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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 1

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

For the quarterly period ended June 30, 2001

OR

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

For the transition period from ________ to ________

Commission File Number: 000-30269

PIXELWORKS, INC.

(Exact name of registrant as specified in its charter)

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

7700 SW Mohawk
Tualatin, Oregon 97062
(503) 612-6700
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the last 90 days.

Yes /x/ No / /

Number of shares of Common Stock outstanding as of July 31, 2001: **41,227,958**

PIXELWORKS, INC.

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PART I—FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PIXELWORKS, INC.

CONDENSED BALANCE SHEETS

(in thousands)

	June 30, 2001	December 31, 2000
	(Unaudited)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 57,224	$ 49,681
Short-term marketable securities	29,768	54,051
Accounts receivable, net	5,199	6,608
Inventories, net	5,780	3,280
Prepaid expenses and other current assets	2,521	592
Total current assets	100,492	114,212
Property and equipment, net	4,242	3,660
Long-term marketable securities	8,574	—
Goodwill and assembled workforce, net	78,711	—
Other assets, net	10,909	2,422
Total assets	$ 202,928	$ 120,294
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 7,060	$ 10,724
Accrued liabilities	3,484	3,117
Total current liabilities	10,544	13,841
Shareholders' equity:		
Common stock	258,817	126,260
Deferred stock compensation	(11,312)	(2,206)
Note receivable for common stock	(159)	(172)
Accumulated deficit	(54,962)	(17,429)
Total shareholders' equity	192,384	106,453
Total liabilities and shareholders' equity	$ 202,928	$ 120,294

The accompanying notes are an integral part of these condensed financial statements.

PIXELWORKS, INC.

CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands, except share and per share data)

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Revenue	$ 22,732	$ 12,123	$ 44,075	$ 19,187
Cost of revenue(1)	11,988	7,411	24,060	11,906
Gross profit	10,744	4,712	20,015	7,281
Operating expenses:				
Research and development(2)	4,310	2,344	8,534	4,034
Selling, general and administrative(3)	4,112	2,122	7,607	3,906
Amortization of goodwill and assembled workforce	4,359	—	7,265	—
Patent settlement expense	—	—	—	4,078
In-process research and development expense	—	—	32,400	—
Amortization of deferred stock compensation	2,539	582	4,333	1,026
Total operating expenses	15,320	5,048	60,139	13,044
Loss from operations	(4,576)	(336)	(40,124)	(5,763)
Interest income	1,128	926	2,590	1,221
Interest expense	—	—	—	(38)
Other expense, net	—	—	—	10
Interest and other income, net	1,128	926	2,590	1,193
Income (loss) before income taxes	(3,448)	590	(37,534)	(4,570)
Income tax provision	—	—	—	—
Net income (loss)	(3,448)	590	(37,534)	(4,570)
Preferred stock beneficial conversion feature	—	—	—	9,995
Accretion of preferred stock redemption preference	—	—	—	2,100
Net income (loss) attributable to common shareholders	$ (3,448)	$ 590	$ (37,534)	$ (16,665)
Basic net income (loss) per share	$ (0.08)	$ 0.03	$ (0.94)	$ (1.14)
Diluted net income (loss) per share	$ (0.08)	$ 0.02	$ (0.94)	$ (1.14)
Weighted average shares—basic	40,956,346	21,259,225	40,108,316	14,573,270
Weighted average shares—diluted	40,956,346	35,768,527	40,108,316	14,573,270

Amount excludes amortization of deferred stock compensation of:				
(1) Cost of revenue	$ 10	$ 20	$ 20	$ 24
(2) Research and development	1,909	213	3,218	392
(3) Selling, general and administrative	620	349	1,095	610

The accompanying notes are an integral part of these condensed financial statements.

PIXELWORKS, INC.

CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

	Six Months Ended June 30,	
	2001	2000
Cash flows from operating activities:		
Net loss	$ (37,534)	$ (4,570)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	2,065	1,071
Provision for doubtful accounts	—	57
Amortization of goodwill and assembled workforce	7,265	—
Amortization of deferred stock compensation	4,333	1,026
Patent settlement expense	—	4,078
In-process research and development expense	32,400	—
Changes in operating assets and liabilities:		
Accounts receivable	1,408	(385)
Inventories	(2,500)	(555)
Prepaid expenses and other current assets	(1,415)	(494)
Accounts payable	(4,005)	2,151
Accrued liabilities	367	682
Net cash provided by operating activities	2,384	3,061
Cash flows from investing activities:		
Purchases of property and equipment	(2,209)	(1,679)
Other assets	(1,821)	(995)
Investment in Jaldi	(7,500)	—
Purchases of marketable securities	(40,653)	(5,906)
Maturities of marketable securities	56,361	—
Net cash provided by (used in) investing activities	4,178	(8,580)
Cash flows from financing activities:		
Net decrease in lines of credit	—	(669)
Payments on long-term debt	—	(1,083)
Proceeds from issuances of preferred stock	—	26,528
Proceeds from initial public offering, net of costs	—	60,528
Issuances of common stock	981	51
Net cash provided by financing activities	981	85,355
Increase in cash and cash equivalents	7,543	79,836
Cash and cash equivalents at beginning of period	49,681	12,199
Cash and cash equivalents at end of period	$ 57,224	$ 92,035
Supplemental disclosure of cash flow information:		
Cash paid during the respective periods for:		
Interest	$ —	$ —

Taxes	$	66	$	—

The accompanying notes are an integral part of these condensed financial statements.

PIXELWORKS, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

Note 1: Basis of Presentation

The financial information included herein for the three and six months ended June 30, 2001 and 2000 is unaudited; however, such information reflects all adjustments consisting only of normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods. The results of operations for the three and six months ended June 30, 2001 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2001.

These financial statements have been prepared by Pixelworks, Inc. (the "Company") pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such regulations, although the Company believes the disclosures provided are adequate to prevent the information presented from being misleading.

This report on Form 10-Q for the quarter ended June 30, 2001, should be read in conjunction with the Company's Annual Report on Form 10-K filed on April 2, 2001. Portions of the accompanying financial statements are derived from the audited year-end financial statements of the Company dated December 31, 2000.

Segments—Statement of Financial Accounting Standards ("SFAS") No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for disclosure about operating segments in annual financial statements and selected information in interim financial reports. Based on definitions contained within SFAS 131, the Company has determined that it operates within one segment. Substantially all of the assets of the Company are located in the United States. Revenue by geographic region was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Japan	$ 12,303	$ 6,518	$ 22,720	$ 11,057
Taiwan	2,792	2,563	5,813	3,496
Korea	3,268	1,900	7,644	2,796
Europe	2,076	773	3,850	1,044
United States	2,102	183	3,765	552
Other	191	186	283	242
Total revenue	$ 22,732	$ 12,123	$ 44,075	$ 19,187

Note 2: Earnings per share

Basic earnings per share ("EPS") is computed on the basis of weighted average number of common shares outstanding. Diluted EPS is computed on the basis of weighted average common shares outstanding plus the effect of outstanding stock options using the "treasury stock" method, shares of convertible preferred stock on an as converted basis, and shares of restricted stock, if the potential common shares were not anti-dilutive.

The following weighted-average potential common shares have been excluded from the computation of diluted loss per share for the periods presented because the effect would have been anti-dilutive:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Incremental shares of common stock related to stock options	2,457,198	—	2,137,849	2,665,694
Shares of restricted stock subject to repurchase	134,051	—	145,771	1,296,847
Shares of convertible preferred stock on an as converted basis	—	—	—	11,236,058
Total	2,591,249	—	2,283,620	15,198,599

Note 3: Inventories

Inventories are stated at the lower of cost (on a first-in, first-out basis) or market (net realizable value) and consist of the following:

	June 30, 2001	December 31, 2000
Finished goods	$ 5,709	$ 2,763
Work-in-process	71	517
	$ 5,780	$ 3,280

Note 4: Acquisitions

On January 30, 2001, the Company acquired all of the outstanding shares of Panstera, Inc. in exchange for approximately 4,500,000 shares of Pixelworks stock valued as follows:

	Shares	Fair Value
Shares	3,722,953	$ 108,974
Stock options	777,047	22,616
	4,500,000	131,590
Acquisition costs		335
		$ 131,925

The transaction was accounted for by the purchase method of accounting, and accordingly, the results of operations of Panstera, Inc. are included in the Company's financial statements beginning on the date of acquisition.

The allocation of purchase price was as follows:

Net tangible assets	$ 110
Intangible assets:	
Acquired in-process research and development	32,400
Deferred compensation on unvested stock awards assumed	13,440
Assembled workforce	1,800
Goodwill	84,175
Total purchase price	$ 131,925

In connection with this acquisition, the Company recorded a one-time charge of $32.4 million for the write-off of in-process research and development ("IPR&D"). The value assigned to IPR&D related to research projects for which technological feasibility had not been established. The value was determined by estimating the net cash flows from the sale of products from 2001 through 2005 resulting from the completion of such projects, and discounting the net cash flows back to their present value using a risk adjusted rate of 35%. The estimated net cash flows from these products were based on management's estimates of related revenues, cost of goods sold, R&D costs, selling, general and administrative costs and income taxes. The Company then estimated the stage of completion of the products at the date of the acquisition based on R&D costs that had been expended as of the date of acquisition as compared to total R&D costs at completion. The percentages derived from this calculation were then applied to the net present value of future cash flows to determine the in-process charge. The nature of the efforts to develop the in-process technology into commercially viable products principally related to the completion of all planning, designing, prototyping, verification and testing activities that are necessary to establish that the product can be produced to meet its design specification, including function, features and technical performance requirements.

Panstera had four main product groups under development at the acquisition date, each contributing from 11% to 41% to the total IPR&D value. The projects included the development of digital and analog receivers as well as digital processor ICs. The projects ranged from 50% to 85% complete. All projects had expected completion dates within one year and an estimated aggregate cost to complete of $3.2 million.

The following table reflects the unaudited combined results of Pixelworks, Inc. and Panstera, Inc. as if the merger had taken place at the beginning of the three months and six months ended June 30, 2001 and 2000, respectively. The proforma information includes adjustments for non-cash charges for amortization of goodwill and assembled workforce, over 60 months and 36 months, respectively. Both periods exclude a charge of $32.4 million for in-process research and development expense. The proforma 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.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Net revenue	$ 22,732	$ 12,123	$ 44,075	$ 19,187
Net loss	(3,448)	(6,575)	(7,648)	(18,827)
Net loss attributable to common shareholders	(3,448)	(6,575)	(7,648)	(30,922)
Net loss per share:				
Basic and diluted	$ (0.08)	$ (0.26)	$ (0.19)	$ (1.69)
Weighted average shares outstanding:				
Basic and diluted	40,956,346	24,982,170	40,725,379	18,296,472

On January 30, 2001, the Company made an investment of $7.5 million in exchange for a 19.6% equity interest in privately-held Jaldi Semiconductor Corporation ("Jaldi"). The investment is accounted for at cost and included in other assets on the balance sheet. Pixelworks and Jaldi entered into an agreement that gives Pixelworks the option to acquire the remaining interest in Jaldi in exchange for 1.85 million shares of Pixelworks common stock. Pixelworks may exercise its option at any time prior to June 30, 2002. The exercise of the option becomes mandatory if Jaldi achieves a specific development milestone before April 1, 2002, which consists of the JD1 Integrated Circuit shipping to a customer in its production implementation while meeting agreed upon cost, performance and technical specifications. Upon obtainment of the milestone by Jaldi, Pixelworks must either exercise the option within 30 days thereafter or pay Jaldi $10,000,000. As of the balance sheet date, Jaldi had not reached its development milestone, however, it is continuing to make progress towards this milestone. The Company has not assigned any value to the purchase option.

Note 5: Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 133, as amended, establishes methods of accounting for derivative financial instruments and hedging activities related to those instruments as well as other hedging activities. Because we currently hold no derivative financial instruments and do not currently engage in hedging activities, adoption of SFAS No. 133 did not have any impact on our financial condition or results of operations for the three months ended June 30, 2001.

In July 2001, FASB issued SFAS Nos. 141 and 142 ("FAS 141 and 142"), *Business Combinations and Goodwill and Other Intangible Assets*. FAS 141 replaces APB 16 and eliminates pooling-of interests accounting prospectively. It also provides guidance on purchase accounting related to the recognition of intangible assets and accounting for negative goodwill. FAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Under FAS 142, goodwill will be tested annually and whenever events or circumstances occur indicating that goodwill might be impaired. FAS 141 and 142 are effective for all business combinations initiated after June 30, 2001. Companies are required to adopt FAS 142 for fiscal years beginning after December 15, 2001. The Company will adopt FAS 142 on January 1, 2002.

FAS 141 will require, upon adoption of FAS 142, that the Company evaluate its existing intangible assets and goodwill that were acquired in a prior purchase business combination, and to make any necessary reclassifications in order to conform with the new criteria in FAS 141 for recognition apart from goodwill. Upon adoption of FAS 142, the Company will be required to reassess the useful lives

and residual values of all intangible assets acquired, and make any necessary amortization period adjustments by the end of the first interim period after adoption. In addition, to the extent an intangible asset is identified as having an indefinite useful life, the Company will be required to test the intangible asset for impairment in accordance with the provisions of FAS 142 within the first interim period. Any impairment loss will be measured as of the date of adoption and recognized as the cumulative effect of a change in accounting principle in the first interim period.

In connection with FAS 142's transitional goodwill impairment evaluation, the Company will be required to perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. To accomplish this, the Company must identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. The Company will then have up to six months from the date of adoption to determine the fair value of each reporting unit and compare it to the reporting unit's carrying amount. To the extent a reporting unit's carrying amount exceeds its fair value, an indication exists that the reporting unit's goodwill may be impaired and the Company must perform the second step of the transitional impairment test. In the second step, the Company must compare the implied fair value of the reporting unit's goodwill, determined by allocating the reporting unit's fair value to all of it assets and liabilities in a manner similar to a purchase price allocation in accordance with FAS 141, to its carrying amount, both of which would be measured as of the date of adoption. This second step is required to be completed as soon as possible, but no later than the end of the year of adoption. Any transitional impairment loss will be recognized as the cumulative effect of a change in accounting principle in the Company's statement of earnings.

As of the date of adoption, the Company expects to have unamortized goodwill in the amount of $68.7 million and unamortized identifiable intangible assets in the amount of $1.3 million, which will be subject to the transition provisions of FAS 141 and 142. Amortization expense related to goodwill was $7.0 million for the 6 months ended June 30, 2001. Because of the extensive effort needed to comply with adopting FAS 141 and 142, it is not practicable to reasonably estimate the impact of adopting these Statements on the Company's financial statements at the date of this report, including whether it will be required to recognize any transitional impairment losses as the cumulative effect of a change in accounting principle.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis is designed to be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations set forth in the Company's Annual Report on Form 10-K filed on April 2, 2001 (the "Form 10-K").

Overview

We design, develop and market complete system-on-a-chip integrated circuits ("ICs") and software that enable the visual display of broadband content. Our technology translates and optimizes video, computer graphics, and visual Web information for display on a wide variety of electronic devices including LCD monitors, projectors, and televisions. We have announced products with Compaq, Dell, InFocus Corporation, NEC-Mitsubishi, Samsung, Sanyo, Sony and ViewSonic, and have more than 75 customers.

On May 19, 2000 we sold 5,750,000 shares of Common Stock at $10.00 per share in an Initial Public Offering ("IPO"). In June 2000, we sold a further 862,500 shares of Common Stock under the terms of the over allotment agreement relating to that Initial Public Offering. The net proceeds, amounting to approximately $60.5 million are currently invested in various marketable securities and may be used for general corporate purposes.

On January 30, 2001 we invested $7.5 million in Jaldi Semiconductor Corporation ("Jaldi"), a privately held fabless semiconductor start-up developing application specific reconfigurable Digital Signal Processing ("DSP") technology, in exchange for a minority interest in Jaldi. We have an option to purchase the remaining interest in Jaldi for 1.85 million shares of Pixelworks Common Stock. Under its agreement with Pixelworks, Jaldi is subject to one specific development milestone consisting of the JD1 Integrated Circuit shipping to a customer, in its production implementation while meeting agreed upon cost, performance and technical specifications. Upon obtainment of the milestone by Jaldi, Pixelworks must either exercise the option within 30 days thereafter or pay Jaldi $10,000,000. We intend to acquire the remaining interest upon Jaldi's successful completion of this milestone.

Also on January 30, 2001 we completed the acquisition of all of the outstanding capital stock and stock options of Panstera, Inc. ("Panstera"), a privately held fabless semiconductor company located in San Jose, California, in exchange for 4.5 million shares of Pixelworks Common Stock. The acquisition was recorded as a purchase transaction. The Company recorded a $32.4 million charge for in-process research and development ("IPR&D") related to the Panstera acquisition. Panstera is a fabless semiconductor company that is developing a broad line of mixed signal ICs that provide an end-to-end family of products for mass market, XGA resolution LCD monitors. At the time of the acquisition, Panstera did not have any products that had reached technological feasibility. Panstera had four main product groups under development at the acquisition date, each contributing from 11% to 41% to the total IPR&D value. The projects included the development of digital and analog receivers as well as digital processor ICs. The projects ranged from 50% to 85% complete. All projects had expected completion dates within one year and an estimated aggregate cost to complete of $3.2 million.

The estimated completion dates of the IPR&D projects acquired from Panstera remain substantially unchanged. We sell our products worldwide through a direct sales force and indirectly through distributors and manufacturers representatives. Distributors have been established in Japan, Taiwan and China. Manufacturers representatives support European and Korean sales. In addition to our Tualatin, Oregon corporate headquarters, we have facilities in California, Japan, Taiwan and Korea.

We recognize revenue from product sales upon shipment. Pixelworks complies with the revenue recognition guidance summarized in Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*. Reserves for sales returns and allowances are recorded at the time of shipment.

Historically, significant portions of our product revenue have been from a relatively small number of customers and distributors. Our top five customers accounted for 44.1% and 54.8% of total revenue for the six months ended June 30, 2001 and 2000, respectively.

Significant portions of our products are sold overseas. Sales outside the U.S. accounted for 91.5% and 97.1% of total revenue for the six months ended June 30, 2001 and 2000, respectively. Our end customers, branded manufacturers and integrators, incorporate our products into systems that are sold worldwide. All revenue to date has been denominated in U.S. dollars.

Results of Operations

Three Months Ended June 30, 2001 Compared to Three Months Ended June 30, 2000

Revenue. Revenue increased $10.6 million from $12.1 million for the three months ended June 30, 2000 to $22.7 million for the three months ended June 30, 2001, an increase of 87.6%. The increase in revenue resulted from increased shipments of PW111, PW112, PW164, PW165, and PW365 ImageProcessor ICs. All of these products, with the exception of the PW164, were products that were newly introduced and not shipping in the period ended June 30, 2000. The increase in revenue was partially offset by decreased shipments of PW264 and PW364 ImageProcessor ICs. We shipped ImageProcessors ICs into three primary categories of products, namely LCD monitors, multimedia projectors, and advanced televisions. Revenue from LCD monitor manufacturers and multimedia projector manufacturers represented approximately 95% of revenue for the three months ended June 30, 2001. We had one customer, Epson, that represented approximately 13% of revenue for the three months ended June 30, 2001. No other customer represented 10% or more of revenue for the three months ended June 30, 2001.

Gross profit. Gross profit margin was 47.2% for the three months ended June 30, 2001 compared to 38.7% for the three months ended June 30, 2000, inclusive of $10,000 and $20,000 of amortization of deferred stock compensation respectively. The improvement in gross profit margin resulted primarily from the introduction of new products with higher average gross profit margins, and fixed costs being spread over higher revenue. Approximately 34% of revenue for the three months ended June 30, 2001 was from newly introduced products that were not shipping in the three months ended June 30, 2000.

Research and development. Research and development expense, inclusive of amortization of deferred stock compensation, was $6.2 million or 27.4% of revenue for the three months ended June 30, 2001 compared to $2.6 million, or 21.1% of revenue for the three months ended June 30, 2000. The increase of $3.6 million resulted primarily from a $1.7 million increase in amortization of deferred stock compensation and $1.1 million increase in compensation expenses related to an increase in personnel of 28 employees, primarily as a result of the Panstera acquisition. Upon completion of the acquisition of Panstera in January 2001, the Company recorded deferred stock compensation expense related to the unvested portion of the stock option grants to employees that were assumed by Pixelworks. Other changes resulted from a $423,000 increase in depreciation and amortization, and a $313,000 increase in expenses related to engineering consulting services and development services for products in development.

Selling, general and administrative. Selling, general and administrative expense, including amortization of deferred stock compensation, was $4.7 million, or 20.8% of revenue for the three months ended June 30, 2001 compared to $2.5 million, or 20.3% of revenue for the three months ended June 30, 2000. The most significant increase in spending resulted from an increase in personnel of 27 people that resulted in $699,000 in additional compensation expense. Primarily as a result of the acquisition of Panstera, amortization of deferred stock compensation increased $271,000. Additionally, travel spending increased $198,000 due to a larger number of customer visits, rent expense increased $143,000 due to additional building space being rented to support higher headcount, depreciation and

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amortization expense increased $117,000 due to additional purchases of long-term assets, outside services increased $144,000 primarily for legal and accounting services, and investor relations expenses increased $84,000 for increased investor relations activities.

Amortization of goodwill and assembled workforce. Expenses for the amortization of goodwill and assembled workforce were $4.4 million for the three months ended June 30, 2001. At the time of the acquisition of Panstera in January 2001, the Company recorded assets of $83.6 million in goodwill, which is being amortized over sixty months, and $1.8 million in assembled workforce, which is being amortized over thirty months.

Amortization of deferred stock compensation. Stock compensation expense was $2.5 million for the three months ended June 30, 2001, an increase of $2.0 million from $582,000 for the three months ended June 30, 2000. The increase in stock compensation expense resulted from the assumption of Panstera unvested stock option grants to employees. As a result of the acquisition of Panstera, the Company recorded $13.4 million in deferred stock compensation, which is being amortized on an accelerated method over the vesting period of the assumed stock options. Amortization of the June 30, 2001 balance of $11.3 million in deferred stock compensation is estimated to be $5.0 million for the remainder of 2001 and $4.2 million, $1.7 million, and $400,000 for the years ending December 31, 2002, 2003, and 2004, respectively.

Interest and other income and expense, net. Interest and other income and expense, net consists of interest income. Interest income increased $202,000 from $926,000 for the three months ended June 30, 2000 to $1.1 million for the three months ended June 30, 2001. This increase was a result of higher average cash balances as a result of proceeds from the initial public offering in May 2000, which was partially offset by lower yields on invested cash.

Provision for income taxes. The Company recorded no provision for income tax expense during the three months ended June 30, 2001 because the Company does not expect to have an income tax expense for the year ending December 31, 2001. As a result of the acquisition of Panstera the Company added $1.6 million in deferred tax assets, related to Panstera's NOL carry-forward, which will be offset against goodwill when utilized. The combined deferred tax assets of the Company will have a full valuation allowance established until the Company expects that it is more likely than not that the assets will be realized.

Six Months Ended June 30, 2001 Compared to Six Months Ended June 30, 2000

Revenue. Revenue increased $24.9 million from $19.2 million for the six months ended June 30, 2000 to $44.1 million for the six months ended June 30, 2001, an increase of 129.7%. The increase in revenue resulted from increased shipments of PW111, PW112, PW164, PW165, PW171, and PW365 ImageProcessor ICs. All of these products, with the exception of the PW164, were products that were newly introduced and not shipping in the period ended June 30, 2000. Revenue from PW364 and PW264 ImageProcessor ICs were approximately the same in both periods.

Gross profit. Gross profit margin was 45.4% for the six months ended June 30, 2001 compared to 37.8% for the six months ended June 30, 2000, inclusive of $20,000 and $24,000 of amortization of deferred stock compensation respectively. The improvement in gross profit margin resulted primarily from the shipment of newly introduced products with higher gross profit margins, and fixed costs being spread over higher revenue. Gross profit margins also improved as a result of an increased percentage of mature products whose gross profit margins were higher than average.

Research and development. Research and development expense, inclusive of amortization of deferred stock compensation, was $11.8 million or 26.7% of revenue for the six months ended June 30, 2001 compared to $4.4 million, or 23.1% of revenue for the six months ended June 30, 2000. The

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increase of $7.4 million resulted primarily from an increase in amortization of deferred stock compensation of $2.8 million and a $2.0 million increase in compensation expenses related to an increase in personnel of 28 employees, primarily as a result of the Panstera acquisition, a $732,000 increase in depreciation and amortization due to purchases of long-term assets, and a $1.5 million increase in expenses related to engineering consulting and development services for products in development.

Selling, general and administrative. Selling, general and administrative expense, inclusive of amortization of deferred stock compensation, was $8.7 million, or 19.7% of revenue for the six months ended June 30, 2001 compared to $4.5 million, or 23.5% of revenue for the six months ended June 30, 2000. Most of the $4.2 million increase resulted from a $1.3 million increase in compensation expenses related to an increase in personnel of 27 employees and an increase in amortization of deferred stock compensation of $485,000 primarily as a result of the acquisition of Panstera. The balance of the increase consisted of an increase of $342,000 in sales commissions, $269,000 increase in rent due to increased building space to support additional headcount, a $218,000 increase in insurance, a $205,000 increase in accounting and legal expenses, a $215,000 increase in depreciation and amortization, and $307,000 increase in travel as a result of an increase in the number of customer visits and investor relations activities.

Amortization of goodwill and assembled workforce. Expenses for the amortization of goodwill and assembled workforce were $7.3 million for the six months ended June 30, 2001. At the time of the acquisition of Panstera in January 2001, the Company recorded assets of $83.6 million in goodwill, which is being amortized over sixty months, and $1.8 million in assembled workforce, which is being amortized over thirty months. The Company began amortizing these assets in February 2001.

Patent settlement expense. The Company recorded a one-time charge in February 2000 related to the settlement of a patent dispute. Under the terms of the settlement agreement, the Company entered into a perpetual license agreement with InFocus Systems, Inc. for the use of its technology specified in two patents held by InFocus in exchange for $2.4 million in cash and 156,863 shares of the Company's Series D preferred stock, valued at $12.75 per share. An additional $753,000 of the patent settlement expense was recorded based on the difference between the estimated fair value of the underlying common stock and the Series D conversion price of $8.50 per share. Pixelworks received a release of any claims InFocus may have against Pixelworks relating to these patents.

Amortization of deferred stock compensation. Stock compensation expense was $4.3 million for the six months ended June 30, 2001, an increase of $3.3 million from $1.0 million for the six months ended June 30, 2000. The increase in stock compensation expense is the result of the assumption of Panstera unvested stock option grants to employees. As a result of the acquisition of Panstera, the Company recorded $13.4 million in deferred stock compensation, which is being amortized on an accelerated method over the vesting period of the assumed stock options.

Interest and other income and expense, net. Interest and other income and expense, net consists of interest income, interest expense and other income. Interest and other income and expense, net increased $1.4 million from $1.2 million for the six months ended June 30, 2000 to $2.6 million for the six months ended June 30, 2001. This increase was primarily related to an increase in interest income of $1.4 million that resulted from higher average cash balances as a result of proceeds from the initial public offering in May 2000.

Provision for income taxes. The Company recorded no provision for income tax expense during the six months ended June 30, 2001 because the Company does not expect to have an income tax expense for the year ending December 31, 2001.

Liquidity and Capital Resources

As of June 30, 2001, the Company had cash and cash equivalents of $57.2 million and working capital of $89.9 million as compared to cash and cash equivalents of $49.7 million and working capital of $100.4 million as of December 31, 2000. Principal sources of cash during the six months ended June 30, 2001 were proceeds from the maturities of marketable securities, net of purchases of marketable securities, of $15.7 million, cash generated by operating activities of $2.4 million and proceeds from the issuance of stock under the Company's employee stock purchase plan and stock option plans of $1.0 million. Principal uses of cash during the six months ended June 30, 2001 were the investment in Jaldi Semiconductor of $7.5 million and property and equipment expenditures and purchases of other assets of $4.0 million.

Accounts Receivable. Accounts receivable decreased to $5.2 million at June 30, 2001 from $6.6 million at December 31, 2000. Average days sales outstanding ("DSO") were 21 and 33 days at June 30, 2001 and December 31, 2000, respectively. The decrease is due primarily to the timing of shipments during the quarter being more heavily weighted towards the first half of the quarter ended June 30, 2001. The Company expects DSO to be between 30 and 35 days when shipments are spread more evenly throughout the quarter.

Inventories. Inventories increased from $3.3 million at December 31, 2000 to $5.8 million at June 30, 2001, an increase of $2.5 million. Inventory turns were 9 and 13 at June 30, 2001 and December 31, 2000, respectively. An inventory turn of 9 represents approximately 6 weeks of shipments in inventory. The increase in inventory is consistent with growth in the business. Additionally, inventory levels in the quarter ended December 31, 2000 were below desirable levels as a result of limited supply of products from the Company's foundries.

Prepaid Expenses and Other Current Assets. Prepaid expenses and other current assets increased $1.9 million from December 31, 2000 to June 30, 2001. This increase was primarily due to an increase in prepaid insurance, prepaid annual software maintenance fees, and interest receivable from marketable securities.

Long-Term Marketable Securities and Other Assets. Long-term marketable securities consisting of corporate and federal government bonds with maturities ranging from 14 to 15 months were $8.6 million at June 30, 2001. The Company invested proceeds from the maturity of short-term marketable securities into long-term marketable securities in 2001 to take advantage of the more favorable interest rates.

Other assets increased $8.5 million from December 31, 2000 to June 30, 2001. The increase was primarily the result of a $7.5 million investment in Jaldi Semiconductor Corporation on January 31, 2001.

As of June 30, 2001, principal commitments consisted of obligations outstanding under operating leases. These commitments include leases for approximately 31,000 square feet in two facilities located in Tualatin, Oregon, expiring in 2002 and 2004. In connection with the acquisition of Panstera, the Company has assumed the leases of two facilities in San Jose, CA for approximately 8,958 square feet. The total annual estimated costs for these commitments are $848,000, $786,000, $745,000 and $232,000 for the years ending December 31, 2001, 2002, 2003 and 2004, respectively. Although the Company has no other material commitments, we anticipate a substantial increase in our capital expenditures consistent with anticipated growth in our operations, infrastructure and personnel. In the future we may also require a larger inventory of products in order to support anticipated growth in our business.

Upon Jaldi's successful completion of specific development milestones, the Company has an option to purchase the remaining interest in Jaldi for 1.85 million shares of Pixelworks stock, and will incur a breakup fee if the option is not exercised.

The Company believes that its existing cash and cash equivalents and funds generated from operations will be sufficient to fund its operations 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.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. SFAS No. 133, as amended, establishes methods of accounting for derivative financial instruments and hedging activities related to those instruments as well as other hedging activities. Because we currently hold no derivative financial instruments and do not currently engage in hedging activities, adoption of SFAS No. 133 did not have any impact on our financial condition or results of operations for the three months ended June 30, 2001.

In July 2001, FASB issued SFAS Nos. 141 and 142 ("FAS 141 and 142"), *Business Combinations and Goodwill and Other Intangible Assets*. FAS 141 replaces APB 16 and eliminates pooling-of interests accounting prospectively. It also provides guidance on purchase accounting related to the recognition of intangible assets and accounting for negative goodwill. FAS 142 changes the accounting for goodwill from an amortization method to an impairment-only approach. Under FAS 142, goodwill will be tested annually and whenever events or circumstances occur indicating that goodwill might be impaired. FAS 141 and 142 are effective for all business combinations initiated after June 30, 2001. Companies are required to adopt FAS 142 for fiscal years beginning after December 15, 2001. The Company will adopt FAS 142 on January 1, 2002.

FAS 141 will require upon adoption of FAS 142, that the Company evaluate its existing intangible assets and goodwill that were acquired in a prior purchase business combination, and to make any necessary reclassifications in order to conform with the new criteria in FAS 141 for recognition apart from goodwill. Upon adoption of FAS 142, the Company will be required to reassess the useful lives and residual values of all intangible assets acquired, and make any necessary amortization period adjustments by the end of the first interim period after adoption. In addition, to the extent an intangible asset is identified as having an indefinite useful life, the Company will be required to test the intangible asset for impairment in accordance with the provisions of FAS 142 within the first interim period. Any impairment loss will be measured as of the date of adoption and recognized as the cumulative effect of a change in accounting principle in the first interim period. In connection with FAS 142's transitional goodwill impairment evaluation, the Company will be required to perform an assessment of whether there is an indication that goodwill is impaired as of the date of adoption. To accomplish this, the Company must identify its reporting units and determine the carrying value of each reporting unit by assigning the assets and liabilities, including the existing goodwill and intangible assets, to those reporting units as of the date of adoption. The Company will then have up to six months from the date of adoption to determine the fair value of each reporting unit and compare it to the reporting unit's carrying amount. To the extent a reporting unit's carrying amount exceeds its fair value, an indication exists that the reporting unit's goodwill may be impaired and the Company must perform the second step of the transitional impairment test. In the second step, the Company must compare the implied fair value of the reporting unit's goodwill, determined by allocating the reporting unit's fair value to all of it assets and liabilities in a manner similar to a purchase price allocation in accordance with FAS 141, to its carrying amount, both of which would be measured as of the date of adoption. This second step is required to be completed as soon as possible, but no later than the end of the year of adoption. Any transitional impairment loss will be recognized as the cumulative effect of a change in accounting principle in the Company's statement of earnings.

As of the date of adoption, the Company expects to have unamortized goodwill in the amount of $68.7 million and unamortized identifiable intangible assets in the amount of $1.3 million, which will be subject to the transition provisions of FAS 141 and 142. Amortization expense related to goodwill was $7.0 million for the 6 months ended June 30, 2001. Because of the extensive effort needed to comply with adopting FAS 141 and 142, it is not practicable to reasonably estimate the impact of adopting these Statements on the Company's financial statements at the date of this report, including whether it will be required to recognize any transitional impairment losses as the cumulative effect of a change in accounting principle.

Forward-looking Statements

The statements in this report on Form 10-Q relative to the future constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements are based on current expectations, estimates and projections about the company's business. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions that are difficult to predict. Actual results could vary materially from the description contained herein due to many factors including those described above and the following: business and economic conditions, changes in growth in the flat panel monitor, multimedia projector, and advanced television industries, changes in customer ordering patterns, competitive factors, such as rival chip architectures, pricing pressures, insufficient, excess or obsolete inventory and variations in inventory valuation, continued success in technological advances, shortages of manufacturing capacity from our third-party foundries, litigation involving antitrust and intellectual property, the non-acceptance of the combined technologies by leading manufacturers, and other risk factors listed from time to time in the company's Securities and Exchange Commission filings, including but not limited to, the risks detailed in the "Business—Risk Factors" section of the Company's Annual Report on Form 10-K for the year ended December 31, 2000. The forward-looking statements contained in this Form 10-Q speak only as of the date on which they are made, and the company does not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this filing.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Our primary market risk exposure is the impact of interest rate fluctuations on interest income earned on our investment portfolio. The risks associated with market, liquidity and principal are mitigated 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. We currently have no debt instruments or credit facilities.

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 any of our sales. We do not currently hedge against foreign currency rate fluctuations. The effect of an immediate 10% change in exchange rates would not have a material impact on our future operating results or cash flows.

PART II—OTHER INFORMATION

Item 4: Submission of Matters to a Vote of Shareholders

The Company's 2001 Annual Meeting of Shareholders was held on May 8, 2001. At the Annual Meeting, the following nominees were elected as Directors by the votes and for the terms indicated below:

Nominee	For	Withheld	Term Ending
Allen H. Alley	23,454,105	2,867,850	2002
Oliver D. Curme	26,256,134	65,821	2002
Frank Gill	26,256,034	65,921	2002
Mark A. Stevens	26,255,634	66,321	2002
Michael D. Yonker	26,253,934	68,021	2002

Item 6: Exhibits and Reports on Form 8-K

(a)

Exhibits

None

(b)

Reports on Form 8-K

An amendment to Form 8-K on Form 8-K/A presenting historical and pro forma financial statements for Panstera was filed on April 11, 2001.

SIGNATURES

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

PIXELWORKS, INC.

Date: October 4, 2001

/s/ JEFFREY B. BOUCHARD

Jeffrey B. Bouchard
Vice President, Finance and Chief Financial Officer (Principal Financial and Accounting Officer)

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