea	15,396	14,032	14,428
U.S.	6,324	2,265	1,928
Other	13,717	7,470	5,893
	$171,704	$176,211	$140,921

Significant Customers

Sales to distributors represented 46%, 69% and 69% of revenue for the years ended December 31, 2005, 2004 and 2003, respectively. The following distributors accounted for 10% or more of revenue:

	Year Ended December 31,		
	2005	2004	2003
Distributor A	22%	31%	39%
Distributor B	1%	13%	16%

End customers include customers who purchase directly from the Company, as well as, customers who purchase the Company’s products indirectly through distributors and manufacturers’ representatives. Sales to our top five end customers represented 34%, 33% and 35% of revenue for the years ended December 31, 2005, 2004 and 2003, respectively. For the year ended December 31, 2005, one end customer represented 10% of revenue. There were no end customers that represented 10% or more of total revenue for the years ended December 31, 2004 or 2003.

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

	December 31,	
	2005	2004
Account A	16%	26%
Account B	14%	9%
Account C	11%	6%
Account D	4%	11%

NOTE 9. RESTRUCTURING

In October 2005, we initiated a restructuring plan to improve the effectiveness and timeliness of our product development efforts in order to reduce our overall development costs. The restructuring resulted in a reduction-in-force of 36 employees during the fourth quarter of 2005. These employees were given severance benefits, which were expensed and paid in the fourth quarter of 2005. The total amount of these benefits was approximately $1,162. As of December 31, 2005, we had a nominal amount accrued related to this restructuring which was paid in January 2006.

In September 2003, we initiated a restructuring to better position the Company to compete in the advanced television market. The restructuring included the discontinuation of all research and development efforts related to two products. As a result of these actions, we determined that certain tangible and intangible assets related to the discontinued development efforts were permanently impaired because there were no alternate uses for them. Impaired assets included tooling, licensed technology and prepaid royalties. The net book value of the impaired assets totaled $3,927 at the discontinuation date, and this amount was recognized as restructuring expense in the third quarter of 2003. In addition, we implemented a reduction-in-force of 28 employees in the fourth quarter of 2003. The terminated employees were granted termination benefits, which were expensed and paid in the fourth quarter of 2003 on the date of employee communication. The total amount of these benefits was approximately $916. We also subleased approximately 4,000 square feet of our California office as a result of the restructuring. We included the present value of the difference between the future minimum lease payments and the non-cancelable sublease rentals in restructuring expense during the fourth quarter of 2003. This amount totaled $188. We did not incur any amounts related to this restructuring in 2004 or 2005, and we did not have any material amounts accrued related to this restructuring at December 31, 2004, and we had no amounts accrued related to this restructuring at December 31, 2005.

NOTE 10. ACQUISITION

On June 14, 2005, we acquired 100% of the outstanding shares of Equator Technologies, Inc. (“Equator”). Equator develops programmable video compression technology with system-on-chip integrated circuits and software solutions for video entertainment and communications broadband networks. The acquisition of Equator added programmable technologies to Pixelworks customers in order to create a new generation of digital televisions, including those that might integrate Internet Protocol television decoding technology to allow viewing of digital video directly over the Internet. These factors contributed to establishing the purchase price and supported the premium paid over the fair value of the tangible and intangible assets acquired. The results of Equator’s operations are included in our consolidated statement of operations beginning on the date of acquisition.

The aggregate purchase price for Equator was $118,116, which consisted of cash of $107,854, the value of 1,263,417 options exchanged of $8,336, plus acquisition costs of $1,926. The estimated fair value of the options exchanged was calculated using the Black-Scholes option pricing model with the average closing price of Pixelworks’ common stock for two days prior to the announcement of the Agreement and Plan of

Merger, the day of the announcement, and two days following the announcement ($7.62 per share) and following weighted average assumptions: risk-free interest rate of 2.55%, an expected dividend yield of 0%, an expected life of 1.2 years, and volatility of 59%.

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

Purchase price		$118,116
Less net assets acquired:		
Assets acquired:		
Cash	$ 5,044	
Accounts receivable	4,464	
Inventory	10,808	
Other current assets	296	
Non-current assets	6,295	
Developed technology	36,800	
Other acquired intangible assets	4,200	
Deferred stock compensation	2,218	
Less:		
Liabilities assumed	(9,530)	(60,595)
Goodwill		$ 57,521

In connection with this acquisition, we performed a valuation of acquired intangible assets. We assigned $36,800 of the purchase price to acquired developed technology with a 5 year estimated life, $3,400 to customer relationships with a 3 year estimated life, and $800 to backlog and trademark with estimated lives of 1 year or less. In-process research and development was considered in our analysis of the Equator intangible assets, however, it was determined to have no value.

We also recorded gross deferred tax assets of approximately $49,221, subject to a valuation allowance of $28,590, and deferred tax liabilities of $17,000 to recognize the book and tax basis differences of various balance sheet assets and liabilities and corporate tax attributes acquired. If the valuation allowance is subsequently changed, the amount of the adjustment may affect net income or goodwill depending on the nature of the adjustment in the period such change is made.

The goodwill resulting from this transaction was assigned to Pixelworks, Inc., our sole reporting unit and is not deductible for tax purposes.

In addition to the $107,854 cash consideration included in the purchase price, we paid $2,518 cash which was placed in escrow to fund an Employee Bonus Plan that was established between the Equator shareholders and the Equator employees at the date of the acquisition. If certain revenue targets are achieved by March 31, 2006, the Equator shareholders will receive disbursement of the escrow funds. The shareholders will, in turn, pay the amounts disbursed to Equator employees as specified in the Employee Bonus Plan. If targets are not achieved, disbursement of the funds is reduced on a pro-rata basis and excess funds are returned to Pixelworks. The employees will receive payment of the amount earned at specified dates in 2006 and 2007, provided they remain employed by Pixelworks through each payment date. If employees terminate before the payment dates, their bonus amounts are reallocated to remaining plan participants. The bonus amount earned each quarter is expensed to research and development expense or selling, general and administrative expense as appropriate based on each employee's function. During the year ended December 31, 2005, $800 of the bonus was earned by employees. At December 31, 2005, the remaining $1,718 of escrow funds is included in prepaid expenses and other current assets in the consolidated balance sheet.

The purchase price allocation is substantially complete. Certain elements, such as the filing of pre-acquisition tax returns, may impact the final purchase price allocation. Although we do not anticipate significant revisions to the purchase price allocation, material adjustments could occur.

The following table reflects the unaudited combined results of Pixelworks and Equator as if the merger had taken place as of the beginning of each year presented. For the year ended December 31, 2004, weighted average shares related to convertible subordinated debentures of 3,772,495, were excluded from the calculation of diluted weighted average shares outstanding because their inclusion would have been anti-dilutive.

	Year Ended December 31,	
	2005	2004
Net revenue	$ 186,670	$ 192,041
Net income (loss)	$ (49,561)	$ 5,419
Net income (loss) per share:		
Basic	$ (1.05)	$ 0.12
Diluted	$ (1.05)	$ 0.11
Weighted average shares outstanding:		
Basic	47,337,122	46,672,766
Diluted	47,337,122	49,409,885

The adjustment to mark-up inventory to fair value of $5,270 is not included in cost of revenue in the pro-forma results of operations as it is not reflective of the ongoing operations of the combined entities. The pro-forma information does not necessarily reflect the actual results that would have occurred, nor is it necessarily indicative of future results of operations of the combined companies.

NOTE 11. GENESIS MICROCHIP TRANSACTION

On March 17, 2003, we announced the execution of a definitive merger agreement with Genesis Microchip. On August 5, 2003, we entered into an agreement terminating the merger agreement. In the termination agreement, we agreed to pay a termination fee of $5,500 to Genesis Microchip. The fee was payable upon execution of the termination agreement, and was recognized as expense in the third quarter of 2003. Total expenses related to the proposed merger during the year ended December 31, 2003 were $8,949.

NOTE 12. QUARTERLY FINANCIAL DATA (UNAUDITED)

	March 31, 2005	June 30, 2005	September 30, 2005	December 31, 2005
Revenue	$ 40,261	$ 41,315	$ 46,794	$ 43,334
Gross profit	16,918	16,202	14,647	15,189
Income (loss) from operations	271	(2,654)	(10,170)	(9,167)
Income (loss) before taxes	1,152	(2,578)	(9,973)	(8,789)
Net income (loss)	836	(2,275)	(5,257)	(35,914)
Net income (loss) per share:				
Basic and diluted	0.02	(0.05)	(0.11)	(0.75)

	March 31, 2004	June 30, 2004	September 30, 2004	December 31, 2004
Revenue	$ 45,270	$ 48,509	$ 43,970	$ 38,462
Gross profit	23,387	23,032	21,710	17,091
Income from operations	9,924	8,810	7,184	2,111
Income before taxes	10,159	8,929	7,822	2,861
Net income	6,553	5,759	5,449	4,020
Net income per share:				
Basic	0.14	0.12	0.12	0.09
Diluted	0.14	0.12	0.11	0.08

NOTE 13: SUBSEQUENT EVENT

In February 2006, we purchased $10,000 of our 1.75% convertible subordinated debentures for $6,800 in cash in the open market. As a result of this transaction, we will recognize a gain in other income of approximately $3,000 in the first quarter of 2006.

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

None.

Item 9A. Controls and Procedures.

As of the end of the period covered by this report, we conducted an evaluation under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934). Based on this evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2005, our disclosure controls and procedures were effective to ensure that information required to be disclosed in our periodic reports filed under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified by the Securities and Exchange Commission's rules and forms.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining a system of internal control over financial reporting as defined under Exchange Act Rule13a-15(f). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. generally accepted accounting principles. All internal control systems, no matter how well designed, have inherent limitations.

We conducted an assessment of the effectiveness of our system of internal control over financial reporting as of December 31, 2005. This assessment was based on criteria established in the framework *Internal Control — Integrated Framework,* issued by the Committee of Sponsoring Organizations of the Treadway Commission. We acquired Equator Technologies, Inc. during 2005. We excluded from our assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, Equator's internal control over financial reporting associated with total assets of $29,359,092 and revenue of $13,140,682.

Our independent registered public accounting firm, KPMG LLP, has issued an audit report on management's assessment of our internal control over financial reporting. Their report appears below.

Changes to Internal Controls

There were no changes to our internal control over financial reporting during the fourth quarter of 2005 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Pixelworks, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Pixelworks Inc. and subsidiaries (the "Company"), maintained effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 31, 2005 is fairly stated, in all material respects, based on criteria established in *Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission(COSO)*.

The Company acquired Equator, Inc. during 2005, and management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, Equator Technologies, Inc.'s internal control over financial reporting associated with total assets of $29,359,092 and total revenues of $13,140,682 included in the consolidated financial statements of the Company and subsidiaries as of and for the year ended December 31, 2005. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of Equator Technologies, Inc.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Pixelworks, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2005, and our report dated March 13, 2006 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP

Portland, Oregon
March 13, 2006

Item 9B. Other Information.

Not applicable.

PART III

Item 10. Directors and Executive Officers of the Registrant.

Information concerning the Directors of the Company is set forth in the Company's Proxy Statement for its 2006 Annual Meeting of Shareholders (the "2006 Proxy Statement") and is incorporated herein by reference.

Information concerning the Executive Officers of the Company is set forth in the 2006 Proxy Statement and is incorporated herein by reference.

Information with respect to Section 16(a) of the Securities Exchange Act is set forth in the 2006 Proxy Statement and is incorporated herein by reference.

Information relating to the audit committee financial expert, the identification of the audit committee of our board of directors and procedures of security holders to recommend nominees to our Board of Directors is contained in our 2006 Proxy Statement and is incorporated herein by reference.

We have adopted a written code of ethics that applies to our CEO, senior financial officers, financial vice presidents, directors and managers and disclosure committee members. We have also adopted a written code of business conduct and ethics that applies to all of our employees, officers and directors. Each code is available on our web site at www.pixelworks.com. Any person may request a copy of either code by writing to us at the following address:

Pixelworks, Inc.
Investor Relations
8100 SW Nyberg Road
Tualatin, Oregon 97062

Item 11. Executive Compensation.

Information with respect to executive compensation is included in the 2006 Proxy Statement and is incorporated herein by reference.

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

Information with respect to security ownership of certain beneficial owners and management is included in the 2006 Proxy Statement and is incorporated herein by reference.

Information with respect to equity compensation plans is included in the 2006 Proxy Statement and is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions.

Information with respect to certain relationships and related transactions with management is included in the 2006 Proxy Statement and is incorporated herein by reference.

Item 14. Principal Accounting Fees and Services.

Information with respect to principal accounting fees and services is included in the 2006 Proxy Statement and is incorporated herein by reference.

PART IV

Item 15. Exhibits, Financial Statement Schedules.

(a) 1. Financial Statements

The following financial statements are included in Item 8:

Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets as of December 31, 2005 and 2004
Consolidated Statements of Operations for the years ended December 31, 2005, 2004 and 2003
Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004 and 2003
Consolidated Statements of Shareholders' Equity and Comprehensive Income (Loss) for the years ended December 31, 2005, 2004 and 2003
Notes to Consolidated Financial Statements

(a) 2. Financial Statement Schedules

All schedules have been omitted as they are either not required or the information is included elsewhere herein.

(a) 3. Exhibits

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

Exhibit Number	Description
2.1	Agreement and Plan of Merger dated as of December 13, 2000 among Pixelworks, Inc., Panther Acquisition, Inc., Panstera, Inc. and those certain shareholders of Panstera, Inc. signatories thereto (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on February 13, 2001).
2.2	Amendment to Agreement and Plan of Merger dated as of January 26, 2001 among Pixelworks Inc., Panther Acquisition, Inc. and Panstera, Inc. (incorporated by reference to Exhibit 2.2 to the Company's Current Report on Form 8-K filed on February 13, 2001).
2.3	Agreement and Plan of Merger and Reorganization dated as of December 6, 2001 among Pixelworks, Inc., Nighthawk Acquisition Corp. and those certain shareholders of nDSP Delaware, Inc. who are signatories thereto (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on January 29, 2002).
2.4	Reorganization Agreement among Pixelworks, Inc., Pixelworks Nova Scotia Company, Certain Shareholders of Jaldi Semiconductor Corp. and Jaldi Semiconductor Corp. dated August 2, 2002 (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-3 filed on October 15, 2002).
2.5	Jaldi Semiconductor, Inc. Exchangeable Share Provisions (incorporated by reference to Exhibit 99.2 to the Company's Registration Statement on Form S-3 filed on October 15, 2002).

Exhibit Number	Description
2.6	Exchangeable Share Support Agreement among Jaldi Semiconductor Corp., Pixelworks, Inc., Pixelworks Nova Scotia and Jaldi Semiconductor Corp. dated September 6, 2002 (incorporated by reference to Exhibit 99.3 to the Company's Registration Statement on Form S-3 filed on October 15, 2002).
2.7	Voting and Exchange Trust Agreement among Jaldi Semiconductor Corp., Pixelworks, Inc., Pixelworks Nova Scotia Company and CIBC Mellon Trust Company, dated September 6, 2002 (incorporated by reference to Exhibit 99.4 to the Company's Registration Statement on Form S-3 filed on October 15, 2002).
2.8	Agreement and Plan of Merger, dated as of March 17, 2003 among Pixelworks, Inc., Display Acquisition Corp. and Genesis Microchip Inc. (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on March 20, 2003).
2.9	Agreement and Plan of Merger dated April 28, 2005 among Pixelworks, Inc., Equator Technologies, Inc., Twain Sub, Inc., and Robert C. Fox, Jr., as Shareholders' Agent (incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on May 3, 2005).
3.1	Sixth Amended and Restated Articles of Incorporation of Pixelworks, Inc., As Amended (incorporated by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2004).
3.2	First Restated Bylaws of Pixelworks, Inc. (incorporated by reference to Exhibit 3.3 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
4.1	Reference is made to Exhibit 3.1 above (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
4.2	Third Amended Registration Rights Agreement dated February 22, 2000 (incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
4.3	Indenture dated May 18, 2004 between Pixelworks, Inc. and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2004).
4.4	Form of 1.75% Convertible Subordinated Debentures due 2024 dated May 18, 2004 (incorporated by reference to Exhibit 4.2 to the Company's Quarterly Report on Form 10-Q filed August 9, 2004).
4.5	Registration Rights Agreement, dated May 18, 2004 among Pixelworks, Inc., Citigroup Global Markets Inc. and D.A. Davidson & Co. (incorporated by reference to Exhibit 4.3 to the Company's Quarterly Report on Form 10-Q filed August 9, 2004).
4.6	Purchase Agreement, dated May 12, 2004 among Pixelworks, Inc. and Citigroup Global Markets Inc. (incorporated by reference to Exhibit 4.4 to the Company's Quarterly Report on Form 10-Q filed August 9, 2004).
10.1	Form of Indemnity Agreement between Pixelworks, Inc. and each of its Officers and Directors (incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000). +

Exhibit Number	Description
10.2	Pixelworks, Inc. 1997 Stock Incentive Plan, as amended (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 filed June 21, 2005). +
10.3	Pixelworks, Inc. 2000 Employee Stock Purchase Plan, As Amended (incorporated by reference to Exhibit 99.2 to the Company's Registration Statement on Form S-8 filed March 23, 2005). +
10.4	Pixelworks, Inc. 2001 Nonqualified Stock Option Plan (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 filed on May 31, 2001). +
10.5	Registration Rights Agreement dated as of December 6, 2001 among Pixelworks, Inc., nDSP Delaware, Inc. and those certain shareholders of nDSP Delaware, Inc. who are signatories thereto (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on January 29, 2002).
10.6	Sublease Agreement Dated September 7, 2001 between Epicor Software Corporation and Pixelworks Inc. (incorporated by reference to Exhibit 10.4 to the Company's Annual Report on Form 10-K filed on March 25, 2002).
10.7	Lease Agreement Dated April 14, 1999 between Southcenter III and IV Investors LLC and Pixelworks, Inc. (incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
10.8	VAutomation Incorporated Synthesizable Soft Core Agreement dated November 4, 1997 between VAutomation Incorporated and Pixelworks, Inc. (incorporated by reference to Exhibit 10.8 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
10.9	Intellectual Property Sublicense Agreement dated March 30, 1999 between VAutomation Incorporated and Pixelworks, Inc. (incorporated by reference to Exhibit 10.9 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
10.10	License Agreement dated February 22, 2000 between Pixelworks, Inc. and InFocus Systems, Inc. (incorporated by reference to Exhibit 10.10 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000).
10.11	Employment Agreement between Jeffrey B. Bouchard and Pixelworks, Inc. (incorporated by reference to Exhibit 10.11 to the Company's Registration Statement on Form S-1 declared effective May 19, 2000). +
10.12	Shareholders Agreement dated as of January 15, 2001 among Pixelworks, Inc., Panstera, Inc., and those certain shareholders of Panstera, Inc. (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on February 13, 2001).
10.13	Third Amendment to Lease dated March 1, 2002 between Copper Mountain Trust Corporation and Pixelworks, Inc. (incorporated by reference to Exhibit 10.13 to the Company's Annual Report on Form 10-K filed on March 25, 2002).
10.14	Form of Pixelworks, Inc. Change of Control Severance Agreement dated March 14, 2003 (incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form S-4 filed on April 18, 2003). +
10.15	Change of Control Severance Agreement dated March 14, 2003 between Jeffrey Bouchard and Pixelworks, Inc. (incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-4 filed on April 18, 2003). +

Exhibit Number	Description
10.16	Change of Control Severance Agreement dated March 14, 2003 between Hans Olsen and Pixelworks, Inc. (incorporated by reference to Exhibit 10.6 to the Company's Registration Statement on Form S-4 filed on April 18, 2003). +
10.17	Fourth Amendment to lease dated June 23, 2003 between Pixelworks, Inc. and Quest Group Trust VI (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on August 14, 2003).
10.18	Fifth Amendment to lease dated February 18, 2004 between Pixelworks, Inc. and Quest Group Trust VI (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on May 7, 2004).
10.19	First Amendment to lease dated February 2004 between Pixelworks, Inc. and Epicor Software Corporation (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q filed on May 7, 2004).
10.20	First Amendment of Lease between Pixelworks, Inc. and Southcenter III & IV Investors LLC (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on August 9, 2004).
10.21	Pixelworks, Inc. 2004 Senior Management Bonus Plan (incorporated by reference to Exhibit 10.22 to the Company's Annual Report on Form 10-K filed on March 15, 2005). +
10.22	Pixelworks, Inc. 2005 Senior Management Bonus Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on March 10, 2005). +
10.23	Equator Technologies, Inc. 1996 Stock Option Plan, as amended (incorporated by reference to Exhibit 99.1 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.24	Stock Option Agreement, dated April 18, 2002, between Equator Technologies, Inc. and Christopher H. Basoglu (incorporated by reference to Exhibit 99.2 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.25	Stock Option Agreement, dated April 8, 2003, between Equator Technologies, Inc. and Christopher H. Basoglu (incorporated by reference to Exhibit 99.3 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.26	Stock Option Agreement, dated November 11, 2003, between Equator Technologies, Inc. and Christopher H. Basoglu (incorporated by reference to Exhibit 99.4 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.27	Stock Option Agreement, dated April 18, 2002, between Equator Technologies, Inc. and Richard E. Christopher (incorporated by reference to Exhibit 99.5 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.28	Stock Option Agreement, dated April 8, 2003, between Equator Technologies, Inc. and Richard E. Christopher (incorporated by reference to Exhibit 99.6 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.29	Stock Option Agreement, dated November 11, 2003, between Equator Technologies, Inc. and Richard E. Christopher (incorporated by reference to Exhibit 99.7 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +

Exhibit Number	Description
10.30	Stock Option Agreement, dated September 15, 2004, between Equator Technologies, Inc. and Richard E. Christopher (incorporated by reference to Exhibit 99.8 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.31	Stock Option Agreement, dated November 11, 2003, between Equator Technologies, Inc. and Michael Myhre (incorporated by reference to Exhibit 99.9 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.32	Stock Option Agreement, dated July 18, 2002, between Equator Technologies, Inc. and Tedford Niday (incorporated by reference to Exhibit 99.10 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.33	Stock Option Agreement, dated April 8, 2003, between Equator Technologies, Inc. and Tedford Niday (incorporated by reference to Exhibit 99.11 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.34	Stock Option Agreement, dated November 11, 2003, between Equator Technologies, Inc. and Tedford Niday (incorporated by reference to Exhibit 99.12 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.35	Stock Option Agreement, dated March 29, 2001, between Equator Technologies, Inc. and John O'Donnell (incorporated by reference to Exhibit 99.13 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.36	Stock Option Agreement, dated July 18, 2002, between Equator Technologies, Inc. and John O'Donnell (incorporated by reference to Exhibit 99.14 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.37	Stock Option Agreement, dated April 8, 2003, between Equator Technologies, Inc. and John O'Donnell (incorporated by reference to Exhibit 99.15 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.38	Stock Option Agreement, dated November 11, 2003, between Equator Technologies, Inc. and John O'Donnell (incorporated by reference to Exhibit 99.16 to the Company's Registration Statement on Form S-8 filed June 17, 2005). +
10.39	Office Lease dated April 12, 2001, by and between Equator Technologies, Inc. and Pike Street Delaware, Inc. (incorporated by reference to Exhibit 10.18 to the Company's Quarterly Report on Form 10-Q filed August 9, 2005).
10.40	Real Property Lease dated March 21, 2001, by and between Equator Technologies, Inc. and Limar Realty Corp. #30 (incorporated by reference to Exhibit 10.19 to the Company's Quarterly Report on Form 10-Q filed August 9, 2005).
10.41	Amendment No. 1 to Office Lease dated July 7, 2005, by and between Equator Technologies, Inc. and 520 Pike Street, Inc. (incorporated by reference to Exhibit 10.20 to the Company's Quarterly Report on Form 10-Q filed November 7, 2005).
10.42	Office Lease Agreement by and between CA-The Concourse Limited Partnership and Pixelworks, Inc.

Exhibit Number	Description
21	Subsidiaries of Pixelworks, Inc.
23	Consent of KPMG LLP.
31.1	Certification of Chief Executive Officer.
31.2	Certification of Chief Financial Officer.
31.3	Certification of Chief Operating Officer.
32.1	Certification of Chief Executive Officer.
32.2	Certification of Chief Financial Officer.
32.3	Certification of Chief Operating Officer.

\+ Indicates a management contract or compensation arrangement.

SIGNATURES

Pursuant to the requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PIXELWORKS, INC.

Dated: March 13, 2006

By: /s/ Allen H. Alley

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

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

Signature	Title	Date
/s/ Allen H. Alley Allen H. Alley	Chairman of the Board, President and Chief Executive Officer	March 13, 2006
/s/ Michael D. Yonker Michael D. Yonker	Vice President, Chief Financial Officer, Treasurer and Secretary	March 13, 2006
/s/ Mark Christensen Mark Christensen	Director	March 13, 2006
/s/ C. Scott Gibson C. Scott Gibson	Director	March 13, 2006
/s/ Frank Gill Frank Gill	Director	March 13, 2006
/s/ Bruce Walicek Bruce Walicek	Director	March 13, 2006

Exhibit 10.42

THE CONCOURSE

THE CONCOURSE II

224 AIRPORT PARKWAY
SAN JOSE, CALIFORNIA

OFFICE LEASE AGREEMENT

BETWEEN

CA-THE CONCOURSE LIMITED PARTNERSHIP
("LANDLORD")

AND

PIXELWORKS, INC., AN OREGON CORPORATION
("TENANT")

OFFICE LEASE AGREEMENT

THIS OFFICE LEASE AGREEMENT (the "LEASE") is made and entered into as of the 05 day of December 28 2005, by and between CA-THE CONCOURSE LIMITED PARTNERSHIP, A DELAWARE LIMITED PARTNERSHIP ("LANDLORD"), and PIXELWORKS, INC., AN OREGON CORPORATION ("TENANT"). The following exhibits and attachments are incorporated into and made a part of the Lease: EXHIBIT A (Outline and Location of Premises), EXHIBIT A-1 (Outline and Location of Refusal Space), EXHIBIT B (Expenses and Taxes), EXHIBIT C (Work Letter), EXHIBIT C-1 (Space Plans), EXHIBIT C-2 (Lobby Work Letter), EXHIBIT D (Commencement Letter), EXHIBIT E (Building Rules and Regulations), EXHIBIT F (Additional Provisions), EXHIBIT F-1 (Hazardous Materials Questionnaire), EXHIBIT G (Parking Agreement) and EXHIBIT H (Asbestos Notification).

1. BASIC LEASE INFORMATION.

1.01 "BUILDING" shall mean the building located at 224 Airport Parkway, San Jose, California, commonly known as The Concourse II, in the project commonly known as The Concourse. "RENTABLE SQUARE FOOTAGE OF THE BUILDING" is deemed to be 114,211 square feet.

1.02 "PREMISES" shall mean the area shown on EXHIBIT A to this Lease. The Premises is located on the 3rd and 4th floors and known as Suite Nos. 300 and 400. If the Premises include one or more floors in their entirety, all corridors and restroom facilities located on such full floors shall be considered part of the Premises. The "RENTABLE SQUARE FOOTAGE OF THE PREMISES" is deemed to be 37,346 square feet. Landlord and Tenant stipulate and agree that the Rentable Square Footage of the Building and the Rentable Square Footage of the Premises are correct.

1.03 "BASE RENT":

PERIOD	ANNUAL RATE PER SQUARE FOOT	MONTHLY BASE RENT
Months 1 - 12	$21.60	$67,222.80
Months 13 - 24	$22.20	$69,090.10
Months 25 - 36	$22.80	$70,957.40
Months 37 - 48	$23.40	$72,824.70
Months 49 - 60	$24.00	$74,692.00
Months 61 - 72	$24.60	$76,559.30
Months 73 - 84	$25.20	$78,426.60

Notwithstanding anything in this Section of the Lease to the contrary, so long as Tenant is not in default under this Lease, Tenant shall be entitled to an abatement of Base Rent in the amount of $67,222.80 per month for 6 consecutive full calendar months of the Term, beginning with the 1st full calendar month of the Term (the "BASE RENT ABATEMENT PERIOD"). The total amount of Base Rent abated during the Base Rent Abatement Period shall equal $403,336.80 (the "ABATED BASE RENT"). If Tenant defaults at any time during the Term and fails to cure such default within any applicable cure period under the Lease, all unamortized Abated Base Rent shall immediately become due and payable. The payment by Tenant of the Abated Base Rent in the event of a default shall not limit or affect any of Landlord's other rights, pursuant to this Lease or at law or in equity. During the Base Rent Abatement Period, only Base Rent shall be abated, and all Additional Rent and other costs and charges specified in this Lease shall remain as due and payable pursuant to the provisions of this Lease.

1.04 "TENANT'S PRO RATA SHARE": 32.6991%.

1.05 "BASE YEAR" for Taxes (defined in EXHIBIT B): 2006; "BASE YEAR" for Expenses (defined in EXHIBIT B): 2006.

1.06 "TERM": A period of 84 months and 0 days. Subject to Section 3, the Term shall commence on March 1, 2006 (the "COMMENCEMENT DATE") and, unless

terminated early in accordance with this Lease, end on February 28, 2013 (the "TERMINATION DATE").

1.07 "ALLOWANCE": $933,650.00, as more particularly described as the Maximum Amount on Exhibit C hereto.

1.08 "SECURITY DEPOSIT": $156,853.20, as more fully described in Section 6.

1.09 "GUARANTOR(S)": None

1.10 "BROKER(S)": Integrated Corporate Property Services and CPS Commercial Property Services, a$ co-brokers.

1.11 "PERMITTED Use": General office use, including, without limitation, (a) software related engineering, design, and product testing, (b) semiconductor related engineering and design, and (c) building, assembling, and physically constructing products related thereto; provided, however, that no more than 10% of the Premises (measured against the total Rentable Square Footage of the Premises) shall be used for building, assembling, and/or physically constructing any products.

1.12 "NOTICE ADDRESS(ES)":

Landlord:	Tenant;
CA-The Concourse Limited Partnership c/o Equity Office 1740 Technology Drive, Suite 150 San Jose, California 95110 Attention: Concourse Property Manager	Prior to the Commencement Date: Pixelworks, Inc. Attn: Chief Operating Officer 8100 SW Nyberg Road Tualatin, OR 97062 With a copy to Corporate Counsel at the same address. From and after the Commencement Date: Pixelworks, Inc. Attn: Chief Operating Officer 8100 SW Nyberg Road Tualatin, OR 97062

With a copy to Corporate Counsel at the same address.

A copy of any notices to Landlord shall be sent to Equity Office, One Market Street, Spear Tower, Suite 600, San Francisco, CA 94105, Attn: Regional Counsel.

1.13 "BUSINESS DAY(S)" are Monday through Friday of each week, exclusive of New Year's Day, Presidents Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day and Christmas Day ("HOLIDAYS"). Landlord may designate additional Holidays that are commonly recognized by other office buildings in the area where the Building is located. "BUILDING SERVICE HOURS" are 8:00 a.m. to 6:00 p.m. on Business Days.

1.14 "LANDLORD WORK" means the work, if any, that Landlord is obligated to perform in the Premises pursuant to a separate agreement (the "WORK LETTER", if any, attached to this Lease as EXHIBIT C.

1.15 "PROPERTY" means the Building and the parcel(s) of land on which it is located and, at Landlord's discretion, the parking facilities and other improvements, if any, serving the Building and the parcel(s) of land on which they are located. '

2. LEASE GRANT.

The Premises are hereby leased to Tenant from Landlord, together with the right to use any portions of the Property that are designated by Landlord for the common use of tenants and others (the "COMMON AREAS").

3. ADJUSTMENT OF COMMENCEMENT DATE; POSSESSION.

3.01 If Landlord is required to perform Landlord Work prior to the Commencement Date: (a) the date set forth in Section 1.06 as the Commencement Date shall instead be defined as the "TARGET COMMENCEMENT DATE"; (b) the actual Commencement Date shall be the date on which the Landlord Work is Substantially Complete (defined below); and (c) the Termination Date will be the last day of the Term as determined based upon the actual Commencement Date. Landlord's failure to Substantially Complete the Landlord Work by the Target Commencement Date shall not be a default by Landlord or otherwise render Landlord liable for damages. Promptly after the determination of the Commencement Date, Landlord and Tenant shall enter into a commencement letter agreement in the form attached as EXHIBIT D. Tenant's failure to execute and return the commencement letter, or to provide written objection to the statements contained in the letter, within 30 days after the date of the letter shall be deemed an approval by Tenant of the statements contained therein. If the Termination Date does not fall on the last day of a calendar month, Landlord and Tenant may elect to adjust the Termination Date to the last day of the calendar month in which the Termination Date occurs by the mutual execution of a commencement letter agreement setting forth such adjusted date. The Landlord Work shall be deemed to be "SUBSTANTIALLY COMPLETE" on the date that all Landlord Work has been performed, other than any details of construction, mechanical adjustment or any other similar matter, the non-completion of which does not materially interfere with Tenant's use of the Premises. If Landlord is delayed in the performance of the Landlord Work as a result of the acts or omissions of Tenant, the Tenant Related Parties (defined in Section 13) or their respective contractors or vendors, including, without limitation, changes requested by Tenant to approved plans, Tenant's failure to comply with any of its obligations under this Lease, or the specification of any materials or equipment with long lead times (a "TENANT DELAY"), the Landlord Work shall be deemed to be Substantially Complete on the date that Landlord could reasonably have been expected to Substantially Complete the Landlord Work absent any Tenant Delay.

If the Commencement Date has not occurred on or before the Outside Completion Date (defined below), Tenant shall be entitled to a rent abatement following the Commencement Date of $2,240.76 for every day in the period beginning on the Outside Completion Date and ending on the Commencement Date. The "OUTSIDE COMPLETION DATE" shall mean the later of (x) March 1, 2006 and (y) the date which is 60 days after the later of the date this Lease is properly executed and delivered by Tenant, the date all prepaid rental, Security Deposits and Guaranties required under this Lease are delivered to Landlord, the date the building permit for the Landlord Work has been obtained, and, if applicable, the date all contingencies, if any, specified in this Lease have been satisfied or waived in writing by Landlord. Landlord and Tenant acknowledge and agree that: (i) the determination of the Commencement Date shall take into consideration the effect of any Tenant Delays by Tenant; and (ii) the Outside Completion Date shall be postponed by the number of days the Commencement Date is delayed due to events of Force Majeure.

3.02 Subject to Landlord's obligation, if any, to perform Landlord Work, the Premises are accepted by Tenant in "as is" condition and configuration without any representations or warranties by Landlord (except as otherwise explicitly set forth herein). By taking possession of the Premises, Tenant agrees that the Premises are in good order and satisfactory condition. Tenant's acceptance of the Premises shall be subject to Landlord's obligation to correct portions of the Landlord Work as set forth on a construction punch list prepared by Landlord and Tenant in accordance with the terms hereof. Within 15 days after Substantial Completion of the Landlord Work, Landlord and Tenant shall together conduct an inspection of the Premises and prepare a "punch list" setting forth any portions of the Landlord Work that are not in conformity with the Landlord Work as required by the terms of this Lease. Notwithstanding the foregoing, at the request of Landlord, such construction punch list shall be mutually prepared by Landlord and Tenant prior to the date on which Tenant first begins to move its furniture, equipment or other personal property into the Premises. Landlord, as part of the Landlord Work, shall use good faith efforts to correct all such items within a reasonable time following the completion of the punch list. Landlord shall not be liable for a failure to deliver possession of the Premises or any other space due to the holdover or unlawful possession of such space by another party, however Landlord shall use reasonable efforts to obtain possession of the space. The commencement date for the space, in such event, shall be

postponed until the date Landlord delivers possession of the Premises to Tenant free from occupancy by any party. If Tenant takes possession of the Premises before the Commencement Date, such possession shall be subject to the terms and conditions of this Lease and Tenant shall pay Rent (defined in Section 4.01) to Landlord for each day of possession before the Commencement Date. However, except for the cost of services requested by Tenant (e.g. freight elevator usage), Tenant shall not be required to pay Rent for any days of possession before the Commencement Date during which Tenant, with the approval of Landlord, is in possession of the Premises for the sole purpose of performing improvements or installing furniture, equipment or other personal property. Subject to the terms of this Section 3, Landlord grants Tenant the right to enter the Premises no earlier than 30 days prior to the Commencement Date, at Tenant's sole risk, (i) following installation of the ceiling grid in the Premises, solely for the purpose of installing telecommunications and data cabling in the Premises, and (ii) following installation of the carpeting in the Premises, solely for the purpose of installing equipment, furnishings and other personalty. Landlord may withdraw such permission to enter the Premises prior to the Commencement Date at any time that Landlord reasonably determines that such entry by Tenant is causing a dangerous situation for Landlord, Tenant or their respective contractors or employees, or if Landlord reasonably determines that such entry by Tenant is hampering or otherwise preventing Landlord from proceeding with the completion of Landlord's Work at the earliest possible date.

4. RENT.

4.01 Tenant shall pay Landlord, without any setoff or deduction, unless expressly set forth in this Lease, all Base Rent and Additional Rent due for the Term (collectively referred to as "RENT"). "ADDITIONAL RENT" means all sums (exclusive of Base Rent) that Tenant is required to pay Landlord under this Lease. Tenant shall pay and be liable for all rental, sales and use taxes (but excluding income taxes), if any, imposed upon or measured by Rent. Base Rent and recurring monthly charges of Additional Rent shall be due and payable in advance on the first day of each calendar month without notice or demand, provided that the installment of Base Rent for the seventh full calendar month of the Term, and the first monthly installment of Additional Rent for Expenses and Taxes, shall be payable upon the execution of this Lease by Tenant. All other items of Rent shall be due and payable by Tenant on or before 30 days after billing by Landlord. Rent shall be made payable to the entity, and sent to the address, Landlord designates and shall be made by good and sufficient check or by other means acceptable to Landlord. Tenant shall pay Landlord an administration fee equal to 5% of all past due Rent, provided that Tenant shall be entitled to a grace period of 5 days for the first 2 late payments of Rent in a calendar year. In addition, past due Rent shall accrue interest at 12% per annum. Landlord's acceptance of less than the correct amount of Rent shall be considered a payment on account of the earliest Rent due. Rent for any partial month during the Term shall be prorated. No endorsement or statement on a check or letter accompanying payment shall be considered an accord and satisfaction. Tenant's covenant to pay Rent is independent of every other covenant in this Lease.

4.02 Tenant shall pay Tenant's Pro Rata Share of Taxes and Expenses in accordance with EXHIBIT B of this Lease.

5. COMPLIANCE WITH LAWS; USE.

The Premises shall be used for the Permitted Use and for no other use whatsoever. Tenant shall comply with all statutes, codes, ordinances, orders, rules and regulations of any municipal or governmental entity whether in effect now or later, including the Americans with Disabilities Act ("LAW(S)"), regarding the operation of Tenant's business and the use, condition, configuration and occupancy of the Premises. In addition, Tenant shall, at its sole cost and expense, promptly comply with any Laws that relate to the "Base Building" (defined below), but only to the extent such obligations are triggered by Tenant's use of the Premises, other than for general office use, or Alterations or improvements in the Premises performed or requested by Tenant. "BASE BUILDING" shall include the structural portions of the Building, the public restrooms and the Building mechanical, electrical and plumbing systems and equipment located in the internal core of the Building on the floor or floors on which the Premises are located. Tenant shall promptly provide Landlord with copies of any notices it receives regarding an alleged violation of Law. Tenant shall comply with the rules and regulations of the Building attached as EXHIBIT E and such other reasonable rules and regulations adopted by Landlord from time to time, including rules and regulations for the performance of Alterations (defined in Section 9).

As of the date hereof, Landlord has not received notice from any governmental agencies that the Building is in violation of either applicable fire/life/safety Laws or Title III of the Americans with

Disabilities Act. Landlord represents, to its knowledge based solely upon that certain Phase I Environmental Site Assessment by Golder Associates dated December 10, 1997, that the Premises are free of Hazardous Materials (as defined below) in amounts and conditions which are in violation of applicable environmental laws. As used in this Lease, "HAZARDOUS MATERIALS" shall mean any material or substance that is now or hereafter defined or regulated by any statute, regulation, ordinance, or governmental authority thereunder, as radioactive, toxic, hazardous, or waste, or a chemical known to the state of California to cause cancer or reproductive toxicity, including but not limited to (i) petroleum and any of its constituents or byproducts, (ii) radioactive materials, (iii) asbestos in any form or condition, and (iv) substances or materials regulated by any of the following, as amended from time to time, and any rules promulgated thereunder: the Comprehensive Environmental Response Compensation and Liability Act of 1980, 42 U.S.C. Sections 9601 et seq.; the Resource Conservation and Recovery Act, 42 U.S.C. Sections 6901, et seq.; the Toxic Substances Control Act, 15 U.S.C. Sections 2601, et seq.; the Clean Water Act, 33 U.S.C. Sections 1251 et seq; the Clean Air Act, 42 U.S.C. Sections 7401 et seq.; The California Health and Safety Code; The California Water Code; The California Labor Code; The California Public Resources Code; The California Fish and Game Code.

6. SECURITY DEPOSIT.

The Security Deposit shall be delivered to Landlord upon the execution of this Lease by Tenant and held by Landlord without liability for interest (unless required by Law) as security for the performance of Tenant's obligations. The Security Deposit is not an advance payment of Rent or a measure of damages. Landlord may use all or a portion of the Security Deposit to satisfy past due Rent or to cure any Default (defined in Section 18) by Tenant, or to satisfy any other loss or damage resulting from Tenant's Default as provided in Section 19. If Landlord uses any portion of the Security Deposit, Tenant shall, within 5 days after demand, restore the Security Deposit to its original amount. Landlord shall return any unapplied portion of the Security Deposit to Tenant within 45 days after the later to occur of: (a) determination of the final Rent due from Tenant; or (b) the later to occur of the Termination Date or the date Tenant surrenders the Premises to Landlord in compliance with Section 25. Landlord may assign the Security Deposit to a successor or transferee and, following the assignment, Landlord shall have no further liability for the return of the Security Deposit. Landlord shall not be required to keep the Security Deposit separate from its other accounts. Tenant hereby waives the provisions of Section 1950.7 of the California Civil Code, or any similar or successor Laws now or hereinafter in effect.

7. BUILDING SERVICES.

7.01 Landlord shall furnish Tenant with the following services: (a) water for use in the Base Building lavatories; (b) customary heat and air conditioning in season during Building Service Hours, although Tenant shall have the right to receive HVAC service during hours other than Building Service Hours by paying Landlord's then standard charge for additional HVAC service and providing such prior notice as is reasonably specified by Landlord; (c) standard janitorial service on Business Days; (d) elevator service; (e) electricity in accordance with the terms and conditions in Section 7.02; (f) access to the Building for Tenant and its employees 24 hours per day/7 days per week, subject to the terms of this Lease and such protective services or monitoring systems, if any, as Landlord may reasonably impose, including, without limitation, sign-in procedures and/or presentation of identification cards; and (g) such other services as Landlord reasonably determines are necessary or appropriate for the Property.

7.02 Electricity used by Tenant in the Premises shall, at Landlord's option, be paid for by Tenant either: (a) through inclusion in Expenses (except as provided for excess usage); (b) by a separate charge payable by Tenant to Landlord; or (c) by separate charge billed by the applicable utility company and payable directly by Tenant. Without the consent of Landlord, Tenant's use of electrical service shall not exceed, either in voltage, rated capacity, use beyond Building Service Hours or overall load, that which Landlord reasonably deems to be standard for the Building. Landlord shall have the right to measure electrical usage by commonly accepted methods, including the installation of measuring devices such as submeters and check meters. If it is determined that Tenant is using excess electricity, Tenant shall pay Landlord Additional Rent for the cost of such excess electrical usage and for the cost of purchasing and installing the measuring device(s).

7.03 Landlord's failure to furnish, or any interruption, diminishment or termination of services due to the application of Laws, the failure of any equipment, the performance of repairs, improvements or alterations, utility interruptions or the occurrence of an event of Force Majeure (defined in Section 26.03) (collectively a "SERVICE FAILURE") shall not render Landlord liable to Tenant, constitute a constructive eviction of Tenant, give rise to an abatement of Rent,

nor relieve Tenant from the obligation to fulfill any covenant or agreement. However, if the Premises, or a material portion of the Premises, are made untenantable for a period in excess of 2 consecutive Business Days as a result of a Service Failure that is reasonably within the control of Landlord to correct, then Tenant, as its sole remedy, shall be entitled to receive an abatement of Rent payable hereunder during the period beginning on the 4th consecutive Business Day of the Service Failure and ending on the day the service has been restored. If the entire Premises have not been rendered untenantable by the Service Failure, the amount of abatement shall be equitably prorated.

8. LEASEHOLD IMPROVEMENTS.

All improvements in and to the Premises, including any Alterations (defined in Section 9.03) (collectively, "LEASEHOLD IMPROVEMENTS") shall remain upon the Premises at the end of the Term without compensation to Tenant, provided that Tenant, at its expense, in compliance with the National Electric Code or other applicable Law, shall remove any Cable (defined in Section 9.01 below). In addition, Landlord, by written notice to Tenant within 30 days prior to the

Termination Date, may require Tenant, at its expense, to remove any Landlord Work or Alterations that, in Landlord's reasonable judgment, are of a nature that would require removal and repair costs that are materially in excess of the removal and repair costs associated with standard office improvements (the Cable and such other items collectively are referred to as "REQUIRED REMOVABLES"). Required Removables shall include, without limitation, internal stairways, raised floors, personal baths and showers, vaults, rolling file systems and structural alterations and modifications. The Required Removables shall be removed by Tenant before the Termination Date. Tenant shall repair damage caused by the installation or removal of Required Removables. If Tenant fails to perform its obligations in a timely manner, Landlord may perform such work at Tenant's expense. Tenant, at the time it requests approval for a proposed Alteration, including any Initial Alterations or Landlord Work, as such terms may be defined in the Work Letter attached as EXHIBIT C, may request in writing that Landlord advise Tenant whether the Alteration, including any Initial Alterations or Landlord Work, or any portion thereof, is a Required Removable. Within 10 days after receipt of Tenant's request, Landlord shall advise Tenant in writing as to which portions of the alteration or other improvements are Required Removables. Notwithstanding the foregoing (except for Cable (if any) and/or any electrical panels/transformers and any above Building standard electrical outlets and hook-ups), no portion of the Landlord Work (which Landlord Work shall be mutually agreed upon and depicted in the Plans (as hereinafter defined)) shall be deemed a Required Removable.

9. REPAIRS AND ALTERATIONS.

9.01 Tenant shall periodically inspect the Premises to identify any conditions that are dangerous or in need of maintenance or repair. Tenant shall promptly provide Landlord with notice of any such conditions. Tenant shall, at its sole cost and expense, perform all maintenance and repairs to the Premises that are not Landlord's express responsibility under this Lease, and keep the Premises in good condition and repair, reasonable wear and tear excepted. Tenant's repair and maintenance obligations include, without limitation, repairs to: (a) floor covering; (b) interior partitions; (c) doors; (d) the interior side of demising walls; (e) electronic, fiber, phone and data cabling and related equipment that is installed by or for the exclusive benefit of Tenant (collectively, "CABLE"); (f) supplemental air conditioning units, kitchens, including hot water heaters, plumbing, and similar facilities exclusively serving Tenant; and (g) Alterations. Subject to the terms of Section 15 below, to the extent Landlord is not reimbursed by insurance proceeds, Tenant shall reimburse Landlord for the cost of repairing damage to the Building caused by the acts of Tenant, Tenant Related Parties and their respective contractors and vendors. If Tenant fails to make any repairs to the Premises for more than 15 days after notice from Landlord (although notice shall not be required in an emergency), Landlord may make the repairs, and Tenant shall pay the reasonable cost of the repairs, together with an administrative charge in an amount equal to 7% of the cost of the repairs.

9.02 Landlord shall keep and maintain in good repair and working order and perform maintenance upon the: (a) structural elements of the Building; (b) mechanical (including HVAC), electrical, plumbing and fire/life safety systems serving the Building in general; (c) Common Areas; (d) roof of the Building; (e) exterior windows of the Building; and (f) elevators serving the Building. Landlord shall promptly make repairs for which Landlord is responsible. Tenant hereby waives any and all rights under and benefits of subsection 1 of Section 1932, and Sections 1941 and 1942 of the California Civil Code, or any similar or successor Laws now or hereinafter in effect.

9.03 Tenant shall not make alterations, repairs, additions or improvements or install any Cable (collectively referred to as "ALTERATIONS") without first obtaining the written consent of Landlord in each instance, which consent shall not be unreasonably withheld or delayed, However, Landlord's consent shall not be required for any Alteration that satisfies all of the following criteria (a "COSMETIC ALTERATION"): (a) is of a cosmetic nature such as painting, wallpapering, hanging pictures and installing carpeting; (b) is not visible from the exterior of the Premises or Building; (c) will not affect the Base Building; (d) does not require work to be performed inside the walls or above the ceiling of the Premises, and (e) costs no more than $20,000.00 to perform. Cosmetic Alterations shall be subject to all the other provisions of this Section 9.03. Prior to starting work, Tenant shall furnish Landlord with plans and specifications; names of contractors reasonably acceptable to Landlord (provided that Landlord may designate specific contractors with respect to Base Building); required permits and approvals; evidence of contractor's and subcontractor's insurance in amounts reasonably required by Landlord and naming Landlord as an additional insured; and any security for performance in amounts reasonably required by Landlord. Changes to the plans and specifications must also be submitted to Landlord for its approval. Alterations shall be constructed in a good and workmanlike manner using materials of a quality reasonably approved by Landlord. Tenant shall reimburse Landlord for any sums paid by Landlord for third party examination of Tenant's plans for non-Cosmetic Alterations. In addition, Tenant shall pay Landlord A fee for Landlord's oversight and coordination of any non-Cosmetic Alterations equal to 5% of the cost of the non-Cosmetic Alterations. Upon completion, Tenant shall furnish "as-built" plans for non-Cosmetic Alterations, completion affidavits and full and final waivers of lien, Landlord's approval of an Alteration shall not be deemed a representation by Landlord that the Alteration complies with Law.

10. ENTRY BY LANDLORD.

Landlord may enter the Premises to inspect, show or clean the Premises or to perform or facilitate the performance of repairs, alterations or additions to the Premises or any portion of the Building. Except in emergencies or to provide Building services, Landlord shall provide Tenant with reasonable prior verbal notice of entry and shall use reasonable efforts to minimize any interference with Tenant's use of the Premises. If reasonably necessary, Landlord may temporarily close all or a portion of the Premises to perform repairs, alterations and additions. However, except in emergencies, Landlord will not close the Premises if the work can reasonably be completed on weekends and after Building Service Hours. Entry by Landlord in compliance with this Section shall not constitute a constructive eviction or entitle Tenant to an abatement or reduction of Rent.

11. ASSIGNMENT AND SUBLETTING.

11.01 Except in connection with a Business Transfer (defined in Section 11.04), Tenant shall not assign, sublease, transfer or encumber any interest in this Lease or allow any third party to use any portion of the Premises (collectively or individually, a "TRANSFER") without the prior written consent of Landlord, which consent shall not be unreasonably withheld, conditioned or delayed if Landlord does not exercise its recapture rights under Section 11.02. If the entity(ies) which directly or indirectly controls the voting shares/rights of Tenant changes at any time, such change of ownership or control shall constitute a Transfer unless Tenant is an entity whose outstanding stock is listed on a recognized securities exchange or if at least 80% of its voting stock is owned by another entity, the voting stock of which is so listed. Tenant hereby waives the provisions of Section 1995.310 of the California Civil Code, or any similar or successor Laws, now or hereinafter in effect, and all other remedies, including, without limitation, any right at law or equity to terminate this Lease, on its own behalf and, to the extent permitted under all applicable Laws, on behalf of the proposed transferee. Any Transfer in violation of this Section shall, at Landlord's option, be deemed a Default by Tenant as described in Section 18, and shall be voidable by Landlord. In no event shall any Transfer, including a Business Transfer, release or relieve Tenant from any obligation under this Lease, and Tenant shall remain primarily liable far the performance of the tenant's obligations under this Lease, as amended from time to time.

11.02 Tenant shall provide Landlord with financial statements for the proposed transferee, a fully executed copy of the proposed assignment, sublease or other Transfer documentation and such other information as Landlord may reasonably request. Within 15 Business Days after receipt of the required information and documentation, Landlord shall either: (a) consent to the Transfer by execution of a consent agreement in a form reasonably designated by Landlord; (b) reasonably refuse to consent to the Transfer in writing; or (c) in the event of an assignment of this Lease or subletting of more than 20% of the Rentable Square Footage of the Premises for more than 50% of the remaining Term (excluding unexercised options), recapture the

portion of the Premises that Tenant is proposing to Transfer (other than pursuant to a Business Transfer). If Landlord exercises its right to recapture, this Lease shall automatically be amended (or terminated if the entire Premises is being assigned or sublet) to delete the applicable portion of the Premises effective on the proposed effective date of the Transfer, although Landlord may require Tenant to execute a reasonable amendment or other document reflecting such reduction or termination. Tenant shall pay Landlord a review fee of $1,500.00 for Landlord's review of any requested Transfer.

11.03 Tenant shall pay Landlord 50% of all rent and other consideration which Tenant receives as a result of a Transfer that is in excess of the Rent payable to Landlord for the portion of the Premises and Term covered by the Transfer. Tenant shall pay Landlord for Landlord's share of the excess within 30 days after Tenant's receipt of the excess. Tenant may deduct from the excess, on a straight-line basis, all reasonable and customary expenses directly incurred by Tenant attributable to the Transfer. If Tenant is in Default, Landlord may require that all sublease payments be made directly to Landlord, in which case Tenant shall receive a credit against Rent in the amount of Tenant's share of payments received by Landlord.

11.04 Tenant may assign this Lease to a successor to Tenant by merger, consolidation or the purchase of substantially all of Tenant's assets, or assign this Lease or sublet all or a portion of the Premises to an Affiliate (defined below), without the consent of Landlord, provided that all of the following conditions are satisfied (a "BUSINESS TRANSFER"); (a) Tenant must not be in Default; (b) Tenant must give Landlord written notice at least 15 Business Days before such Transfer; and (c) if such Transfer will result from a merger or consolidation of Tenant with another entity, then the Credit Requirement (defined below) must be satisfied. Tenant's notice to Landlord shall include information and documentation evidencing the Business Transfer and showing that each of the above conditions has been satisfied. If requested by Landlord, Tenant's successor shall sign a commercially reasonable form of assumption agreement. "AFFILIATE" shall mean an entity controlled by, controlling or under common control with Tenant. The "CREDIT REQUIREMENT" shall be deemed satisfied if, as of the date immediately preceding the date of the Transfer, the financial strength of the entity with which Tenant is to merge or consolidate is not less than that of Tenant, as determined (x) based on credit ratings of such entity and Tenant by both Moody's and Standard & Poor's (or by either such agency alone if applicable ratings by the other agency do not exist), or (y) if such credit ratings do not exist, then in accordance with Moody's KMV RiskCalc (i.e., the on-line software tool offered by Moody's for analyzing credit risk) based on CFO-certified financial statements for such entity and Tenant covering their last two fiscal years ending before the Transfer.

12. LIENS.

Tenant shall not permit mechanics' or other liens to be placed upon the Property, Premises or Tenant's leasehold interest in connection with any work or service done or purportedly done by or for the benefit of Tenant or its transferees. Tenant shall give Landlord notice at least 15 days prior to the commencement of any work in the Premises to afford Landlord the opportunity, where applicable, to post and record notices of non-responsibility. Tenant, within 10 days of notice from Landlord, shall fully discharge any lien by settlement, by bonding or by insuring over the lien in the manner prescribed by the applicable lien Law and, if Tenant fails to do so, Tenant shall be deemed in Default under this Lease and, in addition to any other remedies available to Landlord as a result of such Default by Tenant, Landlord, at its option, may bond, insure over or otherwise discharge the lien. Tenant shall reimburse Landlord for any amount paid by Landlord, including, without limitation, reasonable attorneys' fees.

13. INDEMNITY AND WAIVER OF CLAIMS.

Except to the extent caused by the negligence or willful misconduct of Landlord or any Landlord Related Parties (defined below), Tenant shall indemnify, defend and hold Landlord and Landlord Related Parties harmless against and from all liabilities, obligations, damages, penalties, claims, actions, costs, charges and expenses, including, without, limitation, reasonable attorneys' fees and other professional fees (if and to the extent permitted by Law) (collectively referred to as "LOSSES"), which may be imposed upon, incurred by or asserted against Landlord or any of the Landlord Related Parties by any third party and arising out of or in connection with any damage or injury occurring in the Premises or any acts or omissions (including violations of Law) of Tenant, the Tenant Related Parties (defined below) or any of Tenant's transferees, contractors or licensees. Except to the extent caused by the negligence or willful misconduct of Tenant or any Tenant Related Parties, Landlord shall indemnify, defend and hold Tenant, its trustees, members, principals, beneficiaries, partners, officers, directors, employees and agents ("TENANT RELATED PARTIES") harmless against and from all Losses which

may be imposed upon, incurred by or asserted against Tenant or any of the Tenant Related Parties by any third party and arising out of or in connection with the acts or omissions (including violations of Law) of Landlord or the Landlord Related Parties. Tenant hereby waives all claims against and releases Landlord and its trustees, members, principals, beneficiaries, partners, officers, directors, employees, Mortgagees (defined in Section 23) and agents (the "LANDLORD RELATED PARTIES") from all claims for any injury to or death of persons, damage to property or business loss in any manner related to (a) Force Majeure, (b) acts of third parties, (c) the bursting or leaking of any tank, water closet, drain or other pipe, (d) the inadequacy or failure of any security or protective services, personnel or equipment, or (e) any matter not within the reasonable control of Landlord.

14. INSURANCE.

Tenant shall maintain the following insurance ("TENANT'S INSURANCE"): (a) Commercial General Liability Insurance applicable to the Premises and its appurtenances providing, on an occurrence basis, a minimum combined single limit of $2,000,000.00; (b) Property/Business Interruption Insurance written on an All Risk or Special Cause of Loss Form, including earthquake sprinkler leakage, at replacement cost value and with a replacement cost endorsement covering all of Tenant's business and trade fixtures, equipment, movable partitions, furniture, merchandise and other personal property within the Premises ("TENANT'S PROPERTY") and any Leasehold Improvements performed by or for the benefit of Tenant; (c) Workers' Compensation Insurance in amounts required by Law; and (d) Employers Liability Coverage of at least $1,000,000.00 per occurrence. Any company writing Tenant's Insurance shall have an A.M. Best rating of not less than A-VIII. All Commercial General Liability Insurance policies shall name as additional insureds Landlord (or its successors and assignees), the managing agent for the Building (or any successor), EOP Operating Limited Partnership, Equity Office Properties Trust and their respective members, principals, beneficiaries, partners, officers, directors, employees, and agents, and other designees of Landlord and its successors as the interest of such designees shall appear. In addition, Landlord shall be named as a loss payee with respect to Property/Business Interruption Insurance on the Leasehold Improvements. All policies of Tenant's Insurance shall contain endorsements that the insurer(s) shall give Landlord and its designees at least 30 days' advance written notice of any cancellation, termination, material change or lapse of insurance. Tenant shall provide Landlord with a certificate of insurance evidencing Tenant's Insurance prior to the earlier to occur of the Commencement Date or the date Tenant is provided with possession of the Premises, and thereafter as necessary to assure that Landlord always has current certificates evidencing Tenant's Insurance. So long as the same is available at commercially reasonable rates, Landlord shall maintain so called All Risk property insurance on the Building at replacement cost value as reasonably estimated by Landlord, together with such other insurance coverage as Landlord, in its reasonable judgment, may elect to maintain.

15. SUBROGATION.

Landlord and Tenant hereby waive and shall cause their respective insurance carriers to waive any and all rights of recovery, claims, actions or causes of action against the other for any loss or damage with respect to Tenant's Property, Leasehold Improvements, the Building, the Premises, or any contents thereof, including rights, claims, actions and causes of action based on negligence, which loss or damage is (or would have been, had the insurance required by this Lease been carried) covered by insurance. For the purposes of this waiver, any deductible with respect to a party's insurance shall be deemed covered by and recoverable by such party under valid and collectable policies of insurance.

16. CASUALTY DAMAGE.

16.01 If all or any portion of the Premises becomes untenantable by fire or other casualty to the Premises (collectively a "CASUALTY"), Landlord, with reasonable promptness, shall cause a general contractor selected by Landlord to provide Landlord and Tenant with a written estimate of the amount of time required using standard working methods to Substantially Complete the repair and restoration of the Premises and any Common Areas necessary to provide access to the Premises ("COMPLETION ESTIMATE"). If the Completion Estimate indicates that the Premises or any Common Areas necessary to provide access to the Premises cannot be made tenantable within 270 days from the date the repair is started, then either party shall have the right to terminate this Lease upon written notice to the other within 10 days after receipt of the Completion Estimate. Tenant, however, shall not have the right to terminate this Lease if the Casualty was caused by the negligence or intentional misconduct of Tenant or any Tenant Related Parties. In addition, Landlord, by notice to Tenant within 90 days after the date of the Casualty, shall have the right to terminate this Lease if: (1) the Premises have been materially

damaged and there is less than 2 years of the Term remaining on the date of the Casualty; (2) any Mortgagee requires that the insurance proceeds be applied to the payment of the mortgage debt; or (3) a material uninsured loss to the Building or Premises occurs. In addition, Tenant shall have the right to terminate this Lease if: (1) (a) a substantial portion of the Premises has been damaged by fire or other Casualty and such damage cannot reasonably be repaired within 60 days after the Casualty; (b) there is less than 1 year of the Term remaining on the date of such Casualty; (c) the Casualty was not caused by the negligence or willful misconduct of Tenant or its agents, employees or contractors; and (d) Tenant provides Landlord with written notice of its intent to terminate within 30 days after the date of the fire or other Casualty and/or (2)(a) a substantial portion of the Premises has been damaged by fire or other Casualty and the repair or restoration is not Substantially Complete on or before the Required Completion Date (defined below), (b) the Casualty was not caused by the negligence or willful misconduct of Tenant or its agents, employees or contractors and (c) Tenant provides Landlord with written notice of its intent to terminate before the earlier to occur of: (i) 5 Business Days after the Required Completion Date; and (ii) the date such repair or restoration is Substantially Complete. The "REQUIRED COMPLETION DATE" shall mean the date which is 60 days after the stated estimated completion date as set forth in the Completion Estimate. Landlord and Tenant acknowledge and agree that: (i) the determination of the date upon which the repair and restoration work is Substantially Complete shall take into consideration the effect of any Tenant Delays; and (ii) the Required Completion Date shall be postponed by the number of days the repair and restoration work is delayed due to events of Force Majeure. Notwithstanding any provision herein to the contrary, if Landlord determines in good faith that it will be unable to cause the repair or restoration work be Substantially Complete by the Required Completion Date, Landlord shall have the right to immediately cease its performance of the repair and restoration work and provide Tenant with written notice (the "COMPLETION DATE EXTENSION NOTICE") of such inability, which Completion Date Extension Notice shall set forth the date on which Landlord reasonably believes that the repair and restoration work will be Substantially Complete. Upon receipt of the Completion Date Extension Notice, Tenant shall have the right to terminate this Lease by providing written notice of termination to Landlord within 5 Business Days after the date of the Completion Date Extension Notice. If Tenant does not terminate this Lease within such 5 Business Day period, the Required Completion Date automatically shall be amended to be the date set forth in Landlord's Completion Date Extension Notice.

16.02 If this Lease is not terminated, Landlord shall promptly and diligently, subject to reasonable delays for insurance adjustment or other matters beyond Landlord's reasonable control, restore the Premises, Common Areas and Leasehold Improvements to substantially the same condition they were in immediately before the Casualty (but excluding any Alterations that were performed by Tenant in violation of this Lease). Such restoration shall be to substantially the same condition that existed prior to the Casualty, except for modifications required by Law or any other modifications to the Common Areas deemed desirable by Landlord. Upon notice from Landlord, Tenant shall assign or endorse over to Landlord (or to any party designated by Landlord) all property insurance proceeds payable to Tenant under Tenant's Insurance with respect to any Leasehold Improvements performed by or for the benefit of Tenant; provided if the estimated cost to repair such Leasehold Improvements exceeds the amount of Insurance proceeds received by Landlord from Tenant's insurance carrier, the excess cost of such repairs shall be paid by Tenant to Landlord prior to Landlord's commencement of repairs. Within 15 days of demand, Tenant shall also pay Landlord for any additional excess costs that are determined during the performance of the repairs. In no event shall Landlord be required to spend more for the restoration than the proceeds received by Landlord, whether insurance proceeds or proceeds from Tenant. If, at any time after the Casualty, (a) Landlord is unable to obtain all or any portion of the insurance proceeds from Landlord's insurance, (b) in restoring the Premises and/or the Common Areas providing access to the Premises, Landlord chooses not to spend more than the restoration proceeds received by Landlord, and (c) Landlord provides Tenant written notice of the same (which Landlord shall be obligated to deliver within 30 days of making such determination), then within 30 days of the date thereof and by written notice to Landlord, Tenant shall have the right to terminate this Lease if the Casualty was not caused by the negligence or intentional misconduct of Tenant or any Tenant Related Parties. Landlord shall not be liable for any inconvenience to Tenant, or injury to Tenant's business resulting in any way from the Casualty or the repair thereof. Provided that Tenant is not in Default, during any period of time that all or a material portion of the Premises is rendered untenantable as a result of a Casualty, the Rent shall abate for the portion of the Premises that is untenantable and not used by Tenant.

16.03 If Tenant was entitled to but elected not to exercise its right to terminate the Lease and Landlord does not substantially complete the repair and restoration of the Premises within 2 months after the expiration of the estimated period of time set forth in the Completion

Estimate, which period shall be extended to the extent of any Reconstruction Delays (defined below), then Tenant may terminate this Lease by written notice to Landlord within 15 days after the expiration of such period, as the same may be extended. For purposes of this Lease, the term "RECONSTRUCTION DELAYS" shall mean: (i) any delays caused by the insurance adjustment process; (ii) any delays caused by Tenant; and (iii) any delays caused by events of Force Majeure.

16.04 The provisions of this Lease, including this Section 16, constitute an express agreement between Landlord and Tenant with respect to any and all damage to, or destruction of, all or any part of the Premises or the Property, and any Laws, including, without limitation, Sections 1932(2) and 1933(4) of the California Civil Code, with respect to any rights or obligations concerning damage or destruction in the absence of an express agreement between the parties, and any similar or successor Laws now or hereinafter in effect, shall have no application to this Lease or any damage or destruction to all or any part of the Premises or the Property.

17. CONDEMNATION.

Either party may terminate this Lease if any material part of the Premises is taken or condemned for any public or quasi-public use under Law, by eminent domain or private purchase in lieu thereof (a "TAKING"). Landlord shall also have the right to terminate this Lease if there is a Taking of any portion of the Building or Property which would have a material adverse effect on Landlord's ability to profitably operate the remainder of the Building. The terminating party shall provide written notice of termination to the other party within 45 days after it first receives notice of the Taking. The termination shall be effective as of the effective date of any order granting possession to, or vesting legal title in, the condemning authority. If this Lease is not terminated, Base Rent and Tenant's Pro Rata Share shall be appropriately adjusted to account for any reduction in the square footage of the Building or Premises. All compensation awarded for a Taking shall be the property of Landlord. The right to receive compensation or proceeds are expressly waived by Tenant, however, Tenant may file a separate claim for Tenant's Property and Tenant's reasonable relocation expenses, provided the filing of the claim does not diminish the amount of Landlord's award. If only a part of the Premises is subject to a Taking and this Lease is not terminated, Landlord, with reasonable diligence, will restore the remaining portion of the Premises as nearly as practicable to the condition immediately prior to the Taking. Tenant hereby waives any and all rights it might otherwise have pursuant to Section 1265.130 of the California Code of Civil Procedure, or any similar or successor Laws.

18. EVENTS OF DEFAULT.

In addition to any other default specifically described in this Lease, each of the following occurrences shall be a "DEFAULT": (a) Tenant's failure to pay any portion of Rent when due, if the failure continues for 3 days after written notice to Tenant ("MONETARY DEFAULT"); (b) Tenant's failure (other than a Monetary Default) to comply with any term, provision, condition or covenant of this Lease, if the failure is not cured within 10 days after written notice to Tenant provided, however, if Tenant's failure to comply cannot reasonably be cured within 10 days, Tenant shall be allowed additional time (not to exceed 60 days) as is reasonably necessary to cure the failure so long as Tenant begins the cure within 10 days and diligently pursues the cure to completion; (c) Tenant permits a Transfer without Landlord's required approval or otherwise in violation of Section 11 of this Lease; (d) Tenant or any Guarantor becomes insolvent, makes a transfer in fraud of creditors, makes an assignment for the benefit of creditors, admits in writing its inability to pay its debts when due or forfeits or loses its right to conduct business; (e) the leasehold estate is taken by process or operation of Law; (f) in the case of any ground floor or retail Tenant, Tenant does not lake possession of or abandons or vacates all or any portion of the Premises; or (g) Tenant is in default beyond any notice and cure period under any other lease or agreement with Landlord at the Building or Property. If Landlord provides Tenant with notice of Tenant's failure to comply with any specific provision of this Lease on 3 separate occasions during any 12 month period, Tenant's subsequent violation of such provision shall, at Landlord's option, be an incurable Default by Tenant. All notices sent under this Section shall be in satisfaction of, and not in addition to, notice required by Law.

19. REMEDIES.

19.01 Upon the occurrence of any Default under this Lease, whether enumerated in Section 18 or not, Landlord shall have the option to pursue any one or more of the following remedies without any notice (except as expressly prescribed herein) or demand whatsoever (and without limiting the generality of the foregoing, Tenant hereby specifically waives notice and

demand for payment of Rent or other obligations, except for those notices specifically required pursuant to the terms of Section 18 or this Section 19, and waives any and all other notices or demand requirements imposed by applicable law):

(a) Terminate this Lease and Tenant's right to possession of the Premises and recover from Tenant an award of damages equal to the sum of the following:

(i) The Worth at the Time of Award of the unpaid Rent which had been earned at the time of termination;

(ii) The Worth at the Time of Award of the amount by which the unpaid Rent which would have been earned after termination until the time of award exceeds the amount of such Rent loss that Tenant affirmatively proves could have been reasonably avoided;

(iii) The Worth at the Time of Award of the amount by which the unpaid Rent for the balance of the Term after the time of award exceeds the amount of such Rent loss that Tenant affirmatively proves could be reasonably avoided;

(iv) Any other amount necessary to compensate Landlord for all the detriment either proximately caused by Tenant's failure to perform Tenant's obligations under this Lease or which in the ordinary course of things would be likely to result therefrom; and

(v) All such other amounts in addition to or in lieu of the foregoing as may be permitted from time to time under applicable law.

The "WORTH AT THE TIME OF AWARD" of the amounts referred to in parts (i) and (ii) above, shall be computed by allowing interest at the lesser of a per annum rate equal to: (A) the greatest per annum rate of Interest permitted from time to time under applicable law, or (B) the Prime Rate plus 5%. For purposes hereof, the "PRIME RATE" shall be the per annum interest rate publicly announced as its prime or base rate by a federally insured bank selected by Landlord in the State of California. The "WORTH AT THE TIME OF AWARD" of the amount referred to in part (iii), above, shall be computed by discounting such amount at the discount rate of the Federal Reserve Bank of San Francisco at the time of award plus 1%;

(b) Employ the remedy described in California Civil Code Section 1951.4 (Landlord may continue this Lease in effect after Tenant's breach and abandonment and recover Rent as it becomes due, if Tenant has the right to sublet or assign, subject only to reasonable limitations); or

(c) Notwithstanding Landlord's exercise of the remedy described in California Civil Code Section 1951.4 in respect of an event or events of default, at such time thereafter as Landlord may elect in writing, to terminate this Lease and Tenant's right to possession of the Premises and recover an award of damages as provided above in Paragraph 19.01 (a).

19.02 The subsequent acceptance of Rent hereunder by Landlord shall not be deemed to be a waiver of any preceding breach by Tenant of any term, covenant or condition of this Lease, other than the failure of Tenant to pay the particular Rent so accepted, regardless of Landlord's knowledge of such preceding breach at the time of acceptance of such Rent. No waiver by Landlord of any breach hereof shall be effective unless such waiver is in writing and signed by Landlord.

19.03 TENANT HEREBY WAIVES ANY AND ALL RIGHTS CONFERRED BY SECTION 3275 OF THE CIVIL CODE OF CALIFORNIA AND BY SECTIONS 1174 (c) AND 1179 OF THE CODE OF CIVIL PROCEDURE OF CALIFORNIA AND ANY AND ALL OTHER LAWS AND RULES OF LAW FROM TIME TO TIME IN EFFECT DURING THE LEASE TERM PROVIDING THAT TENANT SHALL HAVE ANY RIGHT TO REDEEM, REINSTATE OR RESTORE THIS LEASE FOLLOWING ITS TERMINATION BY REASON OF TENANT'S BREACH. TENANT ALSO HEREBY WAIVES, TO THE FULLEST EXTENT PERMITTED BY LAW, THE RIGHT TO TRIAL BY JURY IN ANY LITIGATION ARISING OUT OF OR RELATING TO THIS LEASE.

19.04 No right or remedy herein conferred upon or reserved to Landlord is intended to be exclusive of any other right or remedy, and each and every right and remedy shall be cumulative and in addition to any other right or remedy given hereunder or now or hereafter existing by agreement, applicable law or in equity. In addition to other remedies provided in this Lease, Landlord shall be entitled, to the extent permitted by applicable law, to injunctive relief, or to a decree compelling performance of any of the covenants, agreements, conditions or provisions of this Lease, or to any other remedy allowed to Landlord at law or in equity. Forbearance by Landlord to enforce one or more of the remedies herein provided upon an event of default shall not be deemed or construed to constitute a waiver of such default.

19.05 If Tenant is in Default of any of its non-monetary obligations under the Lease, Landlord shall have the right to perform such obligations. Tenant shall reimburse Landlord for the cost of such performance upon demand together with an administrative charge equal to 10% of the cost of the work performed by Landlord.

19.06 This Section 19 shall be enforceable to the maximum extent such enforcement is not prohibited by applicable law, and the unenforceability of any portion thereof shall not thereby render unenforceable any other portion.

20. LIMITATION OF LIABILITY.

NOTWITHSTANDING ANYTHING TO THE CONTRARY CONTAINED IN THIS LEASE, THE LIABILITY OF LANDLORD (AND OF ANY SUCCESSOR LANDLORD) SHALL BE LIMITED TO THE LESSER OF (A) THE INTEREST OF LANDLORD IN THE PROPERTY, OR (B) THE EQUITY INTEREST LANDLORD WOULD HAVE IN THE PROPERTY IF THE PROPERTY WERE ENCUMBERED BY THIRD PARTY DEBT IN AN AMOUNT EQUAL TO 70% OF THE VALUE OF THE PROPERTY. TENANT SHALL LOOK SOLELY TO LANDLORD'S INTEREST IN THE PROPERTY FOR THE RECOVERY OF ANY JUDGMENT OR AWARD AGAINST LANDLORD OR ANY LANDLORD RELATED PARTY. NEITHER LANDLORD NOR ANY LANDLORD RELATED PARTY SHALL BE PERSONALLY LIABLE FOR ANY JUDGMENT OR DEFICIENCY, AND IN NO EVENT SHALL LANDLORD OR ANY LANDLORD RELATED PARTY BE LIABLE TO TENANT FOR ANY LOST PROFIT, DAMAGE TO OR LOSS OF BUSINESS OR ANY FORM OF SPECIAL, INDIRECT OR CONSEQUENTIAL DAMAGE. BEFORE FILING SUIT FOR AN ALLEGED DEFAULT BY LANDLORD, TENANT SHALL GIVE LANDLORD AND THE MORTGAGEE(S) WHOM TENANT HAS BEEN NOTIFIED HOLD MORTGAGES (DEFINED IN SECTION 23 BELOW), NOTICE AND REASONABLE TIME TO CURE THE ALLEGED DEFAULT.

21. RELOCATION.

At Landlord's sole cost and expense, at any time before or during the Term, if Landlord reasonably determines it is necessary for the health and safety of Tenant or of other tenants in the Building, Landlord may relocate Tenant from the Premises to space of reasonably comparable size and utility ("RELOCATION SPACE") within the Building or adjacent buildings within the same project upon 60 days' prior written notice to Tenant. The Relocation Space must contain similar finishes as the Premises, and approximately the same Rentable Square Footage as the Premises and the same number of work stations, offices, breakrooms and reception areas as are contained in the Premises as of the date Tenant receives Landlord's notice of relocation. From and after the date of the relocation, the Base Rent and Tenant's Pro Rata Share shall be adjusted based on the rentable square footage of the Relocation Space. Landlord shall pay Tenant's reasonable costs of relocation, including all costs for moving Tenant's furniture, equipment, supplies and other personal property, as well as the cost of printing and distributing change of address notices to Tenant's customers and one month's supply of stationery showing the new address, and prior to such relocation, Landlord, at Landlord's cost, shall improve the Relocation Space to incorporate improvements and finishes similar to those incorporated within the Premises (the commercial availability of like or similar materials shall be taken into account in such case, so that Landlord will not be required to duplicate materials or finishes which are no longer readily available on the market, but may instead, with Tenant's consent [not to be unreasonably withheld, conditioned or delayed], substitute reasonable replacement materials or finishes). Landlord shall also reimburse Tenant for the reasonable cost to install and connect telecommunication and data cabling in the Relocation Space in the manner and to the extent such cabling existed in the Premises prior to the relocation.

22. HOLDING OVER.

If Tenant fails to surrender all or any part of the Premises at the termination of this Lease, occupancy of the Premises after termination shall be that of a tenancy at sufferance. Tenant's occupancy shall be subject to all the terms and provisions of this Lease, and Tenant shall pay an amount (on a per month basis without reduction for partial months during the holdover) equal to 125% of the sum of the Base Rent and Additional Rent due for the period immediately preceding the holdover. Notwithstanding the foregoing, if Tenant's hold over exceeds three months, then starting in the fourth month, the percentage in the foregoing sentence shall increase from 125% to 150%. No holdover by Tenant or payment by Tenant after the termination of this Lease shall be construed to extend the Term or prevent Landlord from immediate recovery of possession of the Premises by summary proceedings or otherwise. If Landlord is unable to deliver possession of the Premises to a new tenant or to perform improvements for a new tenant as a result of Tenant's holdover and Tenant fails to vacate the Premises within 15 days after notice from Landlord, Tenant shall be liable for all damages that Landlord suffers from the holdover.

23. SUBORDINATION TO MORTGAGES; ESTOPPEL CERTIFICATE.

Tenant accepts this Lease subject and subordinate to any mortgage(s), deed(s) of trust, ground lease(s) or other lien(s) now or subsequently arising upon the Premises, the Building or the Property, and to renewals, modifications, refinancings and extensions thereof (collectively referred to as a "MORTGAGE"). The party having the benefit of a Mortgage shall be referred to as a "MORTGAGEE". This clause shall be self-operative, but upon request from a Mortgagee, Tenant shall execute a commercially reasonable subordination agreement in favor of the Mortgagee. As an alternative, a Mortgagee shall have the right at any time to subordinate its Mortgage to this Lease. Upon request, Tenant, without charge, shall attorn to any successor to Landlord's interest in this Lease. Landlord and Tenant shall each, within 10 days after receipt of a written request from the other, execute and deliver a commercially reasonable estoppel certificate to those parties as are reasonably requested by the other (including a Mortgagee or prospective purchaser). Without limitation, such estoppel certificate may include a certification as to the status of this Lease, the existence of any defaults and the amount of Rent that is due and payable. Notwithstanding the foregoing in this Article to the contrary, as a condition precedent to the future subordination of this Lease to a future Mortgage, Landlord shall be required to provide Tenant with a non-disturbance, subordination, and attornment agreement in favor of Tenant from any Mortgagee who comes into existence after the Commencement Date. Such non-disturbance, subordination, and attornment agreement in favor of Tenant shall provide that, so long as Tenant is paying the Rent due under the Lease and is not otherwise in default under the Lease beyond any applicable cure period, its right to possession and the other terms of the Lease shall remain in full force and effect. Such non-disturbance, subordination, and attornment agreement may include other commercially reasonable provisions in favor of the Mortgagee.

24. NOTICE.

All demands, approvals, consents or notices (collectively referred to as a "NOTICE") shall be in writing and delivered by hand or sent by registered or certified mail with return receipt requested or sent by overnight or same day courier service at the party's respective Notice Address(es) set forth in Section 1. Each notice shall be deemed to have been received on the earlier to occur of actual delivery or the date on which delivery is refused, or, if Tenant has vacated the Premises or any other Notice Address of Tenant without providing a new Notice Address, 3 days after notice is deposited in the U.S. mail or with a courier service in the manner described above. Either party may, at any time, change its Notice Address (other than to a post office box address) by giving the other party written notice of the new address.

25. SURRENDER OF PREMISES.

At the termination of this Lease or Tenant's right of possession, Tenant shall remove Tenant's Property from the Premises, and quit and surrender the Premises to Landlord, broom clean, and in good order, condition and repair, ordinary wear and tear and damage which Landlord is obligated to repair hereunder excepted. If Tenant fails to remove any of Tenant's Property within 2 days after termination of this Lease or Tenant's right to possession, Landlord, at Tenant's sole cost and expense, shall be entitled (but not obligated) to remove and store Tenant's Property. Landlord shall not be responsible for the value, preservation or safekeeping of Tenant's Property. Tenant shall pay Landlord, upon demand, the expenses and storage charges incurred. If Tenant fails to remove Tenant's Property from the Premises or storage,

within 30 days after notice, Landlord may deem all or any part of Tenant's Property to be abandoned and title to Tenant's Property shall vest in Landlord.

26. MISCELLANEOUS.

26.01 This Lease shall be interpreted and enforced in accordance with the Laws of the state or commonwealth in which the Building is located and Landlord and Tenant hereby irrevocably consent to the jurisdiction and proper venue of such state or commonwealth. If any term or provision of this Lease shall to any extent be void or unenforceable, the remainder of this Lease shall not be affected. If there is more than one Tenant or if Tenant is comprised of more than one party or entity, the obligations imposed upon Tenant shall be joint and several obligations of all the parties and entities, and requests or demands from any one person or entity comprising Tenant shall be deemed to have been made by all such persons or entities. Notices to any one person or entity shall be deemed to have been given to all persons and entities. Tenant represents and warrants to Landlord that each individual executing this Lease on behalf of Tenant is authorized to do so on behalf of Tenant and that Tenant is not, and the entities or individuals constituting Tenant or which may own or control Tenant or which may be owned or controlled by Tenant are not, (i) in violation of any laws relating to terrorism or money laundering, or (ii) among the individuals or entities identified on any list compiled pursuant to Executive Order 13224 for the purpose of identifying suspected terrorists or on the most current list published by the U.S. Treasury Department Office of Foreign Assets Control at its official website, http://www.treas.gov/ofac/tllsdn.pdf or any replacement website or other replacement official publication of such list.

26.02 If either party institutes a suit against the other for violation of or to enforce any covenant, term or condition of this Lease, the prevailing party shall be entitled to reimbursement of all of its costs and expenses, including, without limitation, reasonable attorneys' fees. Landlord and Tenant hereby waive any right to trial by jury in any proceeding based upon a breach of this Lease. No failure by either party to declare a default immediately upon its occurrence, nor any delay by either party in taking action for a default, nor Landlord's acceptance of Rent with knowledge of a default by Tenant, shall constitute a waiver of the default, nor shall it constitute an estoppel.

26.03 Whenever a period of time is prescribed for the taking of an action by Landlord or Tenant (other than the payment of the Security Deposit or Rent), the period of time for the performance of such action shall be extended by the number of days that the performance is actually delayed due to strikes, acts of God, shortages of labor or materials, war, terrorist acts, civil disturbances and other causes beyond the reasonable control of the performing party ("FORCE MAJEURE").

26.04 Landlord shall have the right to transfer and assign, in whole or in part, all of its rights and obligations under this Lease and in the Building and Property. Upon transfer Landlord shall be released from any further obligations hereunder and Tenant agrees to look solely to the successor in interest of Landlord for the performance of such obligations, provided that, any successor pursuant to a voluntary, third party transfer (but not as part of an involuntary transfer resulting from a foreclosure or deed in lieu thereof) shall have assumed Landlord's obligations under this Lease.

26.05 Landlord has delivered a copy of this Lease to Tenant for Tenant's review only and the delivery of it does not constitute an offer to Tenant or an option. Tenant represents that it has dealt directly with and only with the Broker as a broker in connection with this Lease. Tenant shall indemnify and hold Landlord and the Landlord Related Parties harmless from all claims of any other brokers claiming to have represented Tenant in connection with this Lease. Landlord shall indemnify and hold Tenant and the Tenant Related Parties harmless from all claims of any brokers claiming to have represented Landlord in connection with this Lease. Equity Office Properties Management Corp. ("EOPMC") is an affiliate of Landlord and represents only the Landlord in this transaction. Any assistance rendered by any agent or employee of EOPMC in connection with this Lease or any subsequent amendment or modification hereto has been or will be made as an accommodation to Tenant solely in furtherance of consummating the transaction on behalf of Landlord, and not as agent for Tenant.

26.06 Time is of the essence with respect to Tenant's exercise of any expansion, renewal or extension rights granted to Tenant. The expiration of the Term, whether by lapse of time, termination or otherwise, shall not relieve either party of any obligations which accrued prior to or which may continue to accrue after the expiration or termination of this Lease.

26.07 Tenant may peacefully have, hold and enjoy the Premises, subject to the terms of this Lease, provided Tenant pays the Rent and fully performs all of its covenants and agreements. This covenant shall be binding upon Landlord and its successors only during its or their respective periods of ownership of the Building.

26.08 This Lease does not grant any rights to light or air over or about the Building. Landlord excepts and reserves exclusively to itself any and all rights not specifically granted to Tenant under this Lease. This Lease constitutes the entire agreement between the parties and supersedes all prior agreements and understandings related to the Premises, including all lease proposals, letters of intent and other documents. Neither party is relying upon any warranty, statement or representation not contained in this Lease. This Lease may be modified only by a written agreement signed by an authorized representative of Landlord and Tenant.

Landlord and Tenant have executed this Lease as of the day and year first above written.

LANDLORD:

CA-THE CONCOURSE LIMITED PARTNERSHIP, A DELAWARE LIMITED PARTNERSHIP

By: EOM GP, L.L.C., a Delaware limited liability company, its general partner

By: Equity Office Management, L.L.C., a
Delaware limited liability company,
its non-member manager

By: /s/ Mark Geisreiter

Name: MARK GEISREITER
Title: RSVP - SFO

LANDLORD'S TAX ID NUMBER (SSN OR FEIN):
36-4156801

TENANT:

PIXELWORKS, INC., AN OREGON CORPORATION

By: /s/ Allen H. Alley

Name: ALLEN H. ALLEY
Title: PRESIDENT AND CEO

By: /s/ Jeff Bouchard

Name: Jeff Bouchard
Title: Chief Financial Officer

TENANT'S TAX ID NUMBER (SSN OR FEIN):
91-1761992

Exhibit 21

Subsidiaries of Pixelworks, Inc.

Equator Technologies, Inc. - a Delaware corporation
Jaldi Semiconductor - a Ontario corporation
nDSP Delaware, Inc. - a Delaware corporation
Panstera, Inc. - a California corporation
Pixelworks Ltd. - a Cayman Island company
Pixelworks Semiconductor Singapore Pte. Ltd. - a Singapore company
Pixelworks Semiconductor Technology (Shanghai) Co. Ltd. - a China company
Pixelworks Semiconductor Technology (Taiwan) Inc. - a Taiwan company

Exhibit 23

Consent of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Pixelworks, Inc.:

We consent to incorporation by reference in the Registration Statement on Form S-8 (Nos. 333-126017, 333-125945, 333-123526, 333-121274, 333-89394, 333-62000, 333-41720 and 333-41722) and Form S-3 (Nos. 333-118100, 333-100548 and 333-67838) of Pixelworks, Inc. of our reports dated March 13, 2006, relating to the consolidated balance sheets of Pixelworks, Inc. as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2005, management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2005, and the effectiveness of internal control over financial reporting as of December 31, 2005, which reports appear in the December 31, 2005 annual report on Form 10-K of Pixelworks, Inc.

Our report dated March 13, 2006, on management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting as of December 31, 2005, contains an explanatory paragraph that states the Company acquired Equator Technologies, Inc. (Equator) during 2005, and management excluded from its assessment of the effectiveness of the Company's internal control over financial reporting associated with total assets of $29,359,092 and total revenues of $13,140,682 included in the consolidated financial statements of the Company and subsidiaries as of and for the year ended December 31, 2005. Our audit of internal control over financial reporting of the Company also excluded an evaluation of the internal control over financial reporting of Equator.

/s/ KPMG LLP

Portland, Oregon
March 13, 2006

Exhibit 31.1

CERTIFICATION

I, Allen H. Alley, certify that:

1. I have reviewed this annual report on Form 10-K of Pixelworks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual 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 officers 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 officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2006

/s/ Allen H. Alley

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

Exhibit 31.2

CERTIFICATION

I, Michael D. Yonker, certify that:

1. I have reviewed this annual report on Form 10-K of Pixelworks, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual 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 officers 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 officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2006

/s/ Michael D. Yonker

Michael D. Yonker
Vice President, Chief Financial Officer, Treasurer and Secretary

Exhibit 31.3

CERTIFICATION

I, Hans H. Olsen, certify that:

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

1. 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 annual report;

2. 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;

3. The registrant's other certifying officers 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

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

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

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

Date: March 13, 2006

/s/ Hans H. Olsen

Hans H. Olsen
Executive Vice President and Chief Operating Officer

Exhibit 32.1

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

In connection with the Annual Report of Pixelworks, Inc. (the "Company") on Form 10-K for the year ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Allen H. Alley, Chairman of the Board, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

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

Date: March 13, 2006

Exhibit 32.2

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

In connection with the Annual Report of Pixelworks, Inc. (the "Company") on Form 10-K for the year ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael D. Yonker, Vice President, Chief Financial Officer, Treasurer and Secretary of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

By: /s/ Michael D. Yonker
Michael D. Yonker
Vice President, Chief Financial Officer,
Treasurer and Secretary

Date: March 13, 2006

Exhibit 32.3

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

In connection with the Annual Report of Pixelworks, Inc. (the "Company") on Form 10-K for the year ended December 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Hans H. Olsen, Executive Vice President and Chief Operating Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

By: /s/ Hans H. Olsen

Hans H. Olsen
Executive Vice President and
Chief Operating Officer

Date: March 13, 2006