PIXELWORKS INC
Form 10-Q/A
July 25, 2003

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PIXELWORKS, INC. Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

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

For the quarterly period ended March 31, 2003

OR

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

For the transition period from to

Commission File Number: 000-30269

PIXELWORKS, INC.

(Exact name of registrant as specified in its charter)

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

8100 SW Nyberg Road
Tualatin, Oregon 97062
(503) 454-1750

(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ý No o

Number of shares of Common Stock outstanding as of April 30, 2003: 44,349,057

PIXELWORKS, INC.

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PIXELWORKS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	March 31, 2003	December 31, 2002
ASSETS	(Unaudited)	
CURRENT ASSETS		
Cash and cash equivalents	$ 89,471	$ 62,152
Short-term marketable securities	15,084	24,915
Accounts receivable, net	8,891	10,421
Inventories, net	10,395	6,788
Prepaid expenses and other current assets	3,210	3,896

	March 31, 2003		December 31, 2002	
Total current assets		127,051		108,172
Long-term marketable securities				14,500
Property and equipment, net		9,160		9,073
Goodwill		82,548		82,548
Other assets		12,409		12,919
Total assets	$	231,168	$	227,212
LIABILITIES AND SHAREHOLDERS' EQUITY				
CURRENT LIABILITIES				
Accounts payable	$	6,743	$	5,084
Accrued liabilities and other liabilities		8,562		7,312
Total current liabilities		15,305		12,396
Shareholders' equity:				
Common stock		289,255		287,566
Shares exchangeable into common stock		9,060		10,491
Deferred stock compensation		(1,861)		(2,402)
Accumulated deficit		(80,591)		(80,839)
Total shareholders' equity		215,863		214,816
Total liabilities and shareholders' equity	$	231,168	$	227,212

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

PIXELWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)
(In thousands, except per share data)

	Three Months Ended March 31,			
	2003		2002	
Revenue	$	32,005	$	22,005
Cost of revenue (inclusive of amortization of deferred stock compensation of $2 in 2003 and $5 in 2002)		17,292		10,543

	Three Months Ended March 31,	
Gross profit	14,713	11,462
Operating expenses:		
Research and development(1)	6,094	5,452
Selling, general and administrative(2)	6,041	5,188
Amortization of assembled workforce	242	
In-process research and development expense		4,200
Amortization of deferred stock compensation	162	1,022
Merger-related expenses	1,580	
Total operating expenses	14,119	15,862
Income (loss) from operations	594	(4,400)
Interest income	385	675
Interest expense	(6)	(30)
Interest income, net	379	645
Income (loss) before income taxes	973	(3,755)
Provision for income taxes	725	151
Net income (loss)	$ 248	$ (3,906)
Net income (loss) per share:		
Basic and diluted	$ 0.01	$ (0.09)
Weighted average shares used in computing net income (loss) per share:		
Basic	45,030	42,420
Diluted	46,347	42,420

Amount excludes amortization of deferred stock compensation of:

(1) Research and development	$ 310	$ 749
(2) Selling, general and administrative	(148)	273

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

PIXELWORKS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(In thousands)

	Three Months Ended March 31, 2003	2002
Cash flows from operating activities:		
Net income (loss)	$ 248	$ (3,906)
Adjustments to reconcile net income (loss) to net cash provided by operating activites:		
Depreciation and amortization	1,615	1,313
Amortization of assembled workforce	242	
Amortization of developed technology	132	88
Amortization of deferred stock compensation	164	1,027
In-process research and development expense		4,200
Changes in operating assets and liabilities, net of assets acquired:		
Accounts receivable	1,531	(935)
Inventories	(3,607)	(2,751)
Prepaid expenses and other current and long-term assets	485	377
Accounts payable	1,659	3,185
Accrued liabilities	1,333	(573)
Net cash provided by operating activities	3,802	2,025
Cash flows from investing activities:		
Purchases of property and equipment	(1,365)	(1,336)
Purchases of other assets and investments		(350)
Acquisition, net of cash acquired		(1,541)
Purchase of marketable securities	(7,470)	(17,016)
Maturities of marketable securities	31,800	8,525
Net cash provided by (used in) investing activities	22,965	(11,718)
Cash flows from financing activities:		
Payments on long-term debt	(83)	(194)
Proceeds from issuances of common stock	635	676
Cash provided by financing activities	552	482
Increase (decrease) in cash and cash equivalents	27,319	(9,211)
Cash and cash equivalents at beginning of period	62,152	53,288
Cash and cash equivalents at end of period	$ 89,471	$ 44,077
Supplemental disclosure of cash flow information:		
Interest paid	$ 6	$ 30
Issuance of stock for acquisition of business	$	$ 20,114

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

PIXELWORKS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)
(In thousands, except per share data)

Note 1: Basis of Presentation

The financial information included herein for the three months ended March 31, 2003 and 2002 is unaudited; however, such information reflects all adjustments consisting only of normal recurring adjustments, which are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods. The results of operations for the three months ended March 31, 2003 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2003.

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

This report on Form 10-Q/A for the quarter ended March 31, 2003, should be read in conjunction with the Company's Annual Report on Form 10-K/A for the year ended December 31, 2002 filed on May 30, 2003 ("Form 10-K/A"). Portions of the accompanying financial statements are derived from the audited year-end financial statements of the Company for the year ended December 31, 2002.

Stock Compensation

Statement of Financial Accounting Standards ("SFAS") No. 123, *Accounting for Stock-Based Compensation*, defines a fair value based method of accounting for an employee stock option or similar instrument. Under the fair value based method, compensation cost is measured at the grant date based on the value of the award and is recognized over the service period, which is usually the vesting period. However, SFAS No. 123 also allows an entity to continue to measure compensation cost using the intrinsic value based method of accounting prescribed by APB Opinion No. 25 ("Opinion 25"), *Accounting for Stock Issued to Employees*. Under the intrinsic value based method, compensation cost is the excess, if any, of the quoted market price of the stock at grant date or other measurement date over the amount an employee must pay to acquire the stock. Entities electing to remain with the accounting in Opinion 25 must make pro forma disclosures of net income and, if presented, earnings per share, as if the fair value based method had been applied. Pixelworks has elected to continue to apply the prescribed accounting in Opinion 25 and make the required disclosures under SFAS No. 123.

Pixelworks accounts for equity instruments issued to non-employees in accordance with the provisions of SFAS No. 123 and Emerging Issues Task Force consensus on Issue No. 96-18, *Accounting for Equity Instruments that are Issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services*. There have been no equity instruments issued to non-employees during the periods presented.

Had Pixelworks accounted for its stock-based compensation plans in accordance with SFAS No. 123, Pixelworks' net loss would approximate the pro forma disclosure as follows:

	Three Months Ended March 31, 2003	Three Months Ended March 31, 2002
Net income (loss):		
As reported	$ 248	$ (3,906)
Stock compensation expense, net of tax, as reported	164	1,027
Stock compensation expense, net of tax, under SFAS 123	(3,513)	(3,578)
Pro forma	$ (3,101)	$ (6,457)

	Three Months Ended March 31,	
Basic and diluted net income (loss) per share:		
As reported	0.01	(0.09)
Pro forma	(0.07)	(0.15)

The effects of applying SFAS No. 123 in this pro forma disclosure are not indicative of future amounts and additional awards are anticipated in future years.

The fair value of the compensation costs reflected in the above pro forma amounts was determined using the Black-Scholes option pricing model and the weighted average assumptions as follows:

Stock Option Plans:

	Three Months Ended March 31,	
	2003	2002
Risk free interest rate	2.92%	2.76%
Expected dividend yield	0%	0%
Expected life - years	5.5	5.4
Volatility	113%	115%

Employee Stock Purchase Plan:

	Three Months Ended March 31,	
	2003	2002
Risk free interest rate	1.84%	4.32%
Expected dividend yield	0%	0%
Expected life - years	1.2	1.0
Volatility	101%	106%

Segments

SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, establishes standards for disclosure about operating segments in annual financial statements and selected information in interim financial reports. Based on definitions contained within SFAS No. 131, the Company has determined that it operates within one segment, the design and marketing of integrated circuits for the advanced display industry. Substantially all of the assets of the Company are located in the United States.

Geographic Information

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

	Three Months Ended March 31,	
	2003	2002
Japan	$ 14,871	$ 9,099
Taiwan	6,121	4,755
Korea	5,047	2,990

	Three Months Ended March 31,	
Malaysia	1,986	2,664
United States	371	337
Other countries	3,609	2,160
Total revenue	$ 32,005	$ 22,005

Significant Customers

The following table shows percentage of total revenue by distributor for those distributors generating 10% or more of total revenue:

	Three Months Ended March 31,	
	2003	2002
Distributor A	44%	38%
Distributor B	11%	14%

During the three months ended March 31, 2003 no end-customers represented more than 10% of total revenue and one end-customer represented 10% of total revenue during the three months ended March 31, 2002. End customers represent customers who indirectly purchase the Company's products through distributors and contract manufacturers as well as directly from the Company.

The following table shows percentage of gross accounts receivable outstanding by account for those accounts representing 10% or more of total revenue:

	March 31, 2003	December 31, 2002
Account A	27%	48%
Account B	15%	16%

Loss of or non-performance by these significant customers could adversely affect Pixelworks financial position or results of operations.

Note 2: Earnings per share

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

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

	Three Months Ended March 31,	
	2003	2002
Potential common stock equivalent shares related to stock options	4,109	3,778
Shares of restricted stock subject to repurchase		67

Potential common stock equivalent shares related to stock options includes weighted shares for which the options' exercise price was greater than the average market price for the period of 4,109 and 1,904 for the three months ended March 31, 2003 and 2002, respectively.

The computation of basic weighted average shares outstanding includes exchangeable shares. These exchangeable shares, which were issued on September 6, 2002 to former shareholders of Jaldi Semiconductor in an asset acquisition, are intended to have characteristics essentially equivalent to our common stock.

Note 3: Balance Sheet Components

Inventories

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

	March 31, 2003	December 31, 2002
Finished goods	$ 7,466	$ 5,249
Work in process	2,929	1,539
	$ 10,395	$ 6,788

Warranty Reserve

At the time revenue is recognized, we provide an accrual for estimated costs to be incurred pursuant to our warranty obligations. Our estimate is based primarily on our historical experience. The following table presents a roll forward of the reserve for warranty returns for the three months ended March 31, 2003:

Balance at January 1, 2003	$ 769
Provision	82
Charge offs	(63)
Balance at March 31, 2003	$ 788

Note 4: Acquisitions

Jaldi Semiconductor Corp.

On September 6, 2002, Pixelworks acquired the remaining equity interest in Jaldi Semiconductor Corporation ("Jaldi"), a privately held development stage fabless semiconductor company based near Toronto in Richmond Hill, Ontario, Canada, in exchange for 1,731 shares exchangeable for Pixelworks common stock and the assumption of all outstanding stock options. Pixelworks made an investment of $7,500 in Jaldi on January 30, 2001 in exchange for a 19.6% equity investment. The acquisition has been accounted for as an asset purchase and the results of Jaldi's operations have been included in the Company's financial statements beginning on September 6, 2002.

8

Jaldi's technology is expected to expand Pixelworks' product portfolio for the digital television market.

Under the terms of the reorganization agreement between Jaldi, Pixelworks, Inc. and Pixelworks Nova Scotia, each outstanding share of Jaldi was exchanged for .531727153 of a Jaldi exchangeable share. Holders of exchangeable shares have dividend, voting and other rights equivalent to common stockholders of Pixelworks, Inc. These exchangeable shares are the economic equivalent of common shares of Pixelworks, Inc. and may be exchanged for those shares on a one-for-one basis at any time. The aggregate purchase price of Jaldi was approximately $24,988 consisting of 1,731 shares that are issuable upon the exchange of the Jaldi exchangeable shares that are valued at $16,376, the assumption of approximately 119 stock options valued at $1,011, and $7,601 cash (including the $7,500 investment in 2001). The estimated fair value of the shares issued was based on the average closing price of Pixelworks' common stock on the day prior to the announcement of the intent to exercise the option to acquire Jaldi, the day of the announcement, and the day following the announcement ($9.46 per share).

The purchase price of this development stage company was derived as follows for accounting purposes:

	Jaldi Shares	Total Pixelworks Common Shares	Fair Value
Common shares	3,256	1,731	$ 16,376
Stock options	224	119	1,011
	3,480	1,850	17,387
Cash investment in 2001			7,500
Acquisition costs			101
Total purchase price			$ 24,988

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

Assets acquired:	
Current assets	$ 2,084
Non-current assets	2,111
Acquired in-process research and development	20,142
Deferred compensation on unvested stock awards assumed	1,205
Assembled workforce	2,909
Less:	
Liabilities assumed	(3,463)
Allocated purchase price	$ 24,988

The purchase price was allocated to the assets acquired and liabilities assumed based on management's analysis and estimates of their fair values. Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable. The in-process research and development ("IPR&D") and the assembled workforce were valued at $6,300 and $910, respectively. The remaining excess purchase price over the identifiable tangible and intangible net assets was $15,841 and was allocated on a pro-rata basis resulting in $1,999 of the excess purchase price being assigned to assembled workforce and $13,842 being assigned to IPR&D assets. The IPR&D was expensed at the date of the acquisition in

accordance with FASB Interpretation No. 4 ("FIN 4"), *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method.*

The value assigned to IPR&D related to research projects for which technological feasibility had not been established and no future alternative uses existed. The fair value was determined using the income approach, which discounts expected future cash flows from projects under development to their net present value using a risk adjusted rate. Each project was analyzed to determine the technological innovations, which included; the utilization of core technology; the complexity, cost and time to complete development; any alternative future use or current technological feasibility; and the stage of completion. Future cash flows were estimated, taking into account the expected life cycles of the product and the underlying technology, relevant market sizes and industry trends. The estimated net cash flows from these products were based on management's estimates of related revenues, cost of goods sold, R&D costs, selling, general and administrative costs, income taxes and charges for the use of contributory assets. A discount rate of 22% was utilized based on the technology of the products, the stage of completion of the projects, the complexity of the development effort and the risks associated with reaching technological feasibility of the projects. The nature of the efforts to develop the in-process technology into commercially viable products principally related to the completion of all planning, designing, prototyping, verification and testing activities that are necessary to establish that the product can be produced to meet its design specification, including function, features and technical performance requirements.

Jaldi had two products under development at the acquisition date, contributing 70% and 30% of the total IPR&D value. The products under development were video processing semiconductors targeting the high-definition digital display markets. The development projects ranged from

70% to 90% complete. All development projects had expected completion dates within one year and an estimated aggregate cost to complete of $1,600. Both products are currently in the pre-production stage with lead customers.

nDSP

On January 14, 2002, the Company acquired 100% of the outstanding shares of nDSP, Inc. ("nDSP"). The results of nDSP's operations have been included in the Company's financial statements beginning on the date of acquisition. nDSP is a fabless semiconductor company involved in the development of video processing ICs for the advanced display market. nDSP, headquartered in California, also has offices in China. The acquisition of nDSP is expected to strengthen Pixelworks' advanced video processing product and technology portfolio and enable the Company to compete in the analog CRT and digital TV market. nDSP's technologies complement the technology found in Pixelworks' system-on-a-chip ICs.

The aggregate purchase price of nDSP was 1,186 shares of Pixelworks common stock valued at $20,114. The estimated fair value of the shares issued was based on the average closing price of Pixelworks' common stock on the day prior to the announcement of the Agreement and Plan of Merger, the day of the announcement, and the day following the announcement ($16.96 per share).

The purchase price for accounting purposes was derived as follows:

	nDSP Shares	Total Pixelworks Common Shares	Fair Value
nDSP Common	6,534	20	$ 337
nDSP Series A preferred	6,693	381	6,465
nDSP Series B preferred	6,119	785	13,312
	19,346	1,186	20,114
Acquisition costs			857
Total purchase price			$ 20,971

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

Assets acquired:	
Current assets	$ 1,409
Non-current assets	741
Acquired in-process research and development	4,200
Developed technology	3,700
Goodwill	14,371
Less:	
Liabilities assumed	(3,450)
Allocated purchase price	$ 20,971

The goodwill is not expected to be deductible for tax purposes.

The purchase price was allocated to the assets acquired and liabilities assumed based on management's analysis and estimates of their fair values. Management's estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable. Of the $22,271 of acquired intangible assets, $3,700 was assigned to acquired developed technology with a seven year estimated remaining life and $4,200 was assigned to IPR&D assets that were expensed at the date of acquisition in accordance with FIN 4. The $14,371 of goodwill was assigned to the Company as a reporting unit. In addition, the Company recorded a deferred tax asset of approximately $6,200, subject to a full valuation allowance, related primarily to nDSP's net operating loss carry-forward, which will be offset against goodwill when utilized.

The value assigned to IPR&D related to research projects for which technological feasibility had not been established and no future alternative uses existed. The fair value was determined using the income approach, which discounts expected future cash flows from projects under development to their net present value using a risk adjusted rate. Each project was analyzed to determine the technological innovations included; the utilization of core technology; the complexity, cost and time to complete development; any alternative future use or current technological feasibility; and the stage of completion. Future cash flows were estimated, taking into account the expected life cycles of the product and the underlying technology, relevant market sizes and industry trends. The estimated net cash flows from these products were based on management's estimates of related revenues, cost of goods sold, R&D costs, selling, general and administrative costs, income taxes and charges for the use of contributory assets. A discount rate was determined for each project based on the technology of the product. For the developed technology a discount rate of 35% was used. The in-process technology rates utilized ranged from 40% to 55% and were based on the stage of completion of the project, the complexity of the development effort and the risks associated with reaching technological feasibility of the project. The nature of the efforts to develop the in-process technology into commercially viable products principally related to the completion of all planning, designing, prototyping, verification and

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testing activities that are necessary to establish that the product can be produced to meet its design specification, including function, features and technical performance requirements.

nDSP had three main product groups under development at the acquisition date, each contributing from 7% to 64% of the total IPR&D value. The projects under development were video processing ICs targeting the digital display and analog CRT television markets. The projects ranged from 20% to 80% complete. All projects had expected completion dates within one year and an estimated aggregate cost to complete of $2,500. Since the date of the acquisition two of the products in development have been completed and development of the third product is expected to be completed in the next twelve months.

Note 5: Proposed Transaction

On March 17, 2003, the Company announced the execution of a definitive merger agreement with Genesis Microchip pursuant to which Genesis Microchip will merge with a subsidiary of Pixelworks and each outstanding share of Genesis Microchip common stock will be converted into the right to receive 2.3366 shares of Pixelworks common stock. Pixelworks will also assume all of Genesis Microchip outstanding options. The acquisition will be accounted for as a reverse acquisition under the purchase method of accounting whereby Genesis Microchip will be deemed the acquirer for accounting purposes because Genesis Microchip stockholders will hold approximately 62% of outstanding shares of the combined company after completion of the merger. The historical financial statements of Genesis Microchip will be the historical financial statements of the combined company. Under the reverse acquisition method, Pixelworks will expense all merger related costs as incurred. During the three months ended March 31, 2003, the Company recognized $1,580 in merger-related expenses.

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

(All references to dollar amounts and shares are in thousands)

This Form 10-Q/A contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934 and Section 27A of the Securities Act of 1933. Words such as "projects," "believes," "expects," "anticipates," "intends," "estimates," "should," "will," "may" and similar expressions are intended to identify forward-looking statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. We believe that the expectations reflected in the forward-looking statements are reasonable but we cannot assure you those expectations will prove to be correct. You should not place undue reliance on the forward-looking statements contained in this Form 10-Q/A. Important factors that could cause the Company's actual results to differ materially from those expectations are disclosed in this Form 10-Q/A, including those provided under the heading "Additional Factors That May Affect Future Results" below and in the reports and other documents filed by Pixelworks with the Securities and Exchange Commission including our Annual Report on Form 10-K/A for the year ending December 31, 2002 and our Registration Statement on Form S-4/A filed on July 3, 2003. If any of these risks or uncertainties materialize or any of these assumptions prove incorrect, the results of Pixelworks could differ materially from the expectations expressed or implied in these documents. The forward-looking statements contained in this Form 10-Q/A 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 filing.

Overview

We design, develop and market system-on-a-chip integrated circuits ("ICs") and software for the advanced display industry. Our system-on-chip and software technology translates and optimizes video and computer graphics for display on a wide variety of electronic devices used in business and consumer markets, including multimedia projectors, flat-panel monitors and digital televisions. Our product line is used by the world's leading manufacturers of consumer electronics and computer display products to enhance image quality and ease of use.

We sell our products worldwide through a direct sales force and indirectly through distributors and manufacturers representatives. Distributors have been established in China, Europe, Japan and Taiwan. Sales to distributors represented 66% and 62% of total revenue for the three months ended March 31, 2003 and 2002, respectively. Manufacturers representatives support some of our European and Korean sales. In addition to our Tualatin, Oregon corporate headquarters, we have facilities in California, Canada, China, Japan and Taiwan.

12

We recognize revenue from product sales to direct customers upon shipment. Revenue from product sales to distributors is recognized upon shipment if the distributor has a firm sales commitment from an end customer. Pixelworks complies with the revenue recognition guidance summarized in Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements*. Reserves for sales returns and allowances are recorded at the time of shipment.

Historically, significant portions of our product revenue have been from a relatively small number of customers and distributors. Our top five end customers accounted for 37% and 46% of total revenue for the three months ended March 31, 2003 and 2002, respectively.

Significant portions of our products are sold overseas. Sales outside the U.S. accounted for 99% of total revenue for the three months ended March 31, 2003 and 2002. Our end customers, branded manufacturers and integrators, incorporate our products into systems that are sold worldwide. All revenue to date has been denominated in U.S. dollars.

Proposed Transaction

On March 17, 2003, we announced the execution of a definitive merger agreement with Genesis Microchip, Inc., a Delaware corporation ("Genesis Microchip"), pursuant to which Genesis Microchip will merge with a subsidiary of Pixelworks and each outstanding share of Genesis Microchip common stock will be converted into a right to receive 2.3366 shares of Pixelworks common stock. Pixelworks will also assume all outstanding options to purchase Genesis Microchip common stock.

Headquartered in Alviso, California, with locations in Canada, China, India, Japan, Korea and Taiwan, Genesis Microchip is a fabless semiconductor company. Genesis Microchip's system-on-a-chip solutions are used worldwide by display manufacturers to produce visibly better images across a broad set of devices including flat-panel displays, digital TVs, digital CRTs, projectors and DVD players. The acquisition will be accounted for as a reverse acquisition under the purchase method of accounting whereby Genesis Microchip will be deemed the acquirer for accounting purposes because Genesis Microchip stockholders will hold approximately 62% of outstanding shares of the combined company after completion of the merger. The historical financial statements of Genesis Microchip will be the historical financial statements of the combined company. We expect to record a one-time charge for purchased in-process research and development expenses ("IPR&D") in the quarter in which the merger is completed. We will also incur other acquisition-related expenses that we expect to be large and ongoing. These expenses include the amortization of deferred stock compensation and the amortization of acquired intangible assets. Under the reverse acquisition method, Pixelworks will expense all merger related costs as incurred.

Acquisitions

On September 6, 2002, Pixelworks acquired the remaining equity interest in Jaldi Semiconductor Corporation ("Jaldi"), a privately held development stage fabless semiconductor company based near Toronto in Richmond Hill, Ontario, Canada, in exchange for approximately 1,731 shares exchangeable for Pixelworks common stock and the assumption of all outstanding stock options. Pixelworks made an investment of $7,500 in Jaldi on January 30, 2001 in exchange for a 19.6% equity investment. The acquisition was recorded as an asset purchase and the results of Jaldi's operations are included in the Company's financial statements beginning on the date of acquisition. The Company incurred a charge of $20,142 in the third quarter of 2002 for purchased IPR&D related to the acquisition. Jaldi had two products under development at the acquisition date, contributing 70% and 30% of the total IPR&D value. The products under development were

13

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video processing semiconductors targeting the high-definition digital display markets. The development projects ranged from 70% to 90% complete. Both projects had expected completion dates within one year and an estimated aggregate cost to complete of $1,600. Both products are currently in the pre-production stage with lead customers.

On January 14, 2002, we acquired all of the outstanding shares of nDSP, Inc. ("nDSP") in exchange for approximately 1,186 shares of Pixelworks stock. nDSP was a privately held fabless semiconductor company providing video processing ICs designed to enhance the picture quality of televisions, flat panel displays and multimedia projectors. The transaction was accounted for by the purchase method of accounting, and accordingly, the results of operations of nDSP, Inc. are included in the Company's financial statements beginning on the date of acquisition. Pixelworks recorded a one-time charge of $4,200 in the third quarter of 2002 for IPR&D related to the acquisition. At the time of the acquisition nDSP had one product line in production and three main product lines under development, each contributing from 7% to 64% of the total IPR&D value. The products under development were video processing ICs targeting the digital display and analog CRT television markets. The products ranged from 20% to 80% complete with expected completion dates within one year and an estimated aggregate cost to complete of $2,500. Since the date of the acquisition two of the products in development have been completed and development of the third product is expected to be completed in the next twelve months.

Results of Operations

Three Months Ended March 31, 2003 Compared to Three Months Ended March 31, 2002

Revenue. Revenue for the three months ended March 31, 2003 increased to $32,005 from $22,005 for the three months ended March 31, 2002, a 45% increase. This increase resulted from an 83% increase in units shipped offset in part by a 21% decline in average selling prices. Revenue from shipments to multimedia projector manufacturers, which represented 58% of total revenue for the three months ended March 31, 2003, increased $6,025, or 48%. The increase was related to growth in the overall multimedia projector market, and in large part due to growth in shipments to projector manufacturers in Japan. Revenue from shipments to LCD monitor manufacturers, which represented 24% of total revenue for the three months ended March 31, 2003, increased $1,371, or 22%. The increase resulted from a 95% increase in unit shipments being partially offset by a 38% decline in average selling prices. The unit growth was primarily attributable to an increase in shipments to LCD smart panel manufacturers. Smart panels represent an alternative to the traditional method for assembling an LCD monitor in which the LCD manufacturer integrates the image processing electronics onto the LCD panel before it is sold to an integrator for final assembly. Revenue from shipments to advanced television manufacturers, which represented 14% of total revenue for the three months ended March 31, 2003, increased $1,895, or 73%. This increase resulted from a 41% increase in unit shipments and a 22% increase in average selling prices. The increase in unit shipments was due to growth in the overall advanced televison industry and in particular, an increase in shipments to plasma display and LCD television manufacturers. Average selling prices increased as a result of a greater percentage of advanced television product shipments to plasma display and LCD television manufactures, which have had higher average selling prices than products shipped to progressive scan CRT television manufacturers. Aggregate selling prices are influenced by the specific mix of product shipments and can therefore vary significantly when comparing periods. We expect aggregate average selling prices is likely to decline in most future periods. Revenue from sources other than multimedia projector, LCD monitor and advanced television manufacturers increased $689.

Gross profit. Gross profit margin was 46% for the period ended March 31, 2003 compared to 52% for the period ended March 31, 2002, inclusive of amortization of acquired developed technology and deferred stock compensation. The reduction in gross profit margin was due to an intensely competitive environment that resulted in average selling prices declining at a more rapid rate than average product costs.

Research and development. Research and development expense, inclusive of amortization of deferred stock compensation, was $6,404 or 20% of total revenue for the three months ended March 31, 2003 compared to $6,201 or 28% of revenue for the three months ended March 31, 2002. The increase in research and development expense resulted from an increase of $441 in compensation expense primarily related to an increase in personnel resulting from our September 2002 acquisition of Jaldi and an increase of $239 in software and equipment related expenses. These increases in expense were partially offset by a $439 decrease in amortization of deferred stock compensation primarily due to the use of the accelerated method of amortization, which recognizes more compensation in earlier periods, and the cancellation of unvested stock options upon employee termination.

Selling, general and administrative. Selling, general and administrative expense, inclusive of amortization of deferred stock compensation, was $5,893 or 18% of total revenue for the three months ended March 31, 2003 which compared to $5,461, or 25% of total revenue for the three months ended March 31, 2002. The increase in expense resulted primarily from a $131 increase in compensation expense due to an increase in the number of employees, a $206 increase in rent expense resulting from leasing additional building space to support a greater number of employees, a $224 increase in insurance, accounting and legal services and a $134 increase in commission related to higher sales. Partially offsetting these increases was a decrease of $421 in amortization of deferred stock compensation primarily due to the cancellation of unvested stock options upon employee termination and the use of the accelerated method of amortization.

Amortization of assembled workforce. As of March 31, 2003, there was $2,424 in assembled workforce on the balance sheet as a result of the acquisition of Jaldi in September 2002. The assembled workforce is being amortized over an estimated life of 36 months at a quarterly rate of

$242.

In-process research and development expense. In-process research and development expense ("IPR&D") for the three months ended March 31, 2002, which resulted from the acquisition of nDSP, was $4,200. IPR&D expense represents the discounted future cash flows from research and development projects in development, but not yet completed, at the time of our acquisition of nDSP. There was no IPR&D expense for the three months ended March 31, 2003.

Amortization of deferred stock compensation. Stock compensation expense was $164 for the three months ended March 31, 2003, inclusive of $2 included in cost of sales, a decrease of $863 from $1,027 for the three months ended March 31, 2002, inclusive of $5 included in cost of sales. The decrease was due primarily to the use of the accelerated method of amortization, which recognizes more compensation expense in earlier periods, and the cancellation of unvested stock options upon employee termination. The decrease was partially offset by an increase in expense related to new options issued in the third quarter of 2002 as a result of the Jaldi acquisition. Amortization of the March 31, 2003 balance of $1,861 in deferred stock compensation is estimated to be $1,234 for the remainder of 2003 and $542 and $85 in 2004 and 2005, respectively.

Merger-related expenses. Merger-related expenses are the expenses incurred by Pixelworks during the quarter ended March 31,2003 related to the proposed merger with Genesis Microchip. For accounting purposes, Pixelworks is being acquired and all expenses incurred by Pixelworks will be expensed as incurred. The expenses consist primarily of legal, investment banking, tax and accounting fees.

Interest income, net. Interest income, net consists of interest income and interest expense. Interest income, net decreased $266 to $379 for the three months ended March 31, 2003 from $645 for the

three months ended March 31, 2002. This decrease was primarily the result of lower yields on invested cash in the current period due to overall interest rates declining over the past year.

Provision for income taxes. The provision for income taxes for the three months ended March 31, 2003 increased to $725 from $151 for the three months ended March 31, 2002. The increase in the provision was attributable to the Company's increased income before taxes. The effective tax rate differs from the federal statutory rate primarily due to the following items; non-cash expenses recognized for book purposes that are not deductible for tax purposes, certain non-deductible merger costs, an increase in the Company's valuation allowance related to Jaldi's net operating losses and various tax credits.

Liquidity and Capital Resources

As of March 31, 2003, the Company had cash and cash equivalents of $89,471 and working capital of $111,746 as compared to cash and cash equivalents of $62,152 and working capital of $95,776 as of December 31, 2002. Principal sources of cash during the three months ended March 31, 2003 were cash generated by operating activities of $3,802, proceeds from the issuance of stock under the Company's employee stock purchase plan and stock option plans of $635, and proceeds from the maturity of marketable securities net of purchases of marketable securities of $24,330. Principal uses of cash during the three months ended March 31, 2003 were debt payments of $83 and property and equipment expenditures of $1,365.

Accounts Receivable. Accounts receivable decreased to $8,891 at March 31, 2003 from $10,421 at December 31, 2002, a decrease of $1,530 or 15%. Average days sales outstanding ("DSO") were 25 and 32 days at March 31, 2003 and December 31, 2002, respectively. The decrease in DSO and in total accounts receivable was primarily related to the timing of shipments within the quarter with a smaller percentage of shipments occurring in the final month of the three months ending March 31, 2003, when compared to the three months ending December 31, 2002.

Inventories. Inventories increased $3,607 from $6,788 at December 31, 2002 to $10,395 at March 31, 2003. The increase was due to an increase of $2,217, or 42%, in finished goods inventory and an increase of $1,390, or 90%, in work in process inventory. The growth in work in process inventory resulted from the growth in products manufactured using the customer owned tooling ("COT") production flow. Under COT, the Company owns the wafers throughout the assembly and test process, which results in longer work in process cycles. Inventory turns were 8 and 11 at March 31, 2003 and December 31, 2002, respectively. Inventory turns of 8 represented approximately 7 weeks of shipments in inventory.

Capital Resources. As of March 31, 2003, principal commitments consisted of obligations outstanding under operating leases. These commitments include leases for approximately 52,000 square feet in two facilities located in Tualatin, Oregon, expiring through 2006 and two facilities in California for approximately 18,000 square feet. In September 2002, the Company added approximately 12,000 square feet in Ontario, Canada as a result of the acquisition of Jaldi. The total annual estimated costs for all leased property commitments are $2,471, $1,567, $1,076 and $289 for the years ending December 31, 2003, 2004, 2005 and 2006, respectively. As a result of the acquisition of nDSP, the Company assumed some debt for equipment leases that as of March 31, 2003 represented approximately $129. All of the equipment lease payments are scheduled for payment over the next 12 months. Although the Company has no other material commitments, we may increase our capital expenditures in the future. In the future we may also require a larger inventory of products in order to support anticipated growth in our business.

On March 17, 2003, the Company announced the execution of a definitive merger agreement with Genesis Microchip pursuant to which Genesis Microchip will merge with a subsidiary of Pixelworks and each outstanding share of Genesis Microchip common stock will be converted into the right to receive 2.3366 shares of Pixelworks common stock. Pixelworks will also assume all of Genesis Microchip outstanding options. Based on the Genesis shares and options outstanding on March 17, 2003 Pixelworks would be required to issue approximately 72,967 common shares and 14,491 stock options. In addition to the shares to be issued, the Company estimates merger-related expense will be approximately $10,500. Under certain circumstances, Pixelworks may be required to pay a $20,000 termination fee if the merger agreement is terminated.

The Company believes that its existing cash and cash equivalents and funds generated from operations will be sufficient to fund its operations for the next twelve months and the foreseeable future. From time to time, we may evaluate acquisitions of businesses, products or technologies that complement our business. Any such transactions, if consummated, may consume a material portion of our working capital or require the issuance of equity securities that may result in dilution to existing shareholders.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. On an on-going basis, the Company evaluates its estimates, including those related to product returns, bad debts, inventories, prepaid expenses, intangible assets, income taxes, warranty obligations, litigation and other contingencies. Pixelworks bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Pixelworks believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements:

The Company records estimated reductions to revenue for customer returns based on historical experience. If actual customer returns increase, the Company may be required to recognize additional reductions to revenue.

The Company provides for the estimated cost of product warranties at the time revenue is recognized based on historical experience. Should actual product failure rates or product replacement costs differ from Pixelworks' estimates, revisions to the estimated warranty liability would be required.

The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of Pixelworks' customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

The Company provides for a reserve against its inventory for estimated obsolescence or unmarketable inventory by calculating the difference between the cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

The Company records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized. Should Pixelworks determine that it would not

be able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Recent Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51.* This Interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable interests in variable interest entities obtained after January 31, 2003. The application of this Interpretation is not expected to have a material effect on the Company's financial statements. The Interpretation requires certain disclosures in financial statements issued after January 31, 2003 if it is reasonably possible that the Company will consolidate or disclose information about variable interest entities when the Interpretation becomes effective.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging*. SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The provisions of SFAS No. 149 will be effective for contracts entered into after June 30,2003. The Company does not expect that the adoption of SFAS No. 149 will have a material effect on its financial position or results of operations.

Additional Factors That May Affect Future Results

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

RISKS RELATED TO OUR PROPOSED MERGER WITH GENESIS MICROCHIP

Pixelworks faces numerous risks in connection with the proposed transaction with Genesis Microchip, which may adversely affect our results of operations whether or not the merger is completed, and the merger may not be completed on a timely basis or at all.

On March 17, 2003 we entered into a merger agreement with Genesis Microchip, Inc. Under the terms of the merger agreement, subject to the receipt of required shareholder and regulatory approvals, Genesis Microchip will become a wholly-owned subsidiary of Pixelworks. We will issue 2.3366 shares of our common stock in exchange for each share of Genesis Microchip common stock outstanding on the date of the merger. This transaction creates additional risks for the company.

In response to the pending merger transaction involving Genesis Microchip, Pixelworks' customers may defer purchasing decisions or elect to switch to other suppliers due to uncertainty about the direction of our product offerings following the merger. Uncertainty surrounding the proposed transaction also may have an adverse effect on employee morale and retention, and result in the diversion of management attention and resources. In addition, the market values of Pixelworks common stock and Genesis Microchip common stock will continue to vary prior to completion of the merger transaction due to changes in the business, operations or prospects of

Pixelworks or Genesis Microchip, market assessments of the merger, regulatory considerations, market and economic considerations, or other factors. However, there will be no adjustment to the exchange ratio between Pixelworks and Genesis Microchip shares in connection with the merger, and the parties do not have a right to terminate the merger agreement based upon changes in the market price of either Pixelworks common stock or Genesis Microchip common stock. Completion of the merger also is subject to numerous risks and uncertainties. Pixelworks and Genesis Microchip may be unable to obtain shareowner or other regulatory approvals required to complete the merger in a timely manner or at all. In order to obtain regulatory approval, we may be required to comply with material restrictions or conditions. If the merger is not completed, the price of Pixelworks common stock may decline to the extent that the current market price of Pixelworks common stock reflects a market assumption that the merger will be completed. In addition, the merger agreement limits Pixelworks' ability to terminate the agreement. In the event of a negative development in the patent litigation brought by Silicon Image, Inc. against Genesis Microchip, Pixelworks would not have the right to unilaterally terminate the merger agreement. A significant portion of Genesis Microchip's revenues could be impacted by this patent litigation. Moreover, Pixelworks would not derive the strategic benefits expected to result from the merger, such as creating a more complete and balanced product portfolio. In addition, our business may be harmed to the extent that customers, suppliers or others believe that we cannot effectively compete in the marketplace without the merger or there is customer and employee uncertainty surrounding the future direction of the product offerings and strategy of Pixelworks on a standalone basis. We also will be required to pay significant costs incurred in connection with the merger, including legal, accounting and financial advisory fees whether or not the merger is completed. Moreover, under specified circumstances, Pixelworks may be required to pay Genesis Microchip a termination fee of $20 million in connection with the termination of the merger agreement. If the merger is completed, we will continue to face risks associated with integration of the businesses and operations of Pixelworks and Genesis Microchip, and we may not realize the anticipated benefits or synergies of the merger (primarily associated with anticipated restructurings and other operational efficiencies) to the extent, or in the timeframe, anticipated. In addition to the integration risks previously discussed, our ability to realize these benefits and synergies could be impacted adversely by practical or legal constraints on combining operations. In addition to the costs and expenses previously discussed, we may be required to make payments to executive officers and key employees under change of control/severance agreements entered into in connection with the merger. In addition, the effective tax rate of Pixelworks following the merger is uncertain and could exceed Pixelworks' currently reported tax rate and the weighted average of the pre-merger tax rates of Pixelworks and Genesis Microchip. Moreover, charges to earnings resulting from the application of the purchase method of accounting may affect the market value of Pixelworks' common stock adversely following the merger, as Pixelworks will incur additional depreciation and amortization expense over the useful lives of certain of the net tangible and intangible assets acquired in connection with the merger, and, to the extent the value of goodwill or intangible assets with indefinite lives acquired in connection with the merger becomes impaired, Pixelworks may be required to incur material charges relating to the impairment of those assets. The foregoing risks are described in more detail in the joint proxy statement/prospectus related to the merger included in Pixelworks registration statement on Form S-4/A dated July 3, 2003.

RISKS RELATED TO OUR OPERATIONS

While we have had quarterly periods of net income, we have incurred net losses on an annual basis since our inception and may not be able to achieve or sustain profitability on either a quarterly or annual basis in the future.

While we had $248 of net income for the three months ended March 31, 2003, our cumulative deficit is $80,591 through March 31, 2003. In the future we expect our research and development and selling, general and administrative expenses to increase. Given expected increases in operating expense, we must increase revenues and gross profit to be profitable. We cannot be certain that we will be profitable in the future or, if we are, that we can sustain or increase profitability on a quarterly or annual basis. This may in turn cause the price of our common stock to decline. In addition, if we are not profitable in the future we may be unable to continue our operations.

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

Our quarterly operating results are likely to vary significantly in the future based on a number of factors related to our industry and the markets for our products, some of which are not in our control and any of which may cause the price of our common stock to fluctuate. These factors include:

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

These factors are difficult to forecast, and these or other factors could seriously harm our business. We anticipate the rate of new orders may vary significantly from quarter to quarter. Our operating expenses and inventory levels are based on our expectations of future revenues and our operating expenses are relatively fixed in the short term. Consequently, if anticipated sales and shipments in any quarter do not occur when expected, operating expenses and inventory levels could be disproportionately high, and our operating results for that quarter and, potentially, future quarters may be negatively impacted. Any shortfall in our revenues would have a direct impact on our business. In addition, fluctuations in our quarterly results could adversely affect the price of our common stock in a manner unrelated to our long-term operating performance.

Because our operating results are volatile and difficult to predict, you should not rely on the results of one quarter as an indication of our future performance. It is possible that in some future quarter our operating results will fall below the expectations of securities analysts and investors. In this event, the price of our common stock may decline significantly.

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

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

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

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

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

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

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

The development of our semiconductors, which incorporate mixed analog and digital signal processing, is highly complex. These complexities require that we employ advanced designs and manufacturing processes that are unproven. Since commencing our operations, we have experienced increased development time and delays in introducing new products. We will not always succeed in developing new products or product enhancements nor do so in a timely

manner. Acquisitions have significantly added to the complexity of our product development efforts. We must now coordinate very complex product development programs between multiple, geographically dispersed locations that were formerly done in one location.

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

Successful development and timely introduction of new or enhanced products depends on a number of other factors, including:

accurate prediction of customer requirements and evolving industry standards, including digital interface and content piracy protection standards;

development of advanced display technologies and capabilities;

timely completion and introduction of new product designs;

use of advanced foundry processes and achievement of high manufacturing yields; and

market acceptance of the new products.

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

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

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

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

We are and will continue to be dependent on a limited number of large distributors and customers for a substantial portion of our revenue. For the three months ended March 31, 2003, and year ended December 31, 2002, sales to distributors represented 66% and 68% of total revenue, respectively. For the three months ended March 31, 2003, and year ended December 31, 2002, sales to Tokyo Electron Device Limited, our distributor in Japan, represented 44% and 45% of total revenue, respectively. During the three months ended March 31, 2003, there were no end customers that represented 10% or more of total revenue. Sales to our top five end-customers for the three months ended March 31, 2003 accounted for approximately 37% of our total sales. Sales to our top five customers accounted for approximately 41% and 43% for the years ended December 31, 2002 and 2001, respectively. As a result of this customer and distributor concentration, any one of the following factors could significantly impact our revenues:

a significant reduction, delay or cancellation of orders from one or more of our key distributors, branded manufacturers or integrators; or

a decision by one or more significant customers to select products manufactured by a competitor, or its own internally developed semiconductor, for inclusion in future product generations.

The display manufacturing market is highly concentrated among relatively few, large manufacturers. We expect our operating results to continue to depend on revenues from a relatively small number of distributors that sell our products to display manufacturers and their suppliers.

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

At March 31, 2003, we had two customers that represented more than 10% of our accounts receivable balance. Tokyo Electron Device was the largest accounts receivable representing 27% of our total accounts receivable. The failure of this distributor or any other customer representing 10% or more of our total accounts receivable to pay these accounts receivable would result in a significant expense that would seriously harm our operating results and would reduce our cash flows.

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

Sales outside of the U.S. accounted for 99%, 98% and 91% of our total revenue for the three months ended March 31, 2003, and the years ended December 31, 2002 and 2001, respectively. Most of our customers are concentrated in China, Japan, Korea and Taiwan, with aggregate sales from those four countries accounting for 88% of total revenue for the three months ended March 31, 2003, and 83% of our total revenue for both of the years ended December 31, 2002 and 2001, respectively. We anticipate that sales outside the U.S. will continue to account for a substantial portion of our revenues in future periods. In addition, customers who incorporate our products into their products sell them outside of the U.S., thereby exposing us indirectly to foreign risks. Additionally, all of our products are manufactured outside of the U.S. We are, therefore, subject to many international risks, including:

- increased difficulties in managing international distributors and manufacturers of our products and components due to varying time zones, languages and business customs;
- foreign currency exchange fluctuations such as the Asian financial crisis that occurred in 1998 which caused a devaluation in the currencies of Japan, Taiwan and Korea resulting in an increased cost of procuring our semiconductors;
- potentially adverse tax consequences such as license fee revenue taxes imposed in Japan;
- difficulties regarding timing and availability of export and import licenses, which have limited our ability to freely move demonstration equipment and samples in and out of Asia;
- political and economic instability;
- reduced or limited protection of our intellectual property, significant amounts of which are contained in software which is more prone to design piracy;
- changes in the regulatory environment in China, Japan, Korea and Taiwan that may significantly impact purchases of our products by our customers;
- increased transaction costs related to sales transactions conducted outside of the U.S. such as charges to secure letters of credit for foreign receivables;

- difficulties in maintaining sales representatives outside of the U.S. that are knowledgeable of the display processor industry and our display processor products; and
- difficulties in collecting accounts receivable.

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

Selling through distributors reduces our ability to forecast sales and increases the complexity of our business. Since our distributors are an intermediary between us and the companies using our products, we must rely on our distributors to accurately report inventory levels and production forecasts. This arrangement requires us to manage a more complex supply chain and monitor the financial condition and credit worthiness of our distributors and customers. Our failure to manage one or more of these challenges could result in excess inventory or shortages that could seriously impact our operating revenue or limit the ability of companies using our semiconductors to deliver their products.

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

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

If we are unable to obtain our products from manufacturers on schedule, our ability to satisfy customer demand will be harmed, and revenue from the sale of products may be lost or delayed. If orders for our products are canceled, expected revenues would not be realized. In addition, if the price charged by our third-party manufacturers increases we will be required to increase our prices, which could harm our competitiveness, or suffer declines in our gross margin.

We use a COT, or customer-owned tooling, process for manufacturing some of our products which exposes us to the possibility of poor yields on manufactured products negatively impacting our gross profit margins and could also result in a reduction or loss of revenue.

We are building some 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 associated with coordination of the manufacturing, assembly and testing process. Failure to effectively use this approach to manufacturing would reduce our revenues and harm our gross margin and results of operations.

We are dependent on our foundries to implement complex semiconductor technologies, which could adversely affect our operations if those technologies are not available, delayed or inefficiently implemented.

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

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

Semiconductor manufacturing technologies change rapidly and manufacturers typically discontinue older manufacturing processes in favor of newer ones. Once a manufacturer makes the decision to retire a manufacturing process, notice is generally given to its customers. Customers will then either retire the affected part or develop a new version of the part that can be manufactured on the newer process. In the event that a manufacturing process is discontinued, our products could become unavailable from our current suppliers. Additionally, migrating to a new, more advanced process requires significant expenditures for research and development. A significant portion of our products use 0.25um embedded DRAM technology and the required manufacturing process for these technologies will likely be available for the next two years. We also utilize a 0.18um standard logic process, which we expect will be readily available for the next three to five years. We have commitments from our suppliers to notify us in the event of a discontinuance of a manufacturing process in order to assist us with product transitions.

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

Our products require manufacturing with state-of-the-art fabrication equipment and techniques. Because the lead-time needed to establish a relationship with a new contract manufacturer is at least six months, and the estimated time for us to adapt a product's design to a particular contract manufacturer's processes is at least four months, there is no readily available alternative source of supply for any specific product. This could cause significant delays in shipping products, which may result in lost revenues and damaged customer relationships.

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

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

appropriate qualifications, our product development efforts, revenues and business could be seriously harmed.

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

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

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

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

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

We develop products based on anticipated market and customer requirements and incur substantial product development expenditures, which can include the payment of large up-front, third-party license fees and royalties, prior to generating associated revenues. Because the development of our products incorporates not only our complex and evolving technology, but also our customers' specific requirements, a lengthy sales process is often required before potential customers begin the technical evaluation of our products. Our customers typically perform numerous tests and extensively evaluate our products before incorporating them into their systems. The time required for testing, evaluation and design of our products into a customer's equipment can take up to six months or more. It can take an additional six months before a customer commences volume shipments of systems that incorporate our products. However, even when we achieve a design win, the customer may never ship systems incorporating our products. Because of our relatively limited history in selling our products, no assurance can be given that the time required for the testing, evaluation and design of our products by our customers would not exceed six months. Because of this lengthy development cycle, we will experience delays between the time we incur expenditures for research and development, sales and marketing, inventory levels and the time we generate revenues, if any, from these expenditures. Additionally, if actual sales volumes for a particular product are substantially less than originally forecasted, we may experience large write-offs of capitalized license fees, product masks and prepaid royalties that would negatively affect our operating results.

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

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

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

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

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

We license technology from third parties that is incorporated into our products or product enhancements. Future products or product enhancements may require additional third-party licenses that may not be available to us or are not available on terms that are commercially reasonable. If we are unable to obtain any third-party license required to develop new products and product enhancements, we may have to obtain substitute technology of lower quality or performance standards or at greater cost, either of which could seriously harm the competitiveness of our products.

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

The markets in which we compete or seek to compete are subject to rapid technological change, frequent new product introductions, changing customer requirements for new products and features, and evolving industry standards. The introduction of new technologies and the emergence of new industry standards could render our products less desirable or obsolete, which could harm our business. Recent examples of changing industry standards include the introduction of high-definition television, or HDTV, new digital receivers and displays with resolutions that have required us to accelerate development of new products to meet these new standards.

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

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

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

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

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

Most of our current manufacturers and customers are located in Asian countries, including, China, Japan, Korea and Taiwan. Because of health concerns in countries in that region, including actions taken in response to Severe Acute Respiratory Syndrome, or SARS, and possible quarantines, the company's sales and product support activities may be impaired which could adversely affect the company's business. Customers located in China, Japan, Korea and Taiwan were responsible for approximately 88% of our revenue for the three months ended March 31, 2003. In addition to the current public health risk in the Pacific Rim region, the area is susceptible to the risk of earthquakes due to the proximity of major earthquake fault lines in the area. In September 1999, a current manufacturer's facilities were affected by a significant earthquake in Taiwan. As a consequence of this earthquake, this manufacturer suffered power outages and disruption that impaired its production capacity. Earthquakes, fire, flooding and other natural disasters in the Pacific Rim region, or political unrest, labor strikes or work stoppages in countries where our manufacturers' and customers are located likely would result in the disruption of our foundry partners' assembly capacity. Any disruption resulting from extraordinary events could cause significant delays in shipments of our solutions until we are able to shift our manufacturing or assembling from the affected contractor to another third-party vendor. There can be no assurance that alternative capacity could be obtained on favorable terms, if at all.

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

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

stop selling products using technology that contains the allegedly infringing intellectual property;

attempt to obtain a license to the relevant intellectual property, which license may not be available on reasonable terms or at all;

attempt to redesign those products that contain the allegedly infringing intellectual property; and

pay damages for past infringement claims that are determined to be valid or which are arrived at in settlement of such litigation or threatened litigation.

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

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

Our ability to compete effectively with other companies will depend, in part, on our ability to maintain the proprietary nature of our technology, including our semiconductor designs and software. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods to protect our proprietary technologies. We hold 3 patents and have 37 patent applications pending with the U.S. Patent and Trademark Office for protection of our significant technologies. In addition to filing patents in the United States, we have applied for 12 patents in Canada. We cannot assure you that the degree of protection offered by patents or trade secret laws will be sufficient. Furthermore, we cannot assure you that any patents will be issued as a result of any pending applications, or that, if issued, any claims allowed will be sufficiently broad to protect our technology. In addition, it is possible that existing or future patents may be challenged, invalidated or circumvented. We provide the computer programming code for our software to selected customers in connection with their product development efforts, thereby increasing the risk that customers will misappropriate our proprietary software. Competitors in both the United States and foreign countries, many of which have substantially greater resources, may apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell our products, or develop similar technology independently or design around our patents. Effective copyright, trademark and trade secret protection may be unavailable or limited in foreign countries.

Any acquisition or equity investment we make could disrupt our business and severely harm our financial condition.

We intend to continue to consider investments in or acquisitions of complementary businesses, products or technologies. To date, we acquired Panstera, Inc. in January 2001, nDSP in January 2002 and Jaldi Semiconductor in September 2002 and in March 2003 announced our intent to merge with Genesis Microchip following shareholder and regulatory approval. The acquisitions of Panstera, nDSP and Jaldi contain a very high level of risk primarily because the investments were made based on in-process technological development that may not be completed, or if completed, may not be commercially viable. If this were the case, our financial results would likely be very negatively affected.

These and any future acquisitions and investments could result in:

- issuance of stock that dilutes current shareholders' percentage of ownership;
- incurrence of debt;

- assumption of liabilities;
- amortization expenses related to other intangible assets;
- impairment of goodwill; or
- large and immediate write-offs.

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

- problems combining the purchased 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.

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

Goodwill represents a significant portion of the Company's total assets.

As of March 31, 2003, goodwill amounted to $82,548, or 36%, of the Company's total assets. Effective January 1, 2002 with the adoption of new accounting standards, the Company is required to review goodwill for possible impairment on an annual basis or when events and circumstances arise which indicate a possible impairment. The review of goodwill for impairment may result in large write-offs of goodwill, which could have a material adverse effect on results of operations.

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

Our ability to successfully market and sell our products in a rapidly evolving market requires effective planning and management processes. We continue to increase the scope of our operations domestically and internationally and have increased our headcount substantially. Through internal growth as well as acquisition, our headcount grew from 176 employees at the end of 2001 to 264 employees on March 31, 2003. Our past growth and our expected future growth places a significant strain on our management systems and resources including our financial and managerial controls, reporting systems and procedures. To manage our growth effectively, we must implement and improve operational and financial systems, train and manage our employee base, and attract and retain qualified personnel with relevant experience. We must also manage multiple relationships with customers, business partners, contract manufacturers, suppliers and other third parties. Moreover, we will spend substantial amounts of time and money in connection with our rapid growth and may have unexpected costs. Our systems, procedures or controls may not be adequate to support our operations and we may not be able to expand quickly enough to exploit potential market opportunities. While we have not, to date, suffered any significant adverse consequences due to our growth, if we do not continue to manage growth effectively our business would be seriously harmed.

RISKS RELATED TO OUR INDUSTRY

Failure of consumer demand for flat panel displays and other display technologies to increase could impede our growth.

Our product development strategies anticipate that consumer demand for flat panel displays and other emerging display products will increase in the future. The success of our products is dependent on increased demand for these products, which are at early stages of development. The potential size of the flat panel display market and the timing of its development are uncertain and will depend upon a number of factors, all of which are beyond our control. In order for the market for many of our products to grow, advanced flat panel displays must be widely available and affordable to consumers. In the past, the supply of advanced flat panel displays has been cyclical. We expect this pattern to continue. Under-capacity in the advanced flat panel display market may limit our ability to increase our revenues because our customers may limit their purchases of our products if they cannot obtain sufficient supplies of advanced flat panel displays. In addition, advance flat panel display prices may remain high because of limited supply, and consumer demand may not grow if the supply of advanced flat panel displays does not increase.

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

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

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

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

We compete with a range of specialized and diversified electronic and semiconductor companies that offer display processors. In particular, we compete against Genesis Microchip Inc., I-Chips Co., Ltd., Macronix International Co., Ltd., Mediatek Corp., Media Reality Technologies, Inc., Micronas Semiconductor Holding AG, Mstar Semiconductor, Inc., Oplus Technologies Ltd.,, Realtek Semiconductor Corp., Silicon Image, Inc., Silcon Optix Inc., SmartASIC Technology, Inc., STMicroelectronics N.V., Torpo Technology Inc., Trident Microsystems, Inc., Trumpion Microelectrics Inc., and other companies. Potential competitors may include diversified semiconductor manufacturers and the semiconductor divisions or affiliates of some of our customers, including ATI, LG Electronics, Inc., Matsushita Electric Industrial Co., Mitsubishi

Corporation, National Semiconductor Corp., NEC Corporation, nVidia, Koninlijke Philips Electronics N.V., Samsung Electronics, Sanyo Electric Co., Ltd., Sharp Corporation, Sony Corporation, Texas Instruments, Inc., Toshiba Corporation. Many of our competitors have longer operating histories and greater resources to support development and marketing efforts. Some of our competitors may operate their own fabrication facilities. These competitors may be able to react faster and devote more resources to efforts that compete directly with our own. In the future, our current or potential customers may also develop their own proprietary display processors and become our competitors. In addition, start-up companies may seek to compete in our markets. Our competitors may develop advanced technologies enabling them to offer more cost-effective and higher quality semiconductors to our customers than those offered by us. Increased competition could harm our business, financial condition and results of operations by, for example, increasing pressure on our profit margin or causing us to lose sales opportunities. We cannot assure you that we can compete successfully against current or potential competitors.

The market for Internet enabled display products may not evolve rapidly enough to support expanded market acceptance of our products and industry standards in this market continue to evolve.

If the emerging market for Internet enabled display products does not develop or does not evolve fast enough to support rapid market acceptance of our products, our business, financial condition and results of operations will be materially and adversely affected. Our success will depend on our ability to achieve design wins with customers developing new products and enhanced products for the Internet enabled display products market and their ability to successfully introduce and promote these products. There can be no assurance that the Internet enabled display products market will develop to the extent or in the timeframes necessary to support expansion of our business. We anticipate that Internet enabled display products will be generally based on industry standards, which are continually evolving. The emergence of new industry standards could render our products or our customers' products unmarketable or obsolete and we may incur substantial unanticipated costs to comply with any new standards. Moreover, our past sales have resulted, to a significant extent, from our ability to anticipate changes in technology and industry standards and to develop and introduce new and enhanced products addressing changes within our industry. Our continued ability to adapt to industry changes and to anticipate future standards, and the rate of adoption and acceptance of those standards, will be a significant factor in maintaining or improving our competitive position and our prospects for growth. There can be no assurance that we will be able to anticipate the evolving standards in the semiconductor industry and, in particular, the applications in the Internet enabled display products market, or that we will be able to successfully develop and introduce new products into this market.

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

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

OTHER RISKS

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

The anti-takeover provisions of Oregon law and our articles of incorporation may make a change in control of our business more difficult, even if a change in control would be beneficial to the shareholders. These provisions may allow the board of directors to prevent changes in the management and control of our business. Under Oregon law, our board of directors may adopt additional anti-takeover measures in the future. One anti-takeover provision that we have is the ability of our board of directors to determine the terms of preferred stock and issue preferred stock without the approval of the holders of the common stock. At this time, there are no shares of preferred stock outstanding. However, because the rights and preferences of any series of preferred stock may be set by the board of directors in its sole discretion without approval of the holders of the common stock, the rights and preferences of this preferred stock may be superior to those of the common stock. Accordingly, the rights of the holders of common stock may be adversely affected.

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

Our executive officers, directors and other principal shareholders, in the aggregate, beneficially owned 10,093 shares or approximately 22% of our outstanding common stock as of March 31, 2003. These shareholders currently have, and will continue to have, significant influence with respect to the election of our directors and approval or disapproval of our significant corporate actions. This influence over our affairs might be adverse to the interest of our other shareholders. In addition, the voting power of these shareholders could have the effect of delaying or preventing a change in control of our business or otherwise discouraging a potential acquirer from attempting to obtain control of us, which could prevent our other shareholders from realizing a premium over the market price for their common stock.

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

The stock market has experienced large price and volume fluctuations that have affected the market price of many companies and have often been unrelated to the operating performance of these companies. These factors, as well as general economic and political conditions, may adversely affect the market price and trading volumes of our common stock in the future. The market price and trading volume may fluctuate significantly in response to a number of factors, including:

- actual or anticipated fluctuations in our operating results;
- changes in expectations as to our future financial performance;
- changes in financial estimates of securities analysts;
- changes in market valuations of other companies;
- announcements by us or our competitors of significant technological innovations, design wins, contracts, standards or acquisitions;
- the operating and stock price performance of other comparable companies; and
- the number of shares of the company that are available for trading by the public and the trading volume of our common stock.

Due to these factors, the price of the Company's common stock may decline and the value of your investment would be reduced.

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

We believe our current cash balances will be sufficient to meet our capital requirements for the next 12 months. However, we may need, or could elect, to seek additional funding prior to that time. To the extent that currently available funds are insufficient to fund our future activities, we may need to raise additional funds through public or private equity or debt financing. Additional funds may not be available on terms favorable to us, or our shareholders. Further, if we issue equity securities, our shareholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of our common stock. If we cannot raise funds on acceptable terms, we may not be able to develop or enhance our products, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements.

Terrorist acts and acts of war may seriously harm our business.

Terrorist acts or acts of war, wherever located around the world, may cause damage or disruption to the company, its employees, facilities, partners, suppliers, distributors, and customers, which could significantly impact the company's revenues, expenses and financial condition. The terrorist attacks that took place in the United States on September 11, 2001 were unprecedented events that have created many economic and political uncertainties, some of which may materially harm the company's business and results of operations. The long-term effects on the company of the September 11, 2001 attacks are unknown. The potential for future attacks, hostilities in the Middle East, including Iraq, and other acts of war or hostility, especially in the Korean peninsula, have created economic and political uncertainties, which could adversely affect our business or results of operations that cannot be predicted. In addition, as a company with headquarters and significant operations located in the United States, we could be adversely impacted by any actions against the United States. We are uninsured for loses and interruptions caused by terrorist acts and acts of war.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

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

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

ITEM 4. CONTROLS AND PROCEDURES

Within the 90-day period prior to the filing of this report, an evaluation was carried out under the supervision and with the participation of the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of our disclosure controls and procedures. Based on that evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. Subsequent to the date of their evaluation, there were no significant changes in the Company's internal controls or in other factors that could significantly affect the disclosure controls, including any corrective actions with regard to significant deficiencies and material weaknesses.

PART II OTHER INFORMATION

Item 6: Exhibits and Reports on Form 8-K

(a) Exhibits

2.1	Agreement and Plan of Merger dated March 17, 2003, by and among Pixelworks Inc., Display Acquisition Corporation and Genesis Microchip Inc.*
10.2	Form of Pixelworks Voting Agreement, dated March 17, 2003, by and among Genesis Microchip Inc. and each of the directors of Pixelworks, Inc.**
10.3	Form of Genesis Microchip Voting Agreement dated March 17, 2003, by and among Pixelworks, Inc. and each of the directors of Genesis Microchip Inc.**
10.4	Form of Pixelworks Change of Control Severance Agreement (as entered into between Pixelworks and each of Allen Alley, Marc Fleischmann, Robert Greenberg, Michael West and Bradley Zenger)**
10.5	Change of Control Severance Agreement between Pixelworks and Jeff Bouchard dated as of March 14, 2003**
10.6	Change of Control Severance Agreement between Pixelworks and Hans Olsen dated as of March 14, 2003**
10.7	Form of Relocation Agreement between Pixelworks Inc. and Hans Olsen**
99.1	Certification of Chief Executive Officer
99.2	Certification of Chief Financial Officer

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* Incorporated by reference to the Company's Current Report on Form 8-K filed on March 20, 2003.

** Incorporated by reference to the Company's Registration Statement on Form S-4 filed on April 18, 2003

(b) Reports on Form 8-K

On January 22, 2003, the Company filed a current report on Form 8-K to report under Item 5 that on January 21, 2003 the Company had issued a press release announcing the results for the quarter and year ended December 31, 2002, and the restatement of its financial results for the quarter and nine months ended September 30, 2002 to reflect a change in accounting for the acquisition of Jaldi Semiconductor Corp.

On March 20, 2003, the Company filed a current report on Form 8-K to report under Item 5 that on March 17, 2003 the Company had issued a press release announcing that it had entered into an Agreement and Plan of Merger by and among Pixelworks, Display Acquisition Corp., a Delaware corporation and a direct wholly-owned subsidiary of Pixelworks, and Genesis Microchip Inc., a Delaware corporation, pursuant to which Display Acquisition Corp. will merge with and into

Genesis Microchip, and Genesis Microchip will be the surviving corporation, a wholly-owned subsidiary of Pixelworks. The Merger Agreement provides that each share of Genesis Microchip common stock will be converted into 2.3366 shares of Pixelworks common stock, plus cash for any fractional shares.

SIGNATURES

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

	PIXELWORKS, INC.
Date: July 25, 2003	/s/ Jeffrey B. Bouchard
	Jeffrey B. Bouchard *Vice President, Finance and Chief Financial Officer (Principal Financial and Accounting Officer)*

CERTIFICATIONS

I, Allen H. Alley, certify that:

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

2. Based on my knowledge, this quarterly 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 quarterly report.

3. Based on my knowledge, the financial statements and other financial information included in this quarterly 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 quarterly report.

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

   a. designed such disclosure controls and procedures 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 quarterly report is being prepared;

   b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

   c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

   a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls.

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: July 25, 2003

/s/ Allen H. Alley

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

38

CERTIFICATIONS

I, Jeffrey B. Bouchard, certify that:

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

2. Based on my knowledge, this quarterly 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 quarterly report.

3. Based on my knowledge, the financial statements and other financial information included in this quarterly 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 quarterly report.

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in the Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a. designed such disclosure controls and procedures 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 quarterly report is being prepared;

b. evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c. presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent function):

a. all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b. any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls.

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: July 25, 2003

/s/ Jeffrey B. Bouchard

Jeffrey B. Bouchard
Vice President, Finance
and Chief Financial Officer