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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2009.

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.)

16760 SW Upper Boones Ferry Road, Suite 101
Portland, OR 97224
(503) 601-4545
(Address of principal executive offices, including zip code,
and Registrant's telephone number, including area code)

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

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

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

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

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

Number of shares of Common Stock outstanding as of April 30, 2009: 13,388,690

PIXELWORKS, INC.
FORM 10-Q
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2009

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	March 31, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 32,539	$ 53,149
Short-term marketable securities	5,706	8,058
Accounts receivable, net	4,457	6,149
Inventories, net	4,165	4,981
Prepaid expenses and other current assets	2,849	3,381
Total current assets	49,716	75,718
Long-term marketable securities	1,920	2,110
Property and equipment, net	4,331	5,187
Other assets, net	5,630	5,331
Acquired intangible assets, net	2,769	3,386
Total assets	$ 64,366	$ 91,732
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 2,674	$ 4,215
Accrued liabilities and current portion of long-term liabilities	6,816	9,419
Current portion of income taxes payable	157	137
Total current liabilities	9,647	13,771
Long-term liabilities, net of current portion	1,722	2,035
Income taxes payable, net of current portion	8,868	10,581
Long-term debt	33,544	60,634
Total liabilities	53,781	87,021
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Preferred stock	—	—
Common stock	334,189	333,974
Accumulated other comprehensive income (loss)	(183)	55
Accumulated deficit	(323,421)	(329,318)
Total shareholders' equity	10,585	4,711
Total liabilities and shareholders' equity	$ 64,366	$ 91,732

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Revenue, net	$ 10,780	$ 23,976
Cost of revenue (1)	6,624	12,305
Gross profit	4,156	11,671
Operating expenses:		
Research and development (2)	4,776	6,722
Selling, general and administrative (3)	3,873	4,686
Restructuring	37	1,008
Amortization of acquired intangible assets	—	90
Total operating expenses	8,686	12,506
Loss from operations	(4,530)	(835)
Gain on repurchase of long-term debt, net	9,024	11,557
Interest expense	(251)	(573)
Interest income	98	983
Amortization of debt issuance costs	(61)	(146)
Other-than-temporary impairment of a marketable security	—	(6,490)
Interest and other income, net	8,810	5,331
Income before income taxes	4,280	4,496
Benefit for income taxes	(1,617)	(1,637)
Net income	$ 5,897	$ 6,133
Net income per share — basic and diluted	$ 0.44	$ 0.41
Weighted average shares outstanding:		
Basic	13,352	14,930
Diluted	14,023	16,648

	2009	2008
(1) Includes:		
Amortization of acquired developed technology	$ 617	$ 705
Additional amortization of non-cancelable prepaid royalty	68	—
Restructuring	47	—
Stock-based compensation	7	18
(2) Includes stock-based compensation	118	449
(3) Includes stock-based compensation	252	425

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2009	2008
Cash flows from operating activities:		
Net income	$ 5,897	$ 6,133
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Gain on repurchase of long-term debt, net	(9,024)	(11,557)
Other-than-temporary impairment of a marketable security	—	6,490
Depreciation and amortization	1,294	1,706
Amortization of acquired intangible assets	617	794
Stock-based compensation	377	892
Amortization of debt issuance costs	61	146
Loss on asset disposals	6	33
Amortization (accretion) on short- and long-term marketable securities	1	(194)
Deferred income tax benefit	—	(446)
Other	16	12
Changes in operating assets and liabilities:		
Accounts receivable, net	1,692	379
Inventories, net	816	3,012
Prepaid expenses and other current and long-term assets, net	(30)	(952)
Accounts payable	(1,541)	(241)
Accrued current and long-term liabilities	(2,785)	(667)
Income taxes payable	(1,693)	(409)
Net cash provided by (used in) operating activities	(4,296)	5,131
Cash flows from investing activities:		
Purchases of marketable securities	(1,197)	(15,189)
Proceeds from maturities of marketable securities	3,500	22,174
Purchases of property and equipment	(127)	(473)
Purchases of other assets	(27)	—
Proceeds from sales of property and equipment	—	4
Net cash provided by investing activities	2,149	6,516
Cash flows from financing activities:		
Repurchase of long-term debt	(17,778)	(37,939)
Payments on asset financings	(523)	(1,803)
Repurchase of common stock	(167)	(1,198)
Proceeds from issuances of common stock	5	35
Net cash used in financing activities	(18,463)	(40,905)
Net change in cash and cash equivalents	(20,610)	(29,258)
Cash and cash equivalents, beginning of period	53,149	74,572
Cash and cash equivalents, end of period	$ 32,539	$ 45,314

See accompanying notes to condensed consolidated financial statements.

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

NOTE 1: BASIS OF PRESENTATION

Nature of Business

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications. Our solutions enable manufacturers of digital display and projection devices, such as large-screen liquid crystal displays and digital front projectors, to differentiate their products with a consistently high level of video quality, regardless of the content's source or format. We were founded in 1997 and are incorporated under the laws of the state of Oregon.

Condensed Consolidated Financial Statements

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

The financial information included herein for the three month periods ended March 31, 2009 and 2008 is unaudited; however, such information reflects all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows of the Company for these interim periods. The financial information as of December 31, 2008 is derived from our audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2008, included in Item 8 of our Annual Report on Form 10-K, filed with the SEC on March 16, 2009, and should be read in conjunction with such consolidated financial statements.

The results of operations for the three month period ended March 31, 2009 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2009.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard No. ("SFAS") 141 (revised 2007), *Business Combinations* ("SFAS 141R"), which replaces SFAS 141, *Business Combinations*. SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, including goodwill, the liabilities assumed and any non-controlling interest in the acquiree. SFAS 141R also establishes disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of a business combination and is effective for our business combinations, if any, occurring after January 1, 2009. SFAS 141R also requires that any future benefit, if recognized due to the reversal of our valuation allowance on $2,769 of our acquired deferred tax assets, will be recognized as an adjustment to income tax expense, rather than allocated to acquired intangible assets.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, "*Recognition and Presentation of Other-Than-Temporary Impairments*." This pronouncement amends SFAS 115, "*Accounting for Certain*

Investments in Debt and Equity Securities," SFAS 124, "*Accounting for Certain Investments Held by Not-for-Profit Organizations*," and EITF Issue No. 99-20, "*Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets*." This FSP requires the recognition of an other-than-temporary impairment if we intend to sell an impaired debt security and it is more likely than not that the security will be sold before it recovers its cost basis. This FSP also requires increased disclosure about the credit and noncredit components of impaired debt securities that are not expected to be sold and also requires increased and more frequent disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. This FSP is effective for interim periods ending after June 15, 2009, but early adoption is permitted for interim periods ending after March 15, 2009. We will adopt the provisions of this FSP for the quarter ended June 30, 2009. The guidance is not expected to impact our consolidated financial statements but will require additional footnote disclosures.

In April 2009, the FASB issued FSP FAS 107-1, APB 28-1, "*Interim Disclosures about Fair Value of Financial Instruments*." This pronouncement amends SFAS No. 107, "*Disclosures about Fair Value of Financial Instruments*," ("SFAS 107") to require disclosures about fair value of financial instruments not measured on the balance sheet at fair value in interim financial statements as well as in annual financial statements. Prior to this FSP, fair values for these assets and liabilities were only disclosed annually. This FSP applies to all financial instruments within the scope of SFAS 107 and requires disclosure of the methods and significant assumptions used to estimate the fair value of financial instruments. This FSP is effective for interim and annual periods ending after June 15, 2009. We will adopt the provisions of this FSP for the quarter ended June 30, 2009. The guidance is not expected to impact our consolidated financial statements but will require additional footnote disclosures.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and judgments that affect amounts reported in the financial statements and accompanying notes. Our significant estimates and judgments include those related to product returns, warranty obligations, bad debts, inventories, property and equipment, intangible assets, impairment of long-lived assets, valuation of investments, amortization of prepaid royalties, valuation of share-based payments, income taxes, litigation and other contingencies. The actual results experienced could differ materially from our estimates.

Reclassifications

Certain reclassifications have been made to the 2008 condensed consolidated financial statements to conform with the 2009 presentation, including the reclassification of payments on asset financing to financing activities in the consolidated statements of cash flow. Similar amounts will be reclassified in future filings for prior periods.

NOTE 2: BALANCE SHEET COMPONENTS

Marketable Securities

As of March 31, 2009 and December 31, 2008, all of our short- and long-term marketable securities are classified as available-for-sale.

Unrealized holding gains (losses) on short- and long-term available-for-sale securities, net of tax, were $77 and $(190), respectively, as of March 31, 2009 and $125 and $0, respectively, as of December 31,

2008. These unrealized holding gains and losses are recorded in accumulated other comprehensive income (loss), a component of shareholders' equity, in the condensed consolidated balance sheets.

On March 31, 2008 we analyzed our long-term equity security for an other-than-temporary impairment in accordance with FASB Staff Position 115-1/124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. As of March 31, 2008, the fair value of our investment had decreased $6,490 from our cost basis of $10,000 to $3,510. After reviewing the investment's rapid decline in value from December 31, 2007 to March 31, 2008, the extended duration of time which the fair value of the investment had been below our cost, as well as decreased target price estimates, analyst downgrades and macroeconomic factors, we determined that we would not recover the cost basis of the investment. Accordingly, we recognized an other-than-temporary impairment loss of $6,490 in our statement of operations during the three months ended March 31, 2008. As of March 31, 2009 we have recorded total other-than-temporary impairments of $7,890 on our long-term equity security.

Accounts Receivable, Net

Accounts receivable are recorded at invoiced amount and do not bear interest when recorded or accrue interest when past due. We do not have any off balance sheet exposure risk related to customers. Accounts receivable are stated net of an allowance for doubtful accounts, which is maintained for estimated losses that may result from the inability of our customers to make required payments. Accounts receivable, net consists of the following:

	March 31, 2009	December 31, 2008
Accounts receivable, gross	$ 4,999	$ 6,691
Less: allowance for doubtful accounts	(542)	(542)
Accounts receivable, net	$ 4,457	$ 6,149

Our allowance for doubtful accounts had no provisions, recoveries or other activity during the first quarters of 2009 and 2008.

Inventories, Net

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

Inventories, net consist of the following:

	March 31, 2009	December 31, 2008
Finished goods	$ 3,497	$ 4,617
Work-in-process	4,371	5,358
	7,868	9,975
Less: reserve for slow-moving and obsolete items	(3,703)	(4,994)
Inventory, net	$ 4,165	$ 4,981

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

	Three Months Ended March 31, 2009	2008
Balance at beginning of period	$ 4,994	$ 5,950
Provision	136	967
Usage:		
Sales	(296)	(287)
Scrap	(1,131)	(998)
Total usage	(1,427)	(1,285)
Balance at end of period	$ 3,703	$ 5,632

Based upon our forecast and backlog, we do not currently expect to be able to sell or otherwise use the reserved inventory we have on hand at March 31, 2009. However, it is possible that a customer will decide in the future to purchase a portion of the reserved inventory. It is not possible for us to predict if or when this may happen, or how much we may sell. If such sales occur, we do not expect that they will have a material effect on gross profit margin.

Property and Equipment, Net

Property and equipment consists of the following:

	March 31, 2009	December 31, 2008
Gross carrying amount	$ 19,760	$ 20,227
Less: accumulated depreciation and amortization	(15,429)	(15,040)
Property and equipment, net	$ 4,331	$ 5,187

Acquired Intangible Assets, Net

Acquired intangible assets consist of the following developed technology:

	March 31, 2009	December 31, 2008
Gross carrying amount	$ 19,170	$ 19,170
Less: accumulated amortization	(16,401)	(15,784)
Acquired intangible assets, net	$ 2,769	$ 3,386

Estimated future amortization of acquired intangible assets is $1,719 for the nine months ending December 31, 2009 and $1,050 for the year ending December 31, 2010.

Accrued Liabilities and Current Portion of Long-Term Liabilities

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

	March 31, 2009	December 31, 2008
Accrued payroll and related liabilities	$ 2,219	$ 3,749
Current portion of accrued liabilities for asset financings	1,006	1,116
Accrued commissions and royalties	596	728
Reserve for warranty returns	476	593
Accrued interest payable	348	236
Accrued costs related to restructuring	217	940
Reserve for sales returns and allowances	100	100
Other	1,854	1,957
	$ 6,816	$ 9,419

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

	Three Months Ended March 31,	
	2009	2008
Reserve for warranty returns:		
Balance at beginning of period	$ 593	$ 932
Benefit	(98)	(122)
Charge offs	(19)	(68)
Balance at end of period	$ 476	$ 742
Reserve for sales returns and allowances:		
Balance at beginning of period	$ 100	$ 175
Provision	14	3
Charge offs	(14)	(3)
Balance at end of period	$ 100	$ 175

Long-Term Liabilities, Net of Current Portion

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

	March 31, 2009	December 31, 2008
Accrued liabilities for asset financings	$ 676	$ 699
Deferred rent	581	617
Accrued costs related to restructuring	222	262
Payroll and related liabilities	174	182
Other	69	275
	$ 1,722	$ 2,035

Long-Term Debt

In 2004, we issued $150,000 of 1.75% convertible subordinated debentures (the "debentures") due 2024. In February 2006, we repurchased and retired $10,000 of the debentures. In February 2008, we repurchased and retired $50,248 of the debentures in a modified dutch auction tender offer for $37,939 in cash. We recognized a net gain of $11,557 on the repurchase, which included a $13,064 discount, offset by legal and professional fees of $755 and a write-off of debt issuance costs of $752. In August 2008, we repurchased and retired $29,118 of the debentures for $20,615 in cash. We recognized a net gain of $8,113 on the repurchase, which included an $8,503 discount, offset by a write-off of debt issuance costs of $390. In February 2009, we repurchased and retired $27,090 of the debentures for $17,778 in cash. We recognized a net gain on the repurchase of $9,024, which included a $9,346 discount, offset by a write-off of debt issuance costs of $288 and other fees of $34. Gains on the repurchase of our long-term debt are included in other income in our statement of operations. As of March 31, 2009, $33,544 of the debentures are outstanding.

The remaining debentures are convertible, under certain circumstances, into our common stock at a conversion rate of 13.6876 shares of common stock per $1 principal amount of debentures for a total of 459,137 shares. This is equivalent to a conversion price of approximately $73.06 per share. The debentures are convertible if (a) our stock trades above 130% of the conversion price for 20 out of 30 consecutive trading days during any calendar quarter, (b) the debentures trade at an amount less than or equal to 98% of the if-converted value of the debentures for five consecutive trading days, (c) a call for redemption occurs, or (d) in the event of certain other specified corporate transactions. If our debentures are converted into common stock, they can not be settled in cash or other assets.

We may redeem some or all of the debentures for cash on or after May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest. The holders of the debentures have the right to require us to purchase all or a portion of the $33,544 debentures outstanding at each of the following dates: May 15, 2011, May 15, 2014, and May 15, 2019, at a purchase price equal to 100% of the principal amount plus accrued and unpaid interest. The debentures are unsecured obligations and are subordinated in right of payment to all of our existing and future senior debt.

Shareholders' Equity

On September 25, 2007, we announced a share repurchase program under which the Board of Directors authorized the repurchase of up to $10,000 of the Company's common stock over the next twelve months. In August 2008, the Board of Directors approved an extension to the program for an additional twelve months, through September 2009. The program does not obligate the Company to acquire any particular amount of common stock and may be modified or suspended at any time at the Company's discretion. Share repurchases under the program may be made through open market and privately negotiated transactions at the Company's discretion, subject to market conditions and other factors. During 2008 we repurchased 1,625,737 common shares at a cost of $2,626. From January 1, 2009 through March 31, 2009, we repurchased 228,600 shares for $167. As of March 31, 2009, $2,937 remained available for repurchase under the plan. The above numbers reflect the June 4, 2008 one-for-three reverse stock split of our common stock.

NOTE 3: FAIR VALUE MEASUREMENT

On January 1, 2008, we adopted SFAS 157, *Fair Value Measurement*" (SFAS 157) for our financial assets and liabilities. SFAS 157 defines fair value and describes three levels of inputs that may be used to measure fair value:

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

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

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

The table below presents information about our financial assets measured at fair value at March 31, 2009:

	Level 1	Level 2	Level 3	Total
Cash equivalents	$ 26,526	$ 3,999	$ —	$ 30,525
Short-term marketable securities	—	5,706	—	5,706
Long-term marketable securities	1,920	—	—	1,920
Total	$ 28,446	$ 9,705	—	$ 38,151

Level 1 financial assets include money market funds, certificates of deposit and a long-term equity security. Level two financial assets include commercial paper, corporate debt securities and U.S. government agencies debt securities. We primarily use the market approach to determine the fair value of our financial assets. We do not have any financial liabilities required to be measured at fair value on a recurring basis.

FSP 157-2 *Partial Deferral of the Effective Date of Statement 157* (FSP 157-2) deferred the effective date of SFAS 157 for all nonfinancial assets and nonfinancial liabilities to fiscal years beginning after November 15, 2008 and we adopted FSP 157-2 on January 1, 2009. The adoption of SFAS 157 and SFAS 157-2 did not have a material impact on our consolidated financial statements.

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

In April 2009, the FASB issued FSP FAS 157-4, "*Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.*" This pronouncement provides additional guidance for estimating fair value in accordance with SFAS 157, when the volume and level of activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. This FSP is effective for interim periods ending after June 15, 2009 and we will adopt the provisions of this FSP for the quarter ended June 30, 2009. We do not currently have any financial assets in non-active markets and the adoption of this guidance is not expected to impact our consolidated financial statements.

NOTE 4: RESTRUCTURING PLANS

In December 2008, we initiated a restructuring plan to reduce our operating expenses in response to decreases in current and forecasted revenue which resulted primarily from the global economic crisis. This plan reduced operations, research and development and administrative headcount in our San Jose, Taiwan and China offices and was substantially completed during the current quarter. Although additional restructuring actions under the 2008 plan are being evaluated, uncertainty regarding the outlook for the remainder of 2009 and beyond impedes our ability to forecast the scope and impact of any potential actions.

In November 2006, we initiated a restructuring plan to reduce operating expenses. This plan included consolidation of our operations in order to reduce compensation and rent expense. As part of this plan we closed our offices in Toronto, Beijing and Shenzhen. Additionally, we eliminated all operations and research and development activities at our Tualatin location and transferred them to our offices in San Jose, Shanghai and Hsin Chu. The consolidation and closure of these offices and reduction in headcount resulted in charges for non-cancelable leases and termination and retention benefits for effected employees. In connection with this restructuring we also narrowed and redefined our product development strategy which resulted in the write-off of intellectual property assets, tooling, software development tools and charges for related non-cancelable contracts. This plan was completed in the fourth quarter of 2008.

Total restructuring expenses related to these plans were as follows:

	Three Months Ended March 31, 2009	Cumulative Amount Incurred To March 31, 2009
Cost of revenue — restructuring:		
Termination and retention benefits	$ 47	$ 357
Net write-off of assets and reversal of related liabilities	—	2,072
	47	2,429
Operating expenses — restructuring:		
Termination and retention benefits	30	7,735
Consolidation of leased space	7	2,039
Net write-off of assets and reversal of related liabilities	—	13,224
Contract termination fee	—	1,693
Payments, non-cancelable contract	—	827
Other	—	88
	37	25,606
Total restructuring expense	$ 84	$ 28,035

Accrued expenses related to the restructuring plans are included in current and non-current accrued liabilities in the consolidated balance sheets. The following is a summary of the change in accrued liabilities related to our restructuring plans:

	December 31, 2008	Expensed	Payments	March 31, 2009
Termination and retention benefits	$ 737	$ 77	$ (685)	$ 129
Lease termination costs	465	7	(162)	310
Total	$ 1,202	$ 84	$ (847)	$ 439

NOTE 5: INCOME TAXES

The benefit for income taxes recorded for the first quarter of 2009 was primarily due to a benefit of $1,815 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. The benefit for income taxes recorded for the first quarter of 2008 was primarily due to a benefit of $1,000 for refundable research and experimentation credits, a benefit of $559 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, and a deferred tax benefit of $446 which resulted from an increase in the tax rate of a single foreign jurisdiction. These benefits were partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions.

As of March 31, 2009, we continued to provide a full valuation allowance against essentially all of our U.S. and Canadian net deferred tax assets as we do not believe that it is more likely than not that we will realize a benefit from those assets. We have not recorded a valuation allowance against our other foreign net deferred tax assets as we believe that it is more likely than not that we will realize a benefit from those assets.

As of March 31, 2009 and December 31, 2008, the amount of our uncertain tax positions was a liability of $8,868 and $10,581, respectively. A number of years may elapse before an uncertain tax position is resolved by settlement or statute of limitations. Settlement of any particular position could require the use of cash. If the uncertain tax positions we have accrued for are sustained by the taxing authorities in our favor, the reduction of the liability will reduce our effective tax rate. We reasonably expect reductions in the liability for unrecognized tax benefits of approximately $5,283 within the next twelve months due to the expiration of statutes of limitations in foreign jurisdictions. We recognize interest and penalties related to uncertain tax positions in income tax expense in our consolidated statement of operations.

NOTE 6: COMPREHENSIVE INCOME

Total comprehensive income was as follows:

	Three Months Ended March 31,	
	2009	2008
Net income	$ 5,897	$ 6,133
Reclassification adjustment from accumulated other comprehensive income for other-than-temporary loss on marketable security included in net income, net of tax	—	4,810
Unrealized gain (loss) on available-for-sale investments, net of tax	(238)	182
Total comprehensive income	$ 5,659	$ 11,125

NOTE 7: EARNINGS PER SHARE

We calculate earnings per share in accordance with SFAS 128, *Earnings per Share*. Basic earnings per share amounts are computed based on the weighted average number of common shares outstanding and reflect our June 4, 2008 one-for three reverse stock split in all periods presented.

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

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

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Net income used in basic net income per share	$ 5,897	$ 6,133
Interest expense on long-term debt, net of tax and amortization of debt issuance costs, net of tax	275	692
Net income used in diluted net income per share	$ 6,172	$ 6,825
Basic weighted average shares outstanding	13,352	14,930
Common share equivalents:		
Dilutive effect of stock options	1	13
Dilutive effect of conversion of long-term debt	670	1,705
Diluted weighted average shares outstanding	14,023	16,648
Net income per common share — basic and diluted	$ 0.44	$ 0.41

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

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Stock options	2,031	1,635

NOTE 8: SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental disclosure of cash flow information is as follows:

	Three Months Ended March 31, 2009	Three Months Ended March 31, 2008
Cash paid during the period for:		
Interest	$ 140	$ 281
Income taxes	68	207
Non-cash investing and financing activities:		
Acquisitions of property and equipment and other assets under extended payment terms	$ 390	$ 973

NOTE 9: SEGMENT INFORMATION

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

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Geographic Information

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

	Three Months Ended March 31,	
	2009	2008
Japan	$ 4,547	$ 14,005
Taiwan	2,046	1,893
Europe	1,100	2,377
Korea	1,089	1,603
U.S.	645	968
China	304	720
Other	1,049	2,410
	$ 10,780	$ 23,976

Significant Customers

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

	Three Months Ended March 31,	
	2009	2008
Distributors:		
All distributors	48%	52%
Distributor A	28%	28%
Distributor B	10%	10%
End Customers: (1)		
Top five end customers	49%	57%
End customer A	14%	27%
End customer B	11%	0%

(1): End customers include customers who purchase directly from us, as well as customers who purchase our products indirectly through distributors and manufacturers' representatives.

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

	March 31, 2009	December 31, 2008
Account A	25%	32%
Account B	22%	20%
Account C	14%	15%
Account D	10%	0%

NOTE 10: RISKS AND UNCERTAINTIES

Concentration of Suppliers

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

Risk of Technological Change

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

Concentrations of Credit Risk

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

NOTE 11: COMMITMENTS AND CONTINGENCIES

Indemnifications

Certain of our agreements include limited indemnification provisions for claims from third-parties relating to our intellectual property. Such indemnification provisions are accounted for in accordance with FASB Summary of Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others-an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No.34*. The indemnification is limited to the amount paid by the customer. As of March 31, 2009, we have not incurred any material liabilities arising from these indemnification obligations. However, in the future such obligations could immediately impact our results of operations but are not expected to materially affect our business.

Legal Proceedings

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

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

Forward-looking Statements

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

Overview

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications. Our solutions enable manufacturers of digital display and projection devices, such as large-screen liquid crystal displays and digital front projectors, to differentiate their products with a consistently high level of video quality, regardless of the content's source or format. Our core technology leverages unique proprietary techniques for intelligently processing video signals from a variety of sources to ensure that all resulting images are optimized. Additionally, our products help our customers reduce costs and differentiate their display and projection devices, an important factor in industries that experience rapid innovation. Pixelworks' flexible design architecture enables our technology to produce outstanding image quality in our customers' display and projection products with a range of integrated circuit and software solutions. We were founded in 1997 and are incorporated under the laws of the state of Oregon.

Factors Affecting Results of Operations and Financial Condition

General Market Conditions

Economic conditions in the United States and in foreign markets in which we operate substantially affect our sales and profitability. Economic activity in the United States and throughout much of the world has undergone a sudden, sharp downturn. Global credit and capital markets have experienced unprecedented volatility and disruption and business credit and liquidity have tightened in much of the world. Some of our suppliers and customers may face credit issues and could experience cash flow problems and other financial hardships. Consumer confidence and spending are down significantly and we expect weaker demand from our customers to persist throughout 2009. Although we have taken steps to reduce our costs in response to these changes, including the restructuring efforts described below and temporary salary reductions for all employees, these economic conditions are expected to adversely impact our business, results of operations and financial position and we are unable to forecast when or if these conditions will improve.

Restructuring Plans

In December 2008, we initiated a restructuring plan to reduce our operating expenses in response to decreases in current and forecasted revenue which resulted primarily from the global economic crisis. This plan reduced operations, research and development and administrative headcount in our San Jose, Taiwan and China offices. Although this plan was substantially completed during the first quarter of 2009, we will continue to monitor and evaluate the need for additional related restructuring actions in light of global economic uncertainty and its potential impact on our continuing business.

In November 2006, we initiated a restructuring plan to reduce operating expenses and continued to implement this plan throughout 2007 and 2008. As part of this plan we closed offices in Toronto, Beijing and Shenzhen. Additionally, we eliminated all operations and research and development activities at our Tualatin location and transferred them to our offices in San Jose, Shanghai and Hsin Chu. The consolidation and closure of these offices and reduction in headcount resulted in charges for non-cancelable leases and termination and retention benefits for effected employees. In connection with this restructuring, we also narrowed and redefined our product development strategy which resulted in the write-off of intellectual property ("IP") assets, tooling, software development tools and charges for related non-cancelable contracts. This plan was completed during the fourth quarter of 2008.

Results of Operations

Revenue, net

Revenue, net was as follows (dollars in thousands):

	Three months ended March 31,		2009 v 2008	
	2009	**2008**	**$ change**	**% change**
Revenue, net	$10,780	$23,976	$(13,196)	(55)%

Net revenue decreased $13.2 million, or 55%, from the first quarter of 2008 to the first quarter of 2009. The decrease was attributable to a 58% decrease in units sold, partially offset by a 3% increase in average selling price. The decrease in revenue resulted primarily from weakened demand for our products which we believe to be the result of the worldwide economic recession, which our customers responded to by significantly decreasing their inventory levels as end customer demand dropped sharply.

The year-over-year decrease in revenue also resulted from:

- Lower sales of our Integrated Circuits ("ICs") into the advanced television market, as we continue to move away from the commoditized system-on-chip ("SoC") segment of the market with our new line of Motion Estimation Motion Compensation ("MEMC") co-processor ICs, which improve the performance and viewing experience of large advanced LCD panels by reducing motion blur and judder;

- Lower sales of legacy products that we acquired in conjunction with the Equator acquisition; and
- Decreased sales to one of our top-five end customers.

These decreases were partially offset by an increase in sales of our MEMC co-processor ICs and sales of our next generation projector image processor, which together comprised 21% of total revenue in the first quarter of 2009, up from zero percent in the first quarter of 2008.

Current economic and market volatility impedes our ability to determine if, and to what extent, the current trends will continue throughout 2009 and beyond.

Cost of revenue and gross profit

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

	Three months ended March 31,			
	2009	% of revenue	2008	% of revenue
Direct product costs and related overhead [1]	$ 6,045	56%	$ 10,902	45%
Amortization of acquired intangible assets	617	6	705	3
Provision (benefit) for obsolete inventory, net of usage	(160)	(1)	680	3
Additional amortization of non-cancelable prepaid royalty	68	1	—	—
Restructuring	47	0	—	—
Stock-based compensation	7	0	18	0
Total cost of revenue	$ 6,624	61%	$ 12,305	51%
Gross profit	$ 4,156	39%	$ 11,671	49%

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

Cost of revenue increased to 61% of total revenue in the first quarter of 2009, up from 51% of total revenue in the first quarter of 2008. The increase resulted primarily from a change in the mix of products sold and the impact of lower overhead cost absorption due to decreased revenue. We expect that any future increases in sales of our MEMC products and next generation projector processors will decrease our gross margin as a percentage of sales, however these increases may be partially offset by production efficiencies as we improve our manufacturing processes. The net benefit for obsolete inventory in the first quarter of 2009 is due to sales of previously reserved inventory in excess of new provisions for obsolete inventory, and is attributable to our increased focus on inventory management.

Research and development

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

	Three months ended March 31,		2009 v 2008	
	2009	2008	$ change	% change
Research and development	$ 4,776	$ 6,722	$ (1,946)	(29)%

Research and development expense decreased $1.9 million, or 29%, from the first quarter of 2008 to the first quarter of 2009. This decrease is directly attributable to the restructuring efforts that we initiated in November of 2006 and continued to implement throughout 2007 and 2008. These efforts resulted in the following reductions in research and development expenses:

- Depreciation and amortization expense, software maintenance expense and expensed equipment and software decreased $867,000. This decrease is primarily due to reduced levels of engineering software tools due to reductions in research and development personnel and changes in product development strategy.
- Compensation expense decreased $432,000. At March 31, 2009, we had 128 research and development employees compared to 142 at March 31, 2008.
- Stock-based compensation expense decreased $331,000 due to personnel reductions and reduced valuation of our stock options.

Selling, general and administrative

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

	Three months ended March 31,		2009 v 2008	
	2009	2008	$ change	% change
Selling, general and administrative	$ 3,873	$ 4,686	$ (813)	(17)%

Selling, general and administrative expense decreased $813,000, or 17%, from the first quarter of 2008 to the first quarter of 2009. This decrease is directly attributable to the restructuring efforts that we initiated in November of 2006 and implemented throughout 2007 and 2008. These efforts resulted in the following reductions in selling, general and administrative expenses:

- Compensation expense decreased $190,000. As of March 31, 2009, we had 64 employees in selling, general and administrative functions, compared to 66 as of March 31, 2008.
- Sales commissions decreased $174,000 primarily due to lower sales volume.
- Professional fees, including accounting and legal decreased $174,000.
- Stock-based compensation expense decreased $173,000 due to personnel reductions and reduced valuation of our stock options.

Restructuring

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

	Three months ended March 31, 2009	Three months ended March 31, 2008
Consolidation of leased space [1]	$ 7	$ 541
Termination and retention benefits [2]	77	467
Total restructuring expenses	$ 84	$ 1,008
Included in cost of revenue	$ 47	$ —
Included in operating expenses	37	1,008

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

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

In December 2008, we initiated a restructuring plan to reduce our operating expenses in response to decreases in current and forecasted revenue which resulted primarily from the global economic crisis. This plan reduced operations, research and development and administrative headcount in our San Jose, Taiwan and China offices and was substantially completed during the current quarter. Although additional restructuring actions under the 2008 plan are being evaluated, uncertainty regarding the outlook for the remainder of 2009 and beyond impedes our ability to forecast the scope and impact of any potential actions. All restructuring expenses recorded in the first quarter of 2009 were attributable to the December 2008 plan.

In November 2006, we initiated a restructuring plan to reduce operating expenses. This plan included consolidation of our operations in order to reduce compensation and rent expense. As part of this plan we closed our offices in Toronto, Beijing and Shenzhen. Additionally, we eliminated all operations and research and development activities at our Tualatin location and transferred them to our offices in San Jose, Shanghai and Hsin Chu. The consolidation and closure of these offices and reduction in headcount resulted in charges for non-cancelable leases and termination and retention benefits for effected employees. In connection with this restructuring we also narrowed and redefined our product development strategy which resulted in the write-off of IP assets, tooling, software development tools and charges for related non-cancelable contracts. This plan was completed in the fourth quarter of 2008. All restructuring expenses recorded in the first quarter of 2008 were attributable to the November 2006 plan.

The expected benefits from these restructuring plans are fully reflected in our business outlook for the second quarter of 2009, which is presented below.

Interest and other income, net

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

	Three months ended March 31, 2009	2008	$ change
Gain on repurchase of long-term debt, net [1]	$ 9,024	$ 11,557	$ (2,533)
Interest expense [2]	(251)	(573)	322
Interest income [3]	98	983	(885)
Amortization of debt issuance costs [4]	(61)	(146)	85
Other-than-temporary impairment of marketable security, net [5]	—	(6,490)	6,490
Total interest and other income, net	$ 8,810	$ 5,331	$ 3,479

1 In February 2008, we repurchased and retired $50.2 million of our 1.75% convertible subordinated debentures for $37.9 million in cash, including legal and other professional fees of $755,000. We recognized a gain on this repurchase of $11.6 million, net of a write-off of debt issuance costs of $752,000. In February 2009, we repurchased and retired $27.1 million of our outstanding debt for $17.8 million in cash. We recognized a net gain on the repurchase of $9.0 million, which includes a $9.3 million discount, offset by a write-off of debt issuance costs of $288,000 and other fees of $34,000.

2 Interest expense primarily relates to interest payable on our long-term debt. The decrease in the first quarter of 2009 is primarily due to the reduced outstanding principal balance which resulted from our February 2008, August 2008 and February 2009 repurchases of long-term debt.

3 Interest income is earned on cash equivalents and short- and long-term marketable securities. The decrease in the first quarter of 2009 is primarily due to lower balances of marketable securities which resulted from our repurchases of long-term debt as well as decreased yields.

4 The fees associated with the 2004 issuance of our long-term debt have been capitalized and are being amortized over a period of seven years. The decrease in the first quarter of 2009 is due to the write-offs of fees associated with the portions of our long-term debt repurchased in February 2008, August 2008 and February 2009. The remaining amortization period is approximately two years as of March 31, 2009.

5 In the first quarter of 2008, we recognized an other-than-temporary impairment of $6.5 million on an investment in a publicly-traded equity security, due to the duration of time that the investment had been below cost, as well as decreased target price estimates, analyst downgrades and macroeconomic factors.

Benefit for income taxes

The benefit for income taxes recorded for the first quarter of 2009 was primarily due to a benefit of $1.8 million for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. The benefit for income taxes recorded for the first quarter of 2008 was primarily due to a benefit of $1.0 million for refundable research and experimentation credits, a benefit of $559,000 for the reversal of a previously recorded tax contingency due to the expiration of the applicable statute of limitations, and a deferred tax benefit of $446,000 which resulted from an increase in the tax rate of a single foreign jurisdiction. These benefits were partially offset by current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions.

Business Outlook

On April 23, 2009, we provided an outlook for the second quarter of 2009 in our earnings release, which was furnished on a current report on Form 8-K. The outlook provided the following anticipated financial results prepared in accordance with U.S. generally accepted accounting principles:

We expect to record net loss per share in the second quarter of 2009 of $(0.23) to $(0.41), based on the following estimates:

- Second quarter revenue of $13.0 million to $15.0 million.
- Gross profit margin of approximately 38% to 42%.
- Operating expenses of $9.0 million to $10.0 million.

Liquidity and Capital Resources

Cash and short- and long-term marketable securities

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

	March 31, 2009	December 31, 2008	$ change	% change
Cash and cash equivalents	$ 32,539	$ 53,149	$(20,610)	(39)%
Short-term marketable securities	5,706	8,058	(2,352)	(29)
Long-term marketable securities	1,920	2,110	(190)	(9)
Total cash and marketable securities	$ 40,165	$ 63,317	$(23,152)	(37)%

Total cash and marketable securities decreased 37% from December 31, 2008 to March 31, 2009. The net decrease in the first quarter of 2009 resulted primarily from $17.8 million used for the repurchase of long-term debt, $4.3 million used by operating activities, $523,000 in payments on property and equipment and other asset financing, $167,000 for the repurchase of our common stock and $154,000 for purchases of property and equipment and other long-term assets.

At March 31, 2009, cash equivalents and short-term marketable securities included $26.5 million in money market funds and certificates of deposit, $5.2 million in commercial paper, $3.5 million in U.S. government agencies debt securities, and $1.0 million in corporate debt securities. At March 31, 2009, we also held a $1.9 million long-term strategic equity investment in a publicly traded corporation. All of our investments were denominated in U.S. dollars, and our portfolio did not contain direct exposure to subprime mortgages or structured vehicles that derive their value from subprime collateral.

Despite the difficult credit environment, the quality of our short-term investment portfolio remains high. Our investment policy requires that at least 25% of our portfolio matures within 90 days. Additionally, no maturities can extend beyond one year and concentrations with individual securities are limited. Investments must be rated at least A-1 / P-1 by Standard & Poor's / Moody's, and our investment policy is reviewed at least annually by our Audit Committee.

The valuations of our short-term marketable securities are affected by a variety of factors, including changes in interest rates and the actual or perceived financial stability of the issuer. However, due to the high quality of our investments and their short-term nature, there has not been, and we do not expect there to be, a significant fluctuation in the valuation of these investments. Accordingly, we do not expect a materially negative impact on our financial condition from fluctuations in the value of our short-term investments. As of March 31, 2009, we had a total unrealized gain of $77,000 on these investments.

The valuation of our long-term equity investment has fluctuated significantly, and could continue to fluctuate significantly, due to a variety of factors including changes in the global economy and changes in the actual or expected performance of the issuing company. We recorded other-than-temporary impairments related to this investment of $6.5 million and $1.4 million in the first and fourth quarter of 2008, respectively. We may record additional impairment charges in the future if we determine that further declines in value of the investment are other-than-temporary. Such an impairment would negatively impact our results of operations, but would not materially impact our financial condition.

When available, we use quoted prices in active markets for identical assets or liabilities to determine the fair value of our cash equivalents and marketable securities. If quoted prices in active markets for identical assets or liabilities are not available, we use quoted prices for similar assets or liabilities, or use observable inputs other than the quoted prices, to determine fair value. We have no investments which are fair valued based on unobservable inputs.

We anticipate that our existing cash and investment balances will be adequate to fund our operating and investing needs for the next twelve months. From time to time, we may evaluate acquisitions of businesses, products or technologies that complement our business. We may also repurchase additional amounts of our long-term debt and common stock. Any further transactions, if consummated, may consume a material portion of our working capital or require the issuance of equity securities that may result in dilution to existing shareholders.

Accounts receivable, net

Accounts receivable, net decreased to $4.5 million at March 31, 2009 from $6.1 million at December 31, 2008. The average number of days sales outstanding increased to 37 days at March 31, 2009 from 29 days at December 31, 2008. The increase in days sales outstanding was primarily due to the timing of sales within the first quarter of 2009.

Inventories, net

Inventories, net decreased to $4.2 million at March 31, 2009 from $5.0 million at December 31, 2008 as the result of decreased sales during the quarter. Inventory turnover on an annualized basis decreased to 5.1 at March 31, 2009 from 7.0 at December 31, 2008. The decrease in inventory turnover was due to reduced revenue during the first quarter of 2009.

Capital resources

In 2004, we issued $150.0 million of 1.75% convertible subordinated debentures (the “debentures”) due 2024. In February 2006, we repurchased and retired $10.0 million of the debentures. In February 2008, we repurchased and retired $50.2 million principal amount of the debentures for $37.9 million in cash. In August 2008, we repurchased and retired $29.1 million of the debentures for $20.6 million in cash. In February 2009, we repurchased and retired $27.1 million of the debentures for $17.8 million in cash, reducing the balance of our outstanding debentures to $33.5 million.

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

In September 2007, the Board of Directors authorized the repurchase of up to $10.0 million of our common stock over the next twelve months. In August 2008, the Board of Directors approved an extension to the program for an additional twelve months, through September 2009. The program does not obligate us to acquire any particular amount of common stock and may be modified or suspended at any time at our discretion. Share repurchases under the program may be made through open market and privately negotiated transactions at our discretion, subject to market conditions and other factors. We repurchased 228,600 shares for $167,000 between January 1, 2009 and March 31, 2009. During 2008, we repurchased 1,625,737 shares for $2.6 million. As of March 31, 2009, $2.9 million remained available for repurchase under the plan. The above numbers reflect the June 4, 2008 one-for-three reverse stock split of our common stock.

Contractual Payment Obligations

Our contractual obligations for 2009 and beyond are included in our Annual Report on Form 10-K for the year ended December 31, 2008, filed with the Securities and Exchange Commission ("SEC") on March 16, 2009. Our obligations for 2009 and beyond have not changed materially as of March 31, 2009, except for the reduction to the principal amount of long-term debt that we expect the holders of the outstanding debentures to require us to purchase in 2011, as presented above in "Liquidity and Capital Resources."

Off-Balance Sheet Arrangements

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

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

Applying a hypothetical 1% decrease in interest rates to the average balances of our interest bearing cash and investment accounts would not have a significant impact on our results of operations for the first quarter of 2009 or on our financial position as of March 31, 2009. As of March 31, 2009 a significant majority of our cash and investments are held as cash or cash equivalents with yields approaching zero and our interest income is relatively insensitive to future decreases in interest rates.

As of March 31, 2009, we had convertible subordinated debentures of $33.5 million outstanding with a fixed interest rate of 1.75%. Interest rate changes affect the fair value of the debentures, but do not affect our earnings or cash flow.

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

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

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

Inherent Limitations on Effectiveness of Controls

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures will prevent or detect all errors and all fraud. Disclosure controls and procedures, no matter how well designed, operated and managed, can provide only reasonable assurance that the objectives of the disclosure controls and procedures are met. Because of the inherent limitations of disclosure controls and procedures, no evaluation of such disclosure controls and procedures can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

PART II — OTHER INFORMATION

Item 1A. Risk Factors.

Investing in our shares of common stock involves a high degree of risk, and investors should carefully consider the risks described below before making an investment decision. If any of the following risks occur, the market price of our shares of common stock could decline and investors could lose all or part of their investment. Additional risks that we currently believe are immaterial may also impair our business operations. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2008, including our consolidated financial statements and related notes, and our other filings made from time to time with the Securities and Exchange Commission.

Macroeconomic Risks

The current global recession and volatility in global credit and financial markets could materially and adversely affect our business and results of operations.

Financial, commercial and consumer markets have experienced extreme disruption in recent months and there can be no assurance that there will not be further deterioration of these markets. While we do not currently require access to credit markets to finance our operations, these economic developments have affected, and are likely to continue to affect, our business in a number of ways. For instance, the economic crisis has decreased, and may continue to decrease, market acceptance of, and reduce the demand for, our products and the success of our product strategy. We face an increased risk that our customers will be unable to continue their operations and it may become more difficult to collect payments from them on a timely basis, or at all. In addition, the current tightening of credit in financial markets may also adversely affect the ability of our customers to obtain financing for significant purchases and operations. This has resulted, and is likely to continue to result, in a decrease or cancellation of orders for our products.

As a result of the worldwide economic slowdown, it is extremely difficult for us and our customers to forecast future sales levels based on historical information and trends. Portions of our expenses are fixed and other expenses are tied to expected levels of sales activities. To the extent that we do not achieve our anticipated level of sales, our gross profit and net income, have, and could continue to be adversely affected until such expenses are reduced to an appropriate level. Additionally, if we are unable to reduce our costs to respond to future decreases in revenue, we may utilize more of our cash resources than we planned. Any future actions that we take to limit our usage of cash may also reduce our ability to execute on our plans and strategies. We are unable to predict the likely duration and severity of the current disruption in financial markets and adverse economic conditions in the U.S. and other countries.

Company Specific Risks

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

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

We have designed our new strategy to help us take advantage of expected market trends. While we have secured design wins with our new products, our expectations may not be accurate and these markets may not develop or they may take longer to develop than we expect. We cannot assure you that the products we are developing to address our new strategy will adequately address the needs of our target customers, that we will be able to produce our new products at costs that enable us to price these products competitively or that our customers or potential customers will accept our products quickly enough or in sufficient volume to grow revenue and gross profit. Additionally, the current economic crisis may alter current market trends and reduce the demand for our products and the success of our product strategy. A lack of market acceptance or insufficient market acceptance would materially and adversely affect our results of operations.

We have incurred substantial indebtedness as a result of the sale of convertible debentures and may be unable to meet our future capital requirements.

As of March 31, 2009, $33.5 million of our 1.75% convertible subordinated debentures due 2024 were outstanding. Although the remaining debt obligations are due in 2024, the holders of debentures have the right to require us to purchase all or a portion of the outstanding debentures at each of the following dates: May 15, 2011, May 15, 2014 and May 15, 2019. Since the market price of our common stock is significantly below the conversion price of the debentures, the holders of our outstanding debentures are unlikely to convert the debentures into common stock in accordance with the existing terms of the debentures. Accordingly, we expect holders of the debentures to exercise a put option, requiring us to purchase all of the outstanding debentures on May 15, 2011, the earliest date allowed. Our ability to meet our debt service obligations will be dependent upon our future performance, which will be subject to financial, business and other factors affecting our operations, some of which are beyond our control. Additionally, due to recent turmoil in the credit markets and the continued decline in the economy, we may not be able to refinance the debentures at terms that are as favorable as those currently contained in the debentures, or at terms that are acceptable to us at all. These debentures could materially and adversely affect our ability to obtain additional debt or equity financing for working capital, acquisitions or other purposes, limit our flexibility in planning for or reacting to changes in our business, reduce funds available for use in our operations and make us more vulnerable to industry downturns and competitive pressures.

While we believe that our current cash and marketable securities balances will be sufficient to meet our capital requirements for the next twelve months, we cannot assure you that we will be able to maintain sufficient cash and marketable security balances to refinance or pay off the convertible debentures when and if the put option is exercised. We may need, or could elect to seek, additional funding through public or private equity or debt financing, which we may not be able to obtain. 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.

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

The June 4, 2008 one-for-three reverse split of outstanding shares of our common stock has not resulted in a material increase in the bid price of our common stock and we may be unable to maintain compliance with NASDAQ Marketplace Rules without taking additional action, which could include effecting an additional reverse stock split. If we are delisted from the NASDAQ Global Market, there may not be a market for our common stock, which could cause a decrease in the value of an investment in us and adversely affect our business, financial condition and results of operations.

On June 4, 2008, we effected a one-for-three reverse split of our common stock. We effected the reverse split to attempt to regain compliance with NASDAQ Marketplace Rules, particularly the minimum $1.00 per share requirement for continued inclusion on the NASDAQ Global Market. Though the per share price of our common stock increased to over $2.00 per share immediately following the reverse split, the price has since closed below $1.00 per share and we cannot guarantee that it will recover to $1.00 per share. If the price does not recover to $1.00 per share, the stock could become subject to delisting again, and we may seek shareholder approval for an additional reverse split. Although NASDAQ has implemented a temporary suspension of the $1.00 minimum bid price requirement, this requirement is scheduled for reinstatement on July 19, 2009.

A second reverse split could produce negative effects. We could not guarantee that an additional reverse split would result in a long-term or permanent increase in the price of our common stock. The market might perceive a decision to effect an additional reverse split as a negative indicator of our future prospects, and as a result, the price of our common stock might decline after such a reverse split (perhaps by an even greater percentage than would have occurred in the absence of such a reverse split). An additional reverse split could also make it more difficult for us to meet certain other requirements for continued listing on the NASDAQ Global Market, including rules related to the minimum number of shares that must be in the public float, the minimum market value of the public float and the minimum number of round lot holders. Investors might consider the increased proportion of unissued authorized shares to issued shares to have an anti-takeover effect under certain circumstances by allowing for dilutive issuances which could prevent certain shareholders from changing the composition of the board, or could render tender offers for a combination with another entity more difficult to complete successfully. Additionally, customers, suppliers or employees might consider a company with low trading volume risky and might be less likely to transact business with us.

If our common stock is delisted, trading of the stock will most likely take place on an over-the-counter market established for unlisted securities, such as the Pink Sheets or the OTC Bulletin Board. An investor is likely to find it less convenient to sell, or to obtain accurate quotations in seeking to buy, our common stock on an over-the-counter market, and many investors may not buy or sell our common stock due to difficulty in accessing over-the-counter markets, or due to policies preventing them from trading in securities not listed on a national exchange or other reasons. In addition, as a delisted security, our common stock would be subject to SEC rules regarding “penny stock,” which impose additional disclosure requirements on broker-dealers. The regulations relating to penny stocks, coupled with the typically higher cost per trade to investors in penny stocks due to factors such as broker commissions generally representing a higher percentage of the price of a penny stock than of a higher priced stock, would further limit the ability and willingness of investors to trade in our common stock. For these reasons and others, delisting would adversely affect the liquidity, trading volume and price of our common stock, causing the value of an investment in us to decrease and having an adverse effect on our business, financial condition and results of operations, including our ability to attract and retain qualified executives and employees and to raise capital.

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

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

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

Despite our restructuring efforts, we may not achieve profitability in the future and, if we do, we may not be able to sustain or increase profitability on a quarterly or annual basis. If we are not profitable in the future, we may be unable to continue our operations.

In 2006, we initiated restructuring plans, which we implemented throughout 2007 and 2008, aimed at returning the Company to profitability. In December 2008, we initiated an additional restructuring plan to reduce our operating expenses in response to decreases in current and forecasted revenue which resulted primarily from the global economic recession. This plan reduced operations, research and development and administrative headcount in our San Jose, Taiwan and China offices. Although this plan was substantially completed during the first quarter of 2009, we will continue to monitor and evaluate the need for additional related restructuring actions in light of global economic uncertainty and its potential impact on our continuing business.

Despite our restructuring efforts, we may not achieve profitability in the future and, if we do, we may not be able to sustain or increase profitability on a quarterly or annual basis. The years ended December 31, 2004 and December 31, 2008 are our only years of profitability since inception and we may be unable to achieve profitability in future periods. Additionally, our profitability in 2008 was primarily the result of gains we recognized on the repurchase of a portion of our convertible subordinated debentures. We did not achieve operating profits in 2008. If we are not profitable in the future, we may be unable to continue our operations.

If we engage in further restructuring efforts, we may be unable to successfully implement new products or enhancements to our current products, which will adversely affect our future sales and financial condition.

We expect to continue to introduce new and enhanced products, and our future sales will depend on customer acceptance of our new products and the enhancements that we may make to our current products. However, if our recent restructuring efforts are insufficient to reduce our cost structure to a level that is commensurate with our revenue, we may be forced to make additional headcount reductions or implement additional cost saving initiatives. These actions could impact our research and development and engineering activities, which may slow our development of new or enhanced products. If we are unable to successfully introduce new or enhanced products, our sales and financial condition will be adversely affected.

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

The display manufacturing market is highly concentrated and we are, and will continue to be, dependent on a limited number of customers and distributors for a substantial portion of our revenue. Sales to distributors represented 48%, 53% and 57% of revenue for the three month period ended March 31, 2009 and years ended December 31, 2008 and 2007, respectively. Sales to Tokyo Electron Device, or TED, our Japanese distributor, represented 28%, 32% and 33% of revenue for the three month period ended March 31, 2009 and years ended December 31, 2008 and 2007 respectively. Revenue attributable to our top five end customers represented 49%, 55% and 47% of revenue for the three month period ended March 31, 2009 and years ended December 31, 2008 and 2007, respectively. Sales to Seiko Epson Corporation, our top end customer, represented 14%, 24% and 21% of revenue for the three month period ended March 31, 2009 and years ended December 31, 2008 and 2007 respectively. A reduction, delay or cancellation of orders from one or more of our significant customers, or a decision by one or more of our significant customers to select products manufactured by a competitor or to use its own internally-developed semiconductors, would significantly impact our revenue.

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

As of March 31, 2009 and December 31, 2008 we had four and three customers, respectively, that each represented 10% or more of accounts receivable. The concentration of our accounts receivable with a limited number of customers increases our credit risk. The failure of these customers to pay their balances, or any other customer to pay future outstanding balances, would result in an operating expense and reduce our cash flows.

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

We contract with third-party foundries for wafer fabrication and other manufacturers for packaging, assembly and testing of our products. We do not own or operate a semiconductor fabrication facility and do not have the resources to manufacture our products internally. Our wafers are fabricated by Semiconductor Manufacturing International Corporation, Taiwan Semiconductor Manufacturing Corporation and Toshiba Corporation. The wafers used in each of our products are fabricated by only one of these manufacturers.

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

Our requirements represent only a small portion of the total production capacity of our contract manufacturers, who have in the past re-allocated capacity to other customers even during periods of high demand for our products. We expect this may occur again in the future. In addition, the current tightening of credit in financial markets may affect the ability of our suppliers to maintain their production capacity and result in a reduction in the supply of wafers to us. If we are unable to obtain our products from our contract manufacturers on schedule, or at all, our ability to satisfy customer demand will be harmed and revenue from the sale of products may be lost or delayed. If orders for our products are cancelled, expected revenue would not be realized.

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

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

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

Our sales are made on the basis of customer purchase orders rather than long-term purchase commitments. Our customers may cancel or defer purchase orders at any time but we must order wafer inventory from our subcontract manufacturers three to four months in advance. This process requires us to make numerous assumptions concerning demand, each of which may introduce error into our estimates of inventory requirements and the current financial crisis and economic downturn has made it more difficult for us and our customers to accurately forecast demand. If our customers or we overestimate demand, we may purchase components or have products manufactured that we may not be able to use or sell. As a result, we would have excess inventory, which would negatively affect our operating results. For example, we overestimated demand for certain of our products which led to significant charges for obsolete inventory in 2008, 2007 and 2006. Conversely, if our customers or we underestimate demand, or if sufficient manufacturing capacity is not available, we would forego revenue opportunities, lose market share and damage our customer relationships.

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

Sales outside the U.S. accounted for approximately 94% of revenue for the first quarter of 2009, and 95% and 96% of revenue for the years ended December 31, 2008 and 2007, respectively. We anticipate that sales outside the U.S. will continue to account for a substantial portion of our revenue in future periods. In addition, customers who incorporate our products into their products sell a substantial portion of their products outside of the U.S., and all of our products are manufactured outside of the U.S. We are, therefore, subject to many international risks, including, but not limited to:

- increased difficulties in managing international distributors and manufacturers due to varying time zones, languages and business customs;
- foreign currency exchange fluctuations in the currencies of Japan, the People's Republic of China ("PRC"), Taiwan or Korea;
- potentially adverse tax consequences;
- difficulties regarding timing and availability of export and import licenses;
- political and economic instability, particularly in the PRC, Japan, Taiwan, or Korea;
- reduced or limited protection of our IP, particularly in software, which is more prone to design piracy;
- increased transaction costs related to sales transactions conducted outside of the U.S., such as charges to secure letters of credit;
- difficulties in maintaining sales representatives outside of the U.S. that are knowledgeable about our industry and products;
- changes in the regulatory environment in the PRC, Japan, Taiwan and Korea that may significantly impact purchases of our products by our customers;
- outbreaks of SARS, bird flu or other pandemics in the PRC or other parts of Asia; and
- difficulties in collecting outstanding accounts receivable balances.

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

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

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

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

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

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

We have experienced, and may continue to experience, difficulty in hiring and retaining employees with appropriate qualifications. In the last two years a significant portion of our executive management team has turned over, including the Chief Executive Officer, Chief Financial Officer, Vice President of Sales, Vice President of Marketing, Vice President of Business Operations and Vice President, Strategy and Market Development. During 2006 and 2007, we also experienced difficulties hiring and retaining qualified engineers in our Shanghai design center.

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

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

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

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

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

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

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

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

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

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

Our operation of any acquired business would 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.

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

We spend a significant amount of management time and external resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including new

Securities and Exchange Commission rules and regulations, NASDAQ Global Market rules and the Sarbanes-Oxley Act of 2002 which requires management's annual review and evaluation of internal control over financial reporting. While we invest significant time and money in our effort to evaluate and test our internal control over financial reporting, there are inherent limitations to the effectiveness of any system of internal controls and procedures, including cost limitations, the possibility of human error, judgments and assumptions regarding the likelihood of future events, and the circumvention or overriding of the controls and procedures. Accordingly, even effective controls and procedures can provide only reasonable assurance of achieving their control objectives.

Company Risks Related to the Semiconductor Industry and Our Markets

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 and customer requirements, 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 digital projectors and advanced flat panel displays continues to fall, we may be required to offer our products to manufacturers at discounted prices due to increased price competition. At the same time, new alternative technologies and industry standards may emerge that directly compete with technologies we offer. We may be required to increase our investment in research and development at the same time that product prices are falling. In addition, even after making this investment, we cannot assure you that our technologies will be superior to those of our competitors or that our products will achieve market acceptance, whether for performance or price reasons. Failure to effectively respond to these trends could reduce the demand for our products.

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

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

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

The markets in which we compete or seek to compete are subject to rapid technological change, frequent new product introductions, changing customer requirements for new products and features and evolving industry standards. The introduction of new technologies and emergence of new industry standards could render our products less desirable or obsolete, which could harm our business. Examples of changing industry standards include the growing use of broadband to deliver video content, the transition from 720 High Definition to 1080p Full High Definition resolution video, faster screen refresh rates, the proliferation of new display devices and the drive to network display devices together. Our failure to adequately respond to such technological changes could render our products obsolete and significantly decrease our revenue.

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

The development of our semiconductors is highly complex. These complexities require us to employ advanced designs and manufacturing processes that are unproven. The result can be longer and less predictable development cycles. 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;
- development of advanced display technologies and capabilities;
- use of advanced foundry processes and achievement of high manufacturing yields; and
- market acceptance of new products.

If we are unable to successfully develop and introduce products in a timely manner, our business and results of operations will be adversely affected. We have experienced increased development time and delays in introducing new products that have resulted in significantly less revenue than originally expected for those products. Our international structure has significantly added to the complexity of our product development efforts as we must now coordinate very complex product development programs between multiple geographically dispersed locations. Our restructuring plans have also significantly affected our product development efforts by reducing the number of personnel dedicated to product development efforts. We may not be successful in timely delivery of new products with reduced numbers of employees. Any such failure could cause us to lose customers or potential customers, which would decrease our revenue.

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

In the past, the semiconductor industry has been characterized by significant downturns and wide fluctuations in supply and demand. Also, the industry has experienced significant fluctuations in anticipation of changes in general economic conditions, including economic conditions in Asia and North America. The current global economic crisis has caused a slowdown in the demand for our products and other semiconductor products in general, and such slowdown may continue for an extended period of time. The cyclical nature of the semiconductor industry has also led to significant variances in product demand and production capacity. We have experienced, and may continue to experience, periodic fluctuations in our future financial results because of changes in industry-wide conditions.

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

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

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

Because of the lengthy development and sales cycles, we will experience delays between the time we incur expenditures for research and development, sales and marketing and inventory and the time we generate revenue, if any, from these expenditures. Additionally, if actual sales volumes for a particular product are substantially less than originally anticipated, we may experience large write-offs of capitalized license fees, software development tools, product masks, inventories or other capitalized or deferred product-related costs, or increased amortization of non-cancelable prepaid royalties, any of which would negatively affect our operating results. For example, our provisions for obsolete inventory were $1.5 million, $4.4 million and $6.2 million for the years ended December 31, 2008, 2007 and 2006, respectively. Additionally, in 2007, we wrote-off assets with a net book value of $6.9 million due to reductions in research and development personnel and changes in product development strategy.

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

Average selling prices for our products decline over relatively short periods of time, while many of our product costs are fixed. When our average selling prices decline, our gross profit declines unless we are able to sell more units or reduce the cost to manufacture our products. Our operating results are negatively affected when revenue or gross profit declines. We have experienced declines in our average selling prices and expect that we will continue to experience them in the future, although we cannot predict when they may occur or how severe they will be. The current crisis in global credit and financial markets may result in more rapid declines in average selling prices as our competitors reduce their prices in attempts to gain market share or as our potential customers have less cash available for purchases and operations and, in some instances, exit the market. Our financial results will suffer if we are unable to offset any reductions in our average selling prices by increasing our sales volumes, reducing our costs, adding new features to our existing products or developing new or enhanced products in a timely basis with higher selling prices or gross profits.

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

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

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

Our ability to compete effectively with other companies will depend, in part, on our ability to maintain the proprietary nature of our technology, including our semiconductor designs and software. We provide the computer programming code for our software to customers in connection with their product development efforts, thereby increasing the risk that customers will misappropriate our proprietary software. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to help protect our proprietary technologies. As of December 31, 2008 we held 90 patents and had 64 patent applications pending for protection of our significant technologies. Competitors in both the U.S. and foreign countries, many of whom have substantially greater resources than we do, may apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell our products, or they may develop similar technology independently or design around our patents. Effective copyright, trademark and trade secret protection may be unavailable or limited in foreign countries.

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

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

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

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

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

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

Our products require manufacturing with state-of-the-art fabrication equipment and techniques. 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. If we have to qualify a new foundry or packaging, assembly and testing supplier for any of our products, we could incur significant delays in shipping products, which may result in lost revenue and damaged customer relationships.

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

Semiconductor manufacturing technologies change rapidly and manufacturers typically discontinue older manufacturing processes in favor of newer ones. For instance, a portion of our products use embedded dynamic random access memory, ("DRAM") technology, which requires manufacturing processes that are being phased out. We also utilize 0.18um, 0.15um and 0.13um standard logic processes, which may only be available for the next five to seven years. Once a manufacturer makes the decision to retire a manufacturing process, notice is generally given to its customers. Customers will then either retire the affected part or develop a new version of the part that can be manufactured with a newer process. In the event that a manufacturing process is discontinued, our current suppliers may be unwilling or unable to manufacture our current products. Additionally, migrating to a new, more advanced process requires significant expenditures for research and development and takes significant time. We cannot assure you that we will be able to place last time buy orders in the future or that we will find alternate manufacturers of our products.

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

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

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

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

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

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

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

We are building most 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 result in higher product costs, which could make our products less competitive if we increase our prices to compensate for our higher costs, or could result in lower gross profit margins if we do not increase our prices.

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

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

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

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

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

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

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

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

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

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

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

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

Other Risks

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

Our stock price and the stock prices of technology companies similar to Pixelworks have been highly volatile. Market fluctuations, particularly over the past several months, as well as general economic and political conditions, including recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of our common stock. Therefore, the price of our common stock may decline, and the value of your investment may be reduced regardless of our performance. Any inability or perceived inability of investors to realize a gain on an investment in our common stock could have an adverse effect on our business, financial condition and results of operations, by potentially limiting our ability to retain our customers, to attract and retain qualified employees and to raise capital. Additional factors that could negatively impact our stock price include:

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

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

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

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

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

The following table sets forth information about shares repurchased during the first quarter of 2009 under the share repurchase program initiated in September 2007 and reflects the one-for-three reverse split of our common stock effected on June 4, 2008 (in thousands except share and per share data).

Period	Total number of shares purchased(1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs
January 1, 2009 – January 31, 2009	163,000	$ 0.76	163,000	$ 2,981
February 1, 2009 – February 28, 2009	65,600	0.67	65,600	2,937
March 1, 2009 – March 31, 2009	—	—	—	2,937
Total	228,600	$ 0.73	228,600	

(1) All purchases made on the open market pursuant to the share repurchase program announced in September 2007, under which the board of directors authorized the repurchase of up to $10.0 million of our common stock over the next twelve months. In August 2008, the Board of Directors approved an extension to the program for an additional twelve months, through September 2009. The program does not obligate us to acquire any particular amount of common stock and may be modified or suspended at any time at our discretion. Share repurchases under the program may be made through open market or privately negotiated transactions at our discretion, subject to market conditions and other factors.

Item 6. Exhibits.

10.1 Separation Agreement dated and effective February 11, 2009, by and between Anthony Simon and Pixelworks, Inc. +

10.2 Summary of Pixelworks Non-Employee Director Compensation. +

10.3 Pixelworks, Inc. 2006 Stock Incentive Plan, Terms and Conditions of Restricted Stock Awards. +

10.4 Pixelworks, Inc. 2006 Stock Incentive Plan, Terms and Conditions of Option Grants. +

31.1 Certification of Chief Executive Officer.

31.2 Certification of Chief Financial Officer.

32.1* Certification of Chief Executive Officer.

32.2* Certification of Chief Financial Officer.

+ Indicates a management contract or compensation arrangement.

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

SIGNATURE

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

PIXELWORKS, INC.

Dated: May 7, 2009

/s/ Steven L. Moore

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

Exhibit 10.1

SEPARATION AGREEMENT

This Separation Agreement ("Agreement") is made by and between Pixelworks, Inc. and Anthony Simon ("Executive") (collectively, "Parties"), effective as of the 11th day of February, 2009 ("Effective Date"). As used in this Agreement, "Pixelworks" refers to Pixelworks, Inc. and all of its subsidiaries.

RECITALS

A. Executive has accepted a position of employment with a competitor of Pixelworks. Executive desires to leave his employment with Pixelworks after the date on which the Pixelworks Board of Directors approves the 2008 Senior Management Bonus payout, currently thought to be February 11, 2009 (the "Bonus Payout"). The 2008 Senior Management Bonus plan includes the following requirement for eligibility: "[The employee must be] actively employed by the Company on the day the bonus is approved by the [Board of Directors], anticipated to be on a date in the first quarter of 2009. If employment is terminated for any reason other than death, retirement or extended disability before the [Board of Directors] approves the bonus, the award shall be forfeited."

B. Pixelworks desires to end Executive's employment immediately, so as to limit Executive's exposure to business plans, strategies, technologies and other Pixelworks confidential and proprietary information.

C. The Executive does not believe that the forfeiture clause in the 2008 Senior Management Bonus is valid or applicable.

D. The Parties have come to an amicable agreement to terminate the Executive's employment relationship with Pixelworks.

NOW THEREFORE for good and valuable consideration the adequacy of which is hereby acknowledged, the Parties agree as follows:

AGREEMENT

1. **Employment Termination**. Executive's last day of employment shall be February 6, 2009 ("Termination Date").

2. **Payments; End of Employment Matters**.

2.1. As consideration for section 3 of this Agreement, Pixelworks will pay Executive a gross Bonus Payout of $97,500.00, payable in equal quarterly installments according to the following schedule and provided that Executive has not breached this Agreement: February 26, June 30, September 30 and December 31. Pixelworks will instruct its legal counsel to hold the Bonus Payout and to disperse the payments to Executive according to the terms of this Agreement. Pixelworks will also instruct its legal counsel in advance to release all remaining funds to Executive on the date of either of the following events: (a) a court of competent jurisdiction issues a final order to either (i) wind up or otherwise dissolve Pixelworks as an entity, or (ii) subject Pixelworks to voluntary or involuntary bankruptcy; (b) the closing of a Change in Control transaction. "Change in Control" means that an entity acquires either the majority of Pixelworks' voting stock or all or substantially all of Pixelworks' assets in a single transaction or series of related transactions; or that Pixelworks has merged with, or into, another entity.

2.2. On the Termination Date, Pixelworks paid Executive all of his accrued and unpaid wages and vacation pay through the Termination Date. The amount of accrued vacation pay was $5,664.38.

2.3. Pixelworks has and will withhold all applicable taxes due in connection with any amounts paid to Executive under this Agreement. Executive understands and agrees that he is liable for such taxes. Executive agrees to indemnify Pixelworks against any claim or demand made against it for such tax liabilities.

2.4. Pixelworks provided Executive with a Closing Statement of Stock Options. Executive agrees that the Closing Statement sets forth the deadline by which Executive must exercise any vested stock options. Pixelworks returned to Executive in a lump sum on the Termination Date all dollars, if any, voluntarily deducted under Pixelworks' Employee Stock Purchase Plan.

2.5. Executive understands that all benefits acquired through Pixelworks for Executive and his family members, including health insurance, ceased on the Termination Date, subject to Executive exercising his rights under COBRA or other applicable law to extend such benefits.

2.6. Executive agrees that, other than the amounts contemplated by this Agreement, Pixelworks owes Executive no further compensation that arises from or relates to Executive's employment.

3. **Non-Solicitation**.

3.1. For one year after the Termination Date, Executive will not do any of the following:

a. Directly or indirectly solicit for hire or hire any "Pixelworks Employee" to work for any organization that Executive directly or indirectly controls or any organization that employs Executive as either an employee or a contractor. A "Pixelworks Employee" is a person who is an employee of Pixelworks as of the Termination Date or who was such an employee within the previous six (6) months.

b. Use in any way or for any purpose, or disclose to any person or entity, any Pixelworks "Confidential Information" (other than as expressly authorized in writing by Pixelworks' CEO). "Confidential Information" means all information that qualifies as a trade secret under California or federal law, as well as all information covered by Executive's Confidentiality and Proprietary Rights Agreement, dated August 23, 2005.

3.2. Should Executive breach section 3.1, he forfeits all of the Bonus Payout, and must return to Pixelworks any portion of the Bonus Payout already paid. Furthermore, Executive agrees that the damages to Pixelworks for any breach of section 3.1(a) will be difficult to calculate, and therefore agrees that in the event of such breach, Pixelworks will also be entitled to liquidated damages in an amount equal to the total compensation paid by Pixelworks to the employee in question for the twelve (12) months prior to the breach. The time period for non-solicitation shall extend for an additional year from the date of breach.

4. **Return of Pixelworks Property**. Executive agrees that on the Termination Date, he has returned to Pixelworks all property and confidential materials belonging to Pixelworks, including but not limited to keys, credit cards, telephone calling card, files, records, mobile phones, computer, electronic equipments, computer access codes, computer hardware, computer programs and software, instruction manuals, business plans, and all other property and documents (whether originals, copies, or extracts), which Executive prepared or received in connection with his employment at Pixelworks.

5. **No Admission of Liability**. Executive agrees that nothing in this Agreement or any payments made under it will be construed as an admission of liability by Pixelworks.

6. **Governing Law and Forum**. The laws of the state of California, U.S.A., govern this Agreement, including the Uniform Commercial Code as adopted in that state but excluding the laws regarding choice of law. The parties shall resolve any dispute that arises from or relates to this Agreement exclusively in the federal courts located within Santa Clara County, except that either party may seek injunctive relief to protect its intellectual property and confidentiality in any court of competent jurisdiction.

7. **Successors and Assigns**. This Agreement shall be binding upon Executive's heirs, executors, administrators and other legal representatives and may be assigned and enforced by Pixelworks and its respective successors and assigns.

8. **Severability**. The provisions of this Agreement are severable. If any provision of this Agreement or its application is held invalid, the invalidity shall not affect other obligations, provisions, or applications of this Agreement which can be given effect without the invalid obligations, provisions, or applications.

9. **Waiver**. The failure of any party to demand strict performance of any provision of this Agreement shall not constitute a waiver of any provision, term, covenant, or condition of this agreement or of the right to demand strict performance in the future.

10. **Section Headings**. The section headings contained herein are for reference purposes only and will not in any way affect the meaning or interpretation of this Agreement.

11. **Entire Agreement**. This Agreement constitutes the entire agreement between the Parties and supersedes all prior or contemporaneous oral or written understandings, statements, representations or promises with respect to its subject matter.

12. **Voluntariness**. Executive acknowledges that (i) he has been given sufficient time to consider this Agreement, (ii) he has carefully read and understands this Agreement, (iii) he has been advised to consult with an attorney prior to executing this Agreement, and (iv) he has signed it voluntarily.

IN WITNESS WHEREOF the Parties have signed this Agreement as the 11th of February, 2009.

Anthony Simon		**PIXELWORKS, INC.**	
Sign:	/s/ Anthony Simon	By:	/s/ Bruce Walicek
Date:	February 11, 2009	Title:	Chief Executive Officer
		Date:	February 11, 2009

Exhibit 10.2

Summary of Pixelworks Non-Employee Director Compensation

The following annual cash compensation, which was effective from the third quarter of 2008, has been indefinitely reduced 10% by the board, effective from the second quarter of 2009. Cash compensation is paid in quarterly increments:

Cash compensation:

Board Member Retainer	$27,000 per year
Audit Committee Retainer	$8,000 per year, regular member $16,000 per year, Chair
Compensation Committee Retainer	$5,000 per year, regular member $10,000 per year, Chair
Nominating and Governance Committee Retainer	$3,000 per year, regular member $6,000 per year, Chair

Stock Compensation Plan:

6,000 shares per year (measured from annual meeting to annual meeting), policy to begin with term in office beginning with the 2009 annual meeting. New non-employee Board members will receive an initial recruitment grant of 10,000 shares.

Other:

Mr. Alley's director compensation is determined by the CEO Transition Agreement dated and effective December 12, 2006, by and between Allen Alley and Pixelworks, Inc. (Exhibit 10.10 to the Company's Annual Report on Form 10-K filed on March 12, 2007). Mr. Alley's director cash compensation is also subject to the indefinite 10% reduction described above.

Exhibit 10.3

PIXELWORKS, INC.
AMENDED AND RESTATED 2006 STOCK INCENTIVE PLAN
TERMS AND CONDITIONS OF RESTRICTED STOCK AWARD

1. General. These Terms and Conditions of Restricted Stock Award (these "**Terms**") apply to a particular award ("**Award**") of restricted shares of Common Stock of the Company ("**Restricted Stock**") if referenced in the Notice of Grant of Restricted Stock ("**Grant Notice**") corresponding to that particular Award. The recipient of the Award identified in the Grant Notice is referred to as the "**Grantee**." The effective date of grant of the Award as set forth in the Grant Notice is referred to as the "**Award Date**."

The Award was granted under and subject to the Company's Amended and Restated 2006 Stock Incentive Plan (the "**Plan**"). Capitalized terms are defined in the Plan if not defined herein. The Award has been granted to the Grantee in addition to, and not in lieu of, any other form of compensation otherwise payable or to be paid to the Grantee. The Grant Notice and these Terms are collectively referred to as the "**Award Agreement**" applicable to the Award.

2. Vesting. Subject to Section 7 below, the Award shall vest, and restrictions (other than those set forth in Section 16.1 of the Plan) shall lapse, in percentage installments of the aggregate number of shares of Restricted Stock subject to the Award as set forth on the Grant Notice. The Administrator reserves the right to accelerate the vesting of the Restricted Stock in such circumstances as it, in its sole discretion, deems appropriate and any such acceleration shall be effective only when set forth in a written instrument executed by an officer of the Company.

3. Continuance of Employment. The vesting schedule requires Continuous Status as an Employee or Consultant through each applicable vesting date as a condition to the vesting of the applicable installment of the Award and the rights and benefits under this Award Agreement. Employment or service for only a portion of the vesting period, even if a substantial portion, will not entitle the Grantee to any proportionate vesting or avoid or mitigate a termination of rights and benefits upon or following a termination of employment or services as provided in Section 7 below or under the Plan.

Nothing contained in this Award Agreement or the Plan constitutes an employment or service commitment by the Company or any of its Subsidiaries, affects the Grantee's status, if he or she is an employee, as an employee at will who is subject to termination without cause, confers upon the Grantee any right to remain employed by or in service to the Company or any of its Subsidiaries, interferes in any way with the right of the Company or any of its Subsidiaries at any time to terminate such employment or services, or affects the right of the Company or any of its Subsidiaries to increase or decrease the Grantee's other compensation or benefits. Nothing in this paragraph, however, is intended to adversely affect any independent contractual right of the Grantee without his or her consent thereto.

4. Dividend and Voting Rights. After the Award Date, the Grantee shall be entitled to voting rights with respect to the shares of Restricted Stock subject to the Award even though such shares are not vested, provided that such rights shall terminate immediately as to any shares of Restricted Stock that are forfeited pursuant to Section 7 below. Any dividends payable on the Restricted Stock shall be treated as Restricted Property pursuant to and as contemplated by Section 8.

5. Restrictions on Transfer. Prior to the time that they have become vested pursuant to Section 2 hereof or Section 11 of the Plan, neither the Restricted Stock, nor any interest therein, amount payable in respect thereof, or Restricted Property (as defined in Section 8 hereof) may be sold, assigned, transferred, pledged or otherwise disposed of, alienated or encumbered, either voluntarily or involuntarily. The transfer restrictions in the preceding sentence shall not apply to (a) transfers to the Company, or (b) transfers by will or the laws of descent and distribution.

6. Stock Certificates.

(a) Book Entry Form. The Company shall issue the shares of Restricted Stock subject to the Award either: (a) in certificate form as provided in Section 6(b) below; or (b) in book entry form, registered in the name of the Grantee with notations regarding the applicable restrictions on transfer imposed under this Award Agreement.

(b) Certificates to be Held by Company; Legend. Any certificates representing shares of Restricted Stock that may be delivered to the Grantee by the Company prior to vesting shall be redelivered to the Company to be held by the Company until the restrictions on such shares shall have lapsed and the shares shall thereby have become vested or the shares represented thereby have been forfeited hereunder. Such certificates shall bear the following legend and any other legends the Company may determine to be necessary or advisable to comply with all applicable laws, rules, and regulations:

"The ownership of this certificate and the shares of stock evidenced hereby and any interest therein are subject to substantial restrictions on transfer under an Agreement entered into between the registered owner and Pixelworks, Inc. A copy of such Agreement is on file in the office of the Secretary of Pixelworks, Inc."

(c) Delivery of Certificates Upon Vesting. Promptly after the vesting of any shares of Restricted Stock pursuant to Section 2 hereof or Section 11 of the Plan and the satisfaction of any and all related tax withholding obligations pursuant to Section 9, the Company shall, as applicable, either remove the notations on any shares of Restricted Stock issued in book entry form which have vested or deliver to the Grantee a certificate or certificates evidencing the number of shares of Restricted Stock which have vested (or, in either case, such lesser number of shares as may result after giving effect to Section 9). The Grantee (or the beneficiary or personal representative of the Grantee in the event of the Grantee's death or Disability, as the case may be) shall deliver to the Company any representations or other documents or assurances as the Company or its counsel may determine to be necessary or advisable in order to ensure compliance with all applicable laws, rules, and regulations with respect to the grant of the Award and the delivery of shares of Common Stock in respect thereof. The shares so delivered shall no longer be restricted shares hereunder.

(d) Stock Power; Power of Attorney. Concurrently with the execution and delivery of this Award Agreement, the Grantee shall deliver to the Company an executed stock power in the form attached hereto as Exhibit A, in blank, with respect to such shares. The Company shall not deliver any share certificates in accordance with this Award Agreement unless and until the Company shall have received such stock power executed by the Grantee. The Grantee, by acceptance of the Award, shall be deemed to appoint, and does so appoint by execution of this Award Agreement, the Company and each of its authorized representatives as the Grantee's attorney(s)-in-fact to effect any transfer of unvested forfeited shares (or shares otherwise reacquired by the Company hereunder) to the Company as may be required pursuant to the Plan or this Award Agreement and to execute such documents as the Company or such representatives deem necessary or advisable in connection with any such transfer.

7. Effect of Termination of Employment or Services. If the Grantee's Continuous Status as an Employee or Consultant terminates (the last day of the Grantee's Continuous Status as an Employee or Consultant is referred to as the Grantee's "**Severance Date**"), the Grantee's shares of Restricted Stock (and related Restricted Property as defined in Section 8 hereof) shall be forfeited to the Company to the extent such shares have not become vested pursuant to Section 2 hereof or Section 11 of the Plan upon the Severance Date (regardless of the reason for such termination of Continuous Status as an Employee or Consultant, whether with or without cause, voluntarily or involuntarily, or due to death or Disability). Upon the occurrence of any forfeiture of shares of Restricted Stock hereunder, such unvested, forfeited shares and related Restricted Property shall be automatically transferred to the Company as of the Severance Date, without any other action by the Grantee (or the Grantee's beneficiary or personal representative in the event of the Grantee's death or Disability, as applicable). No consideration shall be paid by the Company with respect to such transfer. The Company may exercise its powers under Section 6(d) hereof and take any other action necessary or advisable to evidence such transfer. The Grantee (or the Grantee's beneficiary or personal representative in the event of the Grantee's death or Disability, as applicable) shall deliver any additional documents of transfer that the Company may request to confirm the transfer of such unvested, forfeited shares and related Restricted Property to the Company.

8. Adjustments Upon Specified Events. Upon the occurrence of certain events relating to the Company's stock contemplated by Section 11.1 of the Plan, the Administrator shall make adjustments in accordance with such section in the number and kind of securities that may become vested under the Award. If any adjustment shall be made under Section 11.1 of the Plan, or an event described in Sections 11.2 or 11.3 of the Plan shall occur, or other dividend shall be paid on the Restricted Stock, and the shares of Restricted Stock are not fully vested upon such event or prior thereto, the restrictions applicable to such shares of Restricted Stock shall continue in effect with respect to any cash, consideration, property or other securities (the "**Restricted Property**" and, for the purposes of this Award Agreement, "Restricted Stock" shall include "Restricted Property", unless the context otherwise requires) received in respect of such Restricted Stock. Such Restricted Property shall vest at such times and in such proportion as the shares of Restricted Stock to which the Restricted Property is attributable vest, or would have vested pursuant to the terms hereof if such shares of Restricted Stock had remained outstanding. To the extent that the Restricted Property includes any cash (other than cash received as a result of a cash dividend), such cash shall be invested, pursuant to policies established by the Administrator, in interest bearing, FDIC-insured (subject to applicable insurance limits) deposits of a depository institution selected by the Administrator, the earnings on which shall be added to and become a part of the Restricted Property. To the extent that the Restricted Property includes cash as a result of a cash dividend, such cash shall be held or retained by the Company and shall be paid (without interest or other earnings) upon or promptly (and in no event more than thirty (30) days after) the shares of Restricted Stock to which such dividends relate become vested. The Grantee shall have no right to receive any Restricted Property (including, without limitation, any such cash as a result of a cash dividend) to the extent the related Restricted Stock is forfeited.

9. Tax Withholding. The Company shall reasonably determine the amount of any federal, state, local or other income, employment, or other taxes which the Company or any of its Subsidiaries may reasonably be obligated to withhold with respect to the grant, vesting, making of an election under Section 83(b) of the Code or other event with respect to the Restricted Stock. The Company (or any of its Subsidiaries last employing the Grantee) shall be entitled to require a cash payment by or on behalf of the Grantee and/or to deduct from other compensation payable to the Grantee any sums required to be withheld in connection with such event. Alternatively, the Grantee or other person in whom the Restricted Stock vests may elect, in such manner and at such time or times prior to any applicable tax date as may be permitted or required under rules established by the Administrator, to have the Company (subject to Section 16.1 of the Plan) withhold and reacquire the appropriate number of shares, valued in a consistent manner at their fair market value or at the sales price in accordance with authorized procedures for cashless exercises, necessary to satisfy the minimum applicable withholding obligation with respect to the vesting of the Restricted Stock. In no event shall the shares withheld exceed the minimum whole number of shares required for tax withholding under applicable law. Any election to have shares so held back and reacquired shall not be available if the Grantee makes or has made an election pursuant to Section 83(b) of the Code with respect to the Award.

10. Notices. Any notice to be given under the terms of this Award Agreement shall be in writing and addressed to the Company at its principal office to the attention of the Secretary, and to the Grantee at the Grantee's last address reflected on the Company's payroll records. Any notice shall be delivered in person or shall be enclosed in a properly sealed envelope, addressed as aforesaid, registered or certified, and deposited (postage and registry or certification fee prepaid) in a post office or branch post office regularly maintained by the United States Government. Any such notice shall be given only when received, but if the Grantee is no longer employed by or provides services to the Company or a Subsidiary, shall be deemed to have been duly given five business days after the date mailed in accordance with the foregoing provisions of this Section 10.

11. Plan. The Award and all rights of the Grantee under this Award Agreement are subject to the terms and conditions of the provisions of the Plan, incorporated herein by reference. The Grantee agrees to be bound by the terms of the Plan and this Award Agreement. The Grantee acknowledges having read and understanding the Plan, the Prospectus for the Plan, and this Award Agreement. Unless otherwise expressly provided in other sections of this Award Agreement, provisions of the Plan that confer discretionary authority on the Board or the Administrator do not (and shall not be deemed to) create any rights in the Grantee unless such rights are expressly set forth herein or are otherwise in the sole discretion of the Board or the

Administrator so conferred by appropriate action of the Board or the Administrator under the Plan after the date hereof.

12. Entire Agreement. This Award Agreement and the Plan together constitute the entire agreement and supersede all prior understandings and agreements, written or oral, of the parties hereto with respect to the subject matter hereof. The Plan may be amended pursuant to Section 13 of the Plan. This Award Agreement may be amended by the Board from time to time. Any such amendment must be in writing and signed by the Company. Any such amendment that materially and adversely affects the Grantee's rights under this Award Agreement requires the consent of the Grantee in order to be effective with respect to the Award. The Company may, however, unilaterally waive any provision hereof in writing to the extent such waiver does not adversely affect the interests of the Grantee hereunder, but no such waiver shall operate as or be construed to be a subsequent waiver of the same provision or a waiver of any other provision hereof.

13. Counterparts. This Award Agreement may be executed simultaneously in any number of counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

14. Section Headings. The section headings of this Award Agreement are for convenience of reference only and shall not be deemed to alter or affect any provision hereof.

15. Governing Law. This Award Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Oregon without regard to conflict of law principles thereunder.

Exhibit 10.4

PIXELWORKS, INC.
AMENDED AND RESTATED 2006 STOCK INCENTIVE PLAN
TERMS AND CONDITIONS OF OPTION GRANT

1. General.

These Terms and Conditions of Option Grant (these "**Terms**") apply to a particular stock option (the "**Option**") if referenced in the Notice of Grant of Stock Options (the "**Grant Notice**") corresponding to that particular grant. The recipient of the Option identified in the Grant Notice is referred to as the "**Grantee**." The per share exercise price of the Option as set forth in the Grant Notice is referred to as the "**Exercise Price**." The effective date of grant of the Option as set forth in the Grant Notice is referred to as the "**Award Date**." The exercise price and the number of shares covered by the Option are subject to adjustment under Section 11 of the Plan.

The Option was granted under and subject to the Pixelworks, Inc. Amended and Restated 2006 Stock Incentive Plan (the "**Plan**"). Capitalized terms are defined in the Plan if not defined herein. The Option has been granted to the Grantee in addition to, and not in lieu of, any other form of compensation otherwise payable or to be paid to the Grantee. The Grant Notice and these Terms are collectively referred to as the "**Option Agreement**" applicable to the Option.

2. Vesting; Limits on Exercise; Incentive Stock Option Status.

The Option shall vest and become exercisable in percentage installments of the aggregate number of shares subject to the Option as set forth on the Grant Notice. The Option may be exercised only to the extent the Option is vested and exercisable.

- Cumulative Exercisability. To the extent that the Option is vested and exercisable, the Grantee has the right to exercise the Option (to the extent not previously exercised), and such right shall continue, until the expiration or earlier termination of the Option.
- No Fractional Shares. Fractional share interests shall be disregarded, but may be cumulated.
- Minimum Exercise. No fewer than 100 shares of Common Stock (subject to adjustment under Section 11 of the Plan) may be purchased at any one time, unless the number purchased is the total number at the time exercisable under the Option.
- Incentive Stock Option Status; $100,000 Value Limit. The Grant Notice indicates whether the Option is intended as an Incentive Stock Option (within the meaning of Section 422 of the U.S. Internal Revenue Code) or a Nonqualified Stock Option. If the Option is intended to qualify as an Incentive Stock Option and the aggregate fair market value of the shares with respect to which Incentive Stock Options (whether granted under the Option or otherwise) first become exercisable by the Grantee in any

calendar year exceeds $100,000, as measured on the applicable Award Dates, the limitations of Section 5.2 of the Plan shall apply and to such extent the Option will be rendered a Nonqualified Stock Option.

3. Continuance of Employment/Service Required; No Employment/Service Commitment.

The vesting schedule applicable to the Option requires Continuous Status as an Employee or Consultant through each applicable vesting date as a condition to the vesting of the applicable installment of the Option and the rights and benefits under this Option Agreement. Employment or service for only a portion of the vesting period, even if a substantial portion, will not entitle the Grantee to any proportionate vesting or avoid or mitigate a termination of rights and benefits upon or following a termination of employment or services as provided in Section 5 below or under the Plan.

Nothing contained in this Option Agreement or the Plan constitutes a continued employment or service commitment by the Company or any of its Subsidiaries, affects the Grantee's status, if he or she is an employee, as an employee at will who is subject to termination without cause, confers upon the Grantee any right to remain employed by or in service to the Company or any Subsidiary, interferes in any way with the right of the Company or any Subsidiary at any time to terminate such employment or service, or affects the right of the Company or any Subsidiary to increase or decrease the Grantee's other compensation.

4. Method of Exercise of Option.

The Option shall be exercisable by the delivery to the Secretary of the Company (or such other person as the Administrator may require pursuant to such administrative exercise procedures as the Administrator may implement from time to time) of:

- a written notice stating the number of shares of Common Stock to be purchased pursuant to the Option or by the completion of such other administrative exercise procedures as the Administrator may require from time to time,
- payment in full for the Exercise Price of the shares to be purchased in cash, check or by electronic funds transfer to the Company, or (subject to compliance with all applicable laws, rules, regulations and listing requirements and further subject to such rules as the Administrator may adopt as to any non-cash payment) in shares of Common Stock already owned by the Grantee, valued at their fair market value (as determined under the Plan) on the exercise date;
- any written statements or agreements required pursuant to Section 16.1 of the Plan; and
- satisfaction of the tax withholding provisions of Section 10 of these Terms.

The Administrator also may, but is not required to, authorize a non-cash payment alternative by notice and third party payment in such manner as may be authorized by the Administrator, or, subject to such procedures as the Administrator may adopt, authorize a "cashless exercise" with a third party who provides simultaneous financing for the purposes of (or who otherwise facilitates) the exercise of the Option.

If the Option is designated as an Incentive Stock Option, the Option will qualify as an Incentive Stock Option only if it meets all of the applicable requirements of the Code. The Option may be rendered a Nonqualified Stock Option if the Administrator permits the use of one or more of the non-cash payment alternatives referenced above.

5. Early Termination of Option.

5.1 Expiration Date. Subject to earlier termination as provided below in this Section 5, the Option will terminate on the "Expiration" date set forth in the Grant Notice (the "**Expiration Date**").

5.2 Possible Termination of Option upon Certain Corporate Events. The Option is subject to termination in connection with certain corporate events as provided in Section 11.3 of the Plan.

5.3 Termination of Option upon a Termination of Grantee's Employment or Services. Subject to earlier termination on the Expiration Date of the Option or pursuant to Section 5.2 above, if the Grantee's Continuous Status as an Employee or Consultant terminates, the following rules shall apply (the last day of the Grantee's Continuous Status as an Employee or Consultant is referred to as the Grantee's "**Severance Date**"):

- other than as expressly provided below in this Section 5.3, (a) the Grantee will have until the date that is 3 months after his or her Severance Date to exercise the Option (or portion thereof) to the extent that it was vested on the Severance Date, (b) the Option, to the extent not vested on the Severance Date, shall terminate on the Severance Date, and (c) the Option, to the extent exercisable for the 3-month period following the Severance Date and not exercised during such period, shall terminate at the close of business on the last day of the 3-month period;
- if the termination of the Grantee's Continuous Status as an Employee or Consultant is the result of the Grantee's death or Disability, (a) the Grantee (or his or her beneficiary or personal representative, as the case may be) will have until the date that is 12 months after the Grantee's Severance Date to exercise the Option (or portion thereof) to the extent that it was vested on the Severance Date, (b) the Option, to the extent not vested on the Severance Date, shall terminate on the Severance Date, and (c) the Option, to the extent exercisable for the 12-month period following the Severance Date and not exercised during such period, shall terminate at the close of business on the last day of the 12-month period;

In all events the Option is subject to earlier termination on the Expiration Date of the Option or as contemplated by Section 5.2. The Administrator shall be the sole judge of whether the Grantee's Continuous Status as an Employee or Consultant has terminated for purposes of this Option Agreement.

Notwithstanding any post-termination exercise period provided for herein or in the Plan, if the Option is designated as an Incentive Stock Option, the Option will qualify as an Incentive Stock Option only if it is exercised within the applicable exercise periods for Incentive Stock Options under, and meets all of the other requirements of, the Code. If the Option is not exercised within the applicable exercise periods for Incentive Stock Options or does not meet such other requirements, the Option will be rendered a Nonqualified Stock Option.

6. Non-Transferability.

The Option and any other rights of the Grantee under this Option Agreement or the Plan are nontransferable and exercisable only by the Grantee, except as set forth in Section 10 of the Plan.

7. Notices.

Any notice to be given under the terms of this Option Agreement shall be in writing and addressed to the Company at its principal office to the attention of the Secretary, and to the Grantee at the address last reflected on the Company's payroll records, or at such other address as either party may hereafter designate in writing to the other. Any such notice shall be delivered in person or shall be enclosed in a properly sealed envelope addressed as aforesaid, registered or certified, and deposited (postage and registry or certification fee prepaid) in a post office or branch post office regularly maintained by the United States Government. Any such notice shall be given only when received, but if the Grantee is no longer employed by or provides services to the Company or a Subsidiary, shall be deemed to have been duly given five business days after the date mailed in accordance with the foregoing provisions of this Section 7.

8. Plan.

The Option and all rights of the Grantee under this Option Agreement are subject to the terms and conditions of the Plan, incorporated herein by this reference. The Grantee agrees to be bound by the terms of the Plan and this Option Agreement. The Grantee acknowledges having read and understanding the Plan, the Prospectus for the Plan, and this Option Agreement. Unless otherwise expressly provided in other sections of this Option Agreement, provisions of the Plan that confer discretionary authority on the Board or the Administrator do not and shall not be deemed to create any rights in the Grantee unless such rights are expressly set forth herein or are otherwise in the sole discretion of the Board or the Administrator so conferred by appropriate action of the Board or the Administrator under the Plan after the date hereof.

9. Entire Agreement.

This Option Agreement and the Plan together constitute the entire agreement and supersede all prior understandings and agreements, written or oral, of the parties hereto with respect to the subject matter hereof. The Plan and this Option Agreement may be amended pursuant to Section 13 of the Plan. Such amendment must be in writing and signed by the Company. The Company may, however, unilaterally waive any provision hereof in writing to the extent such waiver does not adversely affect the interests of the Grantee hereunder, but no such waiver shall operate as or be construed to be a subsequent waiver of the same provision or a waiver of any other provision hereof.

10. Tax Withholding.

Upon any exercise or payment of the Option or, in the case of an Option designated as an Incentive Stock Option, upon the disposition of shares of Common Stock acquired pursuant to the exercise of the Option prior to satisfaction of the holding period requirements of Section 422 of the Code, the Company or one of its Subsidiaries shall have the right at its option to (a) require the Grantee (or the Grantee's personal representative or beneficiary, as the case may be) to pay or provide for payment of at least the minimum amount of any taxes which the Company or one of its Subsidiaries may be required to withhold with respect to such Option exercise or payment; or (b) deduct from any amount otherwise payable in cash to the Grantee (or the Grantee's personal representative or beneficiary, as the case may be) the minimum amount of any taxes which the Company or one of its Subsidiaries may be required to withhold with respect to such cash payment. In any case where a tax is required to be withheld in connection with the delivery of shares of Common Stock pursuant to the Option, the Administrator may in its sole discretion (subject to Section 16.1 of the Plan) require or grant to the Grantee the right to elect, pursuant to such rules and subject to such conditions as the Administrator may establish, that the Company reduce the number of shares to be delivered by (or otherwise reacquire) the appropriate number of shares, valued in a consistent manner at their fair market value or at the sales price in accordance with authorized procedures for cashless exercises, necessary to satisfy the minimum applicable withholding obligation on the Option exercise or payment event. In no event shall the shares withheld exceed the minimum whole number of shares required for tax withholding under applicable law.

11. Governing Law.

This Option Agreement shall be governed by and construed and enforced in accordance with the laws of the State of Oregon without regard to conflict of law principles thereunder.

12. Effect of this Agreement.

Subject to the Company's right to terminate the Option pursuant to Section 11.3 of the Plan, this Option Agreement shall be assumed by, be binding upon and inure to the benefit of any successor or successors to the Company.

13. Counterparts.

This Option Agreement may be executed simultaneously in any number of counterparts, each of which shall be deemed an original but all of which together shall constitute one and the same instrument.

14. Section Headings.

The section headings of this Option Agreement are for convenience of reference only and shall not be deemed to alter or affect any provision hereof.

Exhibit 31.1

CERTIFICATION

I, Bruce A. Walicek, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Pixelworks, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

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

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

Date: May 7, 2009

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

Exhibit 31.2

CERTIFICATION

I, Steven L. Moore, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Pixelworks, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

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

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

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

Date: May 7, 2009

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

Exhibit 32.1

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

In connection with the Quarterly Report of Pixelworks, Inc. (the "Company") on Form 10-Q for the quarterly period ended March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bruce A. Walicek, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

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

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

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

Date: May 7, 2009

Exhibit 32.2

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

In connection with the Quarterly Report of Pixelworks, Inc. (the “Company”) on Form 10-Q for the quarterly period ended March 31, 2009 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Steven L. Moore, Vice President, Chief Financial Officer, Secretary and Treasurer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

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

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

Date: May 7, 2009