PIXELWORKS, INC
Form 10-K
March 09, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2010

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File Number: 000-30269

PIXELWORKS, INC.

(Exact name of registrant as specified in its charter)

Oregon	91-1761992
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
224 Airport Parkway, Suite 400, San Jose, CA	95110
(Address of principal executive offices)	(Zip Code)

408-200-9200

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock	NASDAQ Global Market

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

None

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

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

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

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

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

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company x

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

Aggregate market value of voting Common Stock held by non-affiliates of the registrant at June 30, 2010: $32,875,160. For purposes of this calculation, executive officers and directors are considered affiliates.

Number of shares of Common Stock outstanding as of February 28, 2011: 13,630,558.

Documents Incorporated by Reference

Part III incorporates information by reference to the registrant s definitive proxy statement, to be filed with the Securities and Exchange Commission within 120 days after the close of the fiscal year ended December 31, 2010.

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Forward-looking Statements

This Annual Report on Form 10-K, including Management s Discussion and Analysis of Financial Condition and Results of Operation in Part II, Item 7, contains forward-looking statements that are based on current expectations, estimates, beliefs, assumptions and projections about our business. Words such as expects, anticipates, intends, plans, believes, seeks, estimates and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve numerous risks, uncertainties and assumptions that are difficult to predict. Actual results could vary materially from those contained in forward looking statements due to many factors, including, without limitation: our ability to deliver new products in a timely fashion; our new product yield rates; changes in estimated product costs; product mix; supply of products from third-party foundries; failure or difficulty in achieving design wins; timely customer transition to new product designs; competitive factors, such as rival chip architectures, introduction or traction by competing designs, or pricing pressures; the success of our products in expanded markets; current global economic challenges; levels of inventory at distributors and customers; changes in the digital display and projection markets; changes in customer ordering patterns or lead times; seasonality in the consumer electronics market; our efforts to achieve profitability from operations; insufficient, excess or obsolete inventory and variations in inventory valuation; litigation related to our intellectual property rights; our lower cash position as a result of our prior and any future debt repurchases, and other risks identified in the risk factors contained in Part I, Item 1A of this Annual Report on Form 10-K. These forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Annual Report on Form 10-K. If we do update or correct one or more forward-looking statements, you should not conclude that we will make additional updates or corrections with respect thereto or with respect to other forward-looking statements. Except where the context otherwise requires, in this Annual Report on Form 10-K, the terms Pixelworks, the Company, we, us and our mean Pixelworks, Inc., an Oregon corporation, and its wholly-owned subsidiaries.

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PART I

Item 1. Business.

Overview

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications and hold 138 patents related to the visual display of digital image data. Our solutions enable manufacturers of digital display and projection devices, such as large-screen flat panel televisions and digital front projectors, to manufacture their products with a consistently high level of video quality, regardless of the content s source or format. Our core technology leverages unique proprietary techniques for intelligently processing video signals from a variety of sources to ensure that all resulting images are optimized. Additionally, our products help our customers reduce costs and differentiate their display and projection devices, an important factor in industries that experience rapid innovation. Pixelworks was founded in 1997 and is incorporated under the laws of the state of Oregon.

Pixelworks flexible design architecture enables our technology to produce outstanding image quality in our customers products with a range of single-purpose integrated circuits (ICs), to system-on-chip (SoC) ICs that integrate microprocessor, memory and image processing functions. Additionally, we provide full solutions, including a software development environment and operating system, which enable our customers to more quickly develop and customize their display products, thus reducing their time to market and allowing them to incorporate differentiated features and functions.

Our primary target markets are liquid crystal display (LCD) large-screen televisions and 3LCD and digital light processing (DLP) digital front projectors, however we also target other segments within the flat panel display market, including digital signage.

We have adopted a product strategy that leverages our core competencies in video processing to address the evolving needs of the advanced flat panel display, digital projection and other markets that require superior image quality. We focus our product investments on developing video enhancement solutions for these markets, with particular focus on adding increased performance and functionality. Additionally, we look for ways to leverage our research and development investment into products that address other high-value markets where our innovative proprietary technology provides differentiation for us and our customers. We continually seek to expand our technology portfolio through internal development, co-development with business partners and evaluation of acquisition opportunities.

Digital Video Technology Trends

Over the course of the last several years, video technology has moved rapidly from analog technology, which utilizes waveform signals, to a new generation of digital technologies that utilize a grid of thousands of tiny picture elements, or pixels. Consequently, digital display devices have rapidly evolved to incorporate higher pixel counts and faster rates of screen refresh, both of which contribute to a sharper, clearer image. At the same time, digital display devices have increased in size and begun to incorporate newer video capabilities such as high-definition and, most recently, 3D. Accordingly, the video image processors that drive newer displays have had to increase their capabilities as well to keep pace with the ever growing needs for greater resolution, size and speed that digital technology affords.

The number and variety of digital video applications is increasing rapidly, and video is expanding to play a pervasive role across many aspects of business and personal lifestyle. Digital video content is being delivered from an increasing array of sources that vary dramatically in quality on Blu-ray DVDs, via cable and satellite, across the Internet and on cell phones and smart devices. The sources and quality of video content range from very high-resolution programming produced by network or movie studios to very poor quality clips created by individuals.

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Regardless of the source or quality, increasingly, consumers are sharing video with others and viewing video on a growing array of form factors from handheld devices to large screen displays. At the same time, the consumer expectation for ever higher quality video continues to rise, driven by higher display resolutions on larger TVs. These trends place new demands on video signal and pixel processing technology to enable display and projection devices to provide the best viewing experience possible across multiple display formats. For example, content created for one type of display device, such as a PC, must be scaled up or down to play back clearly on a different device, such as a television. On larger, higher-resolution TV screens, image quality deteriorates significantly, and must be compensated for with video processing technology that restores or even creates higher video quality.

The latest generations of advanced digital display devices enhance image performance in a number of ways, chief among them being increasing the size of the display, increasing the display resolution and increasing the number of times per second the image is refreshed. Premium displays currently feature full HD resolutions of 1920 columns by 1080 rows of pixels progressively scanned (1080p), display frame rates of 240Hz or more, are 3D ready and measure from 32 inches to 70 inches or more diagonally. In addition to the need for image enhancement, various applications, such as digital signage, Internet- enabled televisions and connected classroom environments, are creating a need for new networking capabilities that can enable the sharing of video across display devices and display environments.

Large-Screen Flat Panel Display Market

The market for flat panel displays has risen rapidly over the past decade and is projected to be worth more than $100 billion in sales annually by 2012, according to the industry research firm DisplaySearch. Key segments of growth within the flat panel display industry are consumer applications, such as PC monitors and digital televisions. Digital TVs in particular have transformed the flat panel market, as consumers have enthusiastically embraced advanced television displays that offer sharper and more lifelike images on larger and thinner screens. Increasingly, commercial applications such as public-space advertising, a form of digital signage, are also contributing to the growth of the flat panel market and the drive to improve the image and video quality of the panels themselves.

Flat panel display technologies include LCD, plasma display, rear-projection using LCDs, digital micro-mirror, and newer technologies, such as liquid crystal on silicon (LCoS) and organic light emitting diodes (OLED). Within flat panel displays, LCD and plasma have emerged as the preferred digital display technologies, with LCD leading the market in growth. The digital TV market and its high volume penetration with consumers has helped to secure the dominance of LCD technology. Shipments of LCD TVs are expected to account for around 77% of all TVs sold and grow from 190 million units in 2010 to 215 million units in 2011, according to DisplaySearch.

A large consumer market has pressured flat panel manufacturers to continually improve the quality of their displays, and as a result LCDs and other flat panel displays continue to increase in resolution and size. 1080p resolution is now the high-end standard, and larger flat panel displays are shifting rapidly from refresh rates of 50/60Hz to faster rates of 100/120Hz, 200/240Hz and even 400/480Hz. The shift to large, high-resolution flat panel displays combined with the transition to 1080p content and higher refresh rates is driving the need for high performance processor solutions to meet the enhanced video quality requirements of next generation display products. As flat panel display resolution and size increase, the challenge of judder becomes more of an issue. Judder occurs when content recorded at one rate of frames per second for film content must be converted to faster video rates, and as a result there is a jerkiness, or judder in the resulting video performance. This problem is intensified in larger displays and can be a problem regardless of the panel technology being used.

In addition to judder, LCD panels also suffer from blur in motion images as a result of the way the human brain processes the longer frame durations produced by an LCD panel. In the past, LCD panel manufacturers have tried to reduce blur by increasing the refresh rate of the panel to higher rates and inserting an extra black frame to

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reduce frame duration. But the black frame insertion method has had drawbacks one of which was to make LCD screens seem less bright. Newer motion estimation/motion compensation (MEMC) technology uses the insertion of interpolated frames based on complex mathematical algorithms to shorten the duration of the video frame and create a clearer, crisper picture. MEMC also provides de-judder processing that smoothes out the jerkiness often apparent with large screen displays.

In recent years TV manufacturers have added new design elements and performance features to differentiate their products and slow price declines. Among these are the adoption of light emitting diode (LED) backlighting, an emphasis on lower power consumption, Internet connectivity and the development of 3D-enabled TVs. All of these trends are driving the need for high performance processor solutions to meet the enhanced video quality requirements of next generation display products.

LED backlighting enables higher contrast images in more advanced TVs. Manufacturers can use either dynamic color LEDs that are positioned behind the panel and allow for local area dimming, which provides higher contrast on selected sections of the screen; or white edge-LEDs positioned around the rim of the screen, which use a special diffusion panel to spread the light evenly behind the screen. LED backlighting also serves as a critical enabler of reduced power consumption. Because of its advantages, LED backlighting is expected to surpass traditional backlights that use fluorescent tubes by 2011 and achieve 74% penetration in 2013, according to DisplaySearch. LED backlighting requires a video processing control mechanism that determines when certain LEDs are lit, and how brightly, based on the video being displayed.

The combination of LED backlighting and 200/240 Hz technologies provides an enabling platform for new feature developments in LCD TVs, particularly 3D technology, which is an area of intense interest to television manufacturers and consumers alike. DisplaySearch forecasts that worldwide 3D TV shipments will rise from 3.2 million in 2010 to more than 91 million in 2014.

Consumers desire to use their televisions to view Internet content ranging from YouTube videos to downloaded high definition movies from Netflix and other vendors is driving TV manufacturers to incorporate Internet connectivity into their products. In addition to simple connectivity, these devices must also be able to scale and enhance Internet content so as to be optimally viewed on a large flat panel display. Limitations in bandwidth, latency, noise and content resolution create significant challenges, and video processors must be able to scale poorer quality video, reduce signal noise inherent to networks and enhance image quality in order to ensure optimal video performance. DisplaySearch estimates that approximately 45 million units, or 21% of all TVs shipped in 2010 were Internet enabled, and the number of connected TVs is expected to grow to more than 122 million in 2014.

Increasing screen sizes, higher frame rates, the desire to view Internet content on high-resolution displays, LED backlighting, 3D and other trends all present video performance challenges that must be addressed and are exacerbated with each new cycle of additional features. To differentiate their products, advanced flat panel manufacturers must implement video processing technologies that address these video performance issues as rapidly, as fully and as cost effectively as possible. Additionally, the interplay of performance, features, cost and power consumption is a key area of differentiation for digital television manufacturers. Most features and performance improvements carry cost premiums and increased power consumption, but intelligent design and utilization of appropriate video processing technologies can enable simultaneous improvements.

Digital Projection Market

Increasingly affordable price points are driving continued adoption of digital projectors in business and education, as well as among consumers. Technology improvements are helping reduce the size and weight of projection devices and increasing their performance. Projector models range from larger units designed to be permanently installed in a conference hall or other venue, to ultra portable devices weighing less than two pounds for maximum portability. According to Pacific Media Associates (PMA), the worldwide front projector market grew to a total of 8.49 million units sold in 2010 from 6.33 million units in 2009.

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Currently, the largest segment of the installed front projector market consists of business users who employ multimedia projectors to display both still and video presentation materials from PCs or other sources. Requirements for the business market include portability, compatibility with multiple software and hardware applications and features that ensure simple operation. In educational environments from elementary schools to university campuses, projectors help teachers integrate media-rich instruction into classrooms. Growth in overall projector sales is expected to come both from the business sector and the education market. Tiny, battery powered pico projectors embedded in a cell phone or PC, or available as independent devices weighing less than a pound, also are beginning to take hold in the consumer and business markets, fueled by their capability to display video content at high resolutions.

Consistent with the trends of other consumer products, digital projectors are increasingly incorporating networking capabilities that enable the sharing of video and other content among multiple devices. This in turn is enabling new use models for digital projection in both the education and business environments. For example, one teacher can present the same material simultaneously in multiple classrooms, and students in different classrooms can display and discuss their work. Such connectivity allows instant access to content and sharing of content, which promotes interaction and collaboration among dispersed groups. In the business setting, this connectivity enables teleconferencing and the seamless sharing of content for more effective meetings.

Additional Markets

In addition to the large-screen flat panel display and digital projection markets, other sectors are also taking advantage of the trend towards higher performance and connectivity in digital video technology. Some of the applications expected to grow as a result of enhanced video quality include digital signage, video conferencing and specialty monitors.

Worldwide, the emerging economies of Brazil, Russia, India and China, commonly referred to collectively as BRIC, are expected to be a leading driver of demand for information technology of all kinds, including projectors for business, education and the consumer sectors.

Our Core Technologies and Products

We have developed a portfolio of advanced video algorithms and intellectual property (IP) to address a broad range of challenges in digital video. Our technologies can dramatically improve video quality and are increasingly important as screen size and resulting quality issues increase. Our products are designed with a flexible architecture that allows us to combine algorithms and functional blocks of digital and mixed signal circuitry. Accordingly, our technologies can be implemented across multiple products and in powerful combinations within single products. The majority of our products include one or more technologies to provide high-quality video solutions to our customers.

Some of our proprietary core technologies include:

MEMC (motion estimation/motion compensation). Our proprietary MEMC technology significantly improves the performance and viewing experience of large advanced LCD panels by solving problems such as motion blur and judder. It also supports significant digital TV trends such as 3D, LED backlight local dimming (both edge-lit and full array) and 240Hz and higher frame rates. Additionally, our MEMC technology improves video performance in non-TV applications such as video conferencing, 3D gaming and projection.

Networking. Our networking technology enables the same video stream to be networked across multiple displays, for applications such as connected video projection and digital signage.

Digital keystone correction. Our technology provides enhanced keystone and image correction performance for digital projection systems, particularly for short throw projectors which must project clearly at severe angles due to space limitations.

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Our product development strategy is to leverage our expertise in video processing to address the evolving needs of the advanced flat panel display, digital projection and other markets that require superior image quality. We plan to continue to focus our development resources to maintain our market lead and provide leading edge solutions for the advanced LCD and DLP in the digital projection market and to enhance our video processing solutions for advanced flat panel displays and other markets. Additionally, we look for ways to leverage our research and development investment into products that address high-value markets where our innovative proprietary technology provides differentiation for us and our customers. We deliver our technology in a variety of offerings, which take the form of single-purpose chips, highly integrated SoCs that incorporate specialized software, and full solutions incorporating software and other tools.

Our primary product categories include the following:

ImageProcessor ICs. Our ImageProcessor ICs include embedded microprocessors, digital signal processing technology and software that control the operations and signal processing within high-end display systems such as projectors and high-resolution flat panels. ImageProcessor ICs were our first product offerings and continue to comprise the majority of our business. We have continued to refine the architectures for optimal performance, manufacturing our products on process technologies that align with our customers requirements. Additionally, we provide a software development environment and operating system that enables our customers to more quickly develop and customize the look and feel of their products.

Video Co-Processor ICs. Products in this category work in conjunction with an image processor to post-process video signals in order to enhance the performance or feature set of the overall video solution (for example, by significantly reducing judder and motion blur). Our video co-processor ICs can be used with our ImageProcessor ICs or with image processing solutions from other manufacturers, and in most cases can be incorporated by a display manufacturer without assistance from the supplier of the base image processor. This flexibility enables manufacturers to augment their existing or new designs to enhance their video display products.

Networked Display ICs. Our Networked Display ICs allow the same video stream to be networked across multiple displays, for example to connect projectors in different classrooms or to enable networked streaming of video in digital signage applications. Our Networked Display IC combines video sharing capabilities with video image processing, wireless connectivity and Internet connection to ensure high quality, multi-source video output and enhanced value to our projection display customers.

Customers, Sales and Marketing

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

We utilize direct sales and marketing resources in the U.S., China, Taiwan, Japan and Korea as well as indirect resources in several regions. In addition to sales and marketing representatives, we have field application engineers who provide technical expertise and assistance to manufacturing customers on final product development.

Our global distribution channel is multi-tiered and involves both direct and indirect distribution channels, as described below:

Distributors. Distributors are resellers in local markets who provide engineering support and stock our semiconductors in direct relation to specific manufacturing customer orders. Our distributors

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often have valuable and established relationships with our end customers, and in certain countries it is customary to sell to distributors. While distributor payment to us is not dependent upon the distributor s ability to resell the product or to collect from the end customer, our distributors may provide longer payment terms to end customers than those we would offer. Sales to distributors accounted for 61%, 51% and 53% of revenue in 2010, 2009 and 2008, respectively.

Our largest distributor, Tokyo Electron Device Ltd. (TED), is located in Japan. TED represented 44%, 35% and 32% of revenue in 2010, 2009 and 2008, respectively, and accounted for 45% and 22% of accounts receivable at December 31, 2010 and 2009, respectively. No other distributor accounted for more than 10% of revenue in 2010, 2009 and 2008.

We also have distributor relationships in Taiwan, China, Korea, Europe, Southeast Asia and the U.S.

Direct Relationships. We have established direct relationships with companies that manufacture high-end display systems. Some of our direct relationships are supported by commission-based manufacturers representatives, who are independent sales agents that represent us in local markets and provide engineering support but do not carry inventory. Revenue through direct relationships accounted for 39%, 49% and 47% of total revenue in 2010, 2009 or 2008, respectively.

We have direct relationships with companies falling into the following three classifications:

Integrators. Integrators are original equipment manufacturers who build display devices based on specifications provided by branded suppliers.

Branded Manufacturers. Branded manufacturers are globally recognized manufacturers who develop display device specifications, and manufacture, market and distribute display devices either directly or through resellers to end-users.

Branded Suppliers. Branded suppliers are globally recognized suppliers who develop display device specifications and then source them from integrators, typically in Asia, and distribute them either directly or through resellers to end-users.

Revenue attributable to our top five end customers represented 58%, 56% and 55% of revenue in 2010, 2009 and 2008, respectively. End customers include customers who purchase directly from us as well as customers who purchase products indirectly through distributors. Sales to Seiko Epson Corporation represented more than 10% of revenue in 2010, 2009, and 2008. Sales to SANYO Electric Co., Ltd. represented more than 10% of revenue in 2010 and 2009. Sales to Hitachi represented more than 10% of revenue in 2010. No other end customer accounted for more than 10% of revenue in 2010, 2009 or 2008.

Seasonality

Our business is subject to seasonality related to the markets we serve and the location of our customers. We have historically experienced higher revenue from the multimedia projector market in the third quarter of the year, and lower revenue in the first quarter of the year, as our Japanese customers reduce inventories in anticipation of their March 31 fiscal year end. Additionally, holiday demand for consumer electronics, including high-end televisions, has sometimes contributed to increased revenue in the second half of the year. Our sales in 2010, 2009 and 2008, however, did not follow our historical trends due in part to the global crisis in the credit and financial markets, continued economic uncertainty and reductions in consumer spending. As a result, it is extremely difficult for us to predict when or if historical trends are likely to resume.

Geographic Distribution of Sales

Sales outside the U.S. accounted for approximately 96%, 97% and 95% of our revenue in 2010, 2009 and 2008, respectively.

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Financial information regarding our domestic and foreign operations is presented in Note 11 of the Notes to Consolidated Financial Statements included in Item 8. Financial Statements and Supplementary Data.

Backlog

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

Competition

In general, the semiconductor industry is intensely competitive. The markets for higher performance display and projection devices, including the markets for advanced flat panel display televisions, multimedia projectors and other applications demanding high quality video, are characterized by rapid technological change, evolving industry standards, compressed product life cycles and declining average selling prices. We believe the principal competitive factors in our markets are product performance, time to market, cost, functional versatility provided by software, customer relationships and reputation, patented innovative designs, levels of product integration, compliance with industry standards and system design cost.

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

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

Research and Development

Our internal research and development efforts are focused on the development of our solutions for the multimedia projector and high-end television markets. Our development efforts are focused on pursuing higher levels of video performance, integration and new features in order to provide our customers with solutions that enable them to introduce market leading products and help lower final systems costs for our customers.

We have invested, and expect to continue to invest, significant resources in research and development activities. Our research and development expense was $22.8 million, $20.1 million and $26.5 million in 2010, 2009 and 2008, respectively.

Manufacturing

Within the semiconductor industry we are known as a fabless company, meaning that we do not manufacture the semiconductors that we design and develop, but instead contract with four third-party foundries for wafer fabrication and other manufacturers for packaging, assembly and testing of our products. The fabless approach allows us to concentrate our resources on product design and development where we believe we have greater competitive advantages.

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See Risk Factors in Part I, Item 1A of this Annual Report on Form 10-K for information on risks related to our manufacturing strategy and processes.

Intellectual Property

We rely on a combination of nondisclosure agreements and patent, copyright, trademark and trade secret laws to protect the algorithms, design and architecture of our technology. Currently, we hold 138 patents and have 31 patent applications pending, which relate generally to improvements in the visual display of digital image data including, but not limited to, improvements in image scaling, image correction, automatic image optimization and video signal processing for digital displays. Our U.S. and foreign patents are generally enforceable for 20 years from the date they were filed. Accordingly, our issued patents have from approximately 7 to 16 years remaining in their respective term, depending on their filing date. We believe that the remaining term of our patents is adequate relative to the expected lives of our related products.

We intend to seek patent protection for other significant technologies that we have already developed and expect to seek patent protection for future products and technologies as necessary. Patents may not be issued as a result of any pending applications and any claims allowed under issued patents may be insufficiently broad to protect our technology. Existing or future patents may be invalidated, diluted, circumvented, challenged or licensed to others. Furthermore, the laws of certain foreign countries in which our products are or may be developed, manufactured or sold, including various countries in Asia, may not protect our products or intellectual property rights to the same extent as do the laws of the United States and, thus, make the possibility of piracy of our technology and products more likely in these countries.

The semiconductor industry is characterized by vigorous protection of intellectual property rights, which have resulted in significant and often protracted and expensive litigation. We, our customers or our foundries from time to time may be notified of claims that we may be infringing patents or other intellectual property rights owned by third parties. Litigation by or against us relating to patent infringement or other intellectual property matters could result in significant expense to us and divert the efforts of our technical and management personnel, whether or not such litigation results in a determination favorable to us. In the event of an adverse result in any such litigation, we could be required to pay substantial damages, cease the manufacture, use and sale of infringing products, expend significant resources to develop non-infringing technology, discontinue the use of certain processes or obtain licenses to the infringing technology. We may not be able to settle any alleged patent infringement claim through a cross-licensing arrangement. In the event any third party made a valid claim against us, our customers or our foundries, and a license was not made available to us on terms that are acceptable to us or at all, we would be adversely affected.

See Risk Factors in Part I, Item 1A, and Note 7: Commitments and Contingencies in Part II, Item 8 of this Annual Report on Form 10-K for information on risks related to intellectual property.

Environmental Matters

Environmental laws and regulations are complex, change frequently and have tended to become more stringent over time. We have incurred, and may continue to incur, significant expenditures to comply with these laws and regulations and we may incur additional capital expenditures and asset impairments to ensure that our products and our vendors products are in compliance with these regulations. We would be subject to significant penalties for failure to comply with these laws and regulations.

See Risk Factors in Part I, Item 1A of this Annual Report on Form 10-K for information on environmental risks.

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Employees

As of December 31, 2010, we had a total of 243 employees compared to 222 employees as of December 31, 2009. We consider our relations with our employees to be good.

Availability of Securities and Exchange Commission Filings

We make available through our website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports free of charge as soon as reasonably practicable after we electronically file such material with the Securities and Exchange Commission. Our Internet address is *www.pixelworks.com*. The content on, or that can be accessed through, our website is not incorporated by reference into this filing.

Item 1A. Risk Factors.

Investing in our shares of common stock involves a high degree of risk, and investors should carefully consider the risks described below before making an investment decision. If any of the following risks occur, the market price of our shares of common stock could decline and investors could lose all or part of their investment. Additional risks that we currently believe are immaterial may also impair our business operations. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Annual Report on Form 10-K for the year ended December 31, 2010, including our consolidated financial statements and related notes, and our other filings made from time to time with the Securities and Exchange Commission.

Company Specific Risks

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

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

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

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even if our product strategy is successful at achieving design wins and increasing our revenue, we may continue to incur operating losses due to the significant research and development costs that are required to develop competitive products for the advanced television market.

We have incurred indebtedness as a result of the sale of convertible debentures. We anticipate that we must repay or refinance the debentures by May 2011. We may be unable to meet this, or other, future capital requirements.

As of December 31, 2010, $15.8 million of our 1.75% convertible subordinated debentures (the debentures) were outstanding. Although the debentures are not due until 2024, the holders have the right to require us to purchase all or a portion of the debentures at each of the following dates: May 15, 2011, May 15, 2014 and May 15, 2019. Since the market price of our common stock is significantly below the conversion price of the debentures, we expect the holders to exercise their put option on May 15, 2011. We may not be able to refinance the debentures at terms that are as favorable as those currently contained in the debentures, or at terms that are acceptable to us, or at all. While we believe that our existing working capital, as well as funds available under our short-term line of credit will be sufficient to meet our capital requirements for the next twelve months, we cannot assure you that we will be able to maintain sufficient cash and marketable security balances to refinance or pay off the debentures when and if the put option is exercised, or that such a repurchase would not result in cash reserves too low for us to continue our business as a going concern. We may need, or could elect to seek, additional funding through public or private equity or debt financing, which we may not be able to obtain. If we issue equity securities, our shareholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of our common stock.

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

In December 2010, we entered into a Loan and Security Agreement with Silicon Valley Bank to provide for a secured, working capital-based, revolving line of credit. We view this line of credit as a source of available liquidity to fund fluctuations in our working capital requirements. For example, if we experience an increase in order activity from our customers, our cash balance may decrease due to the need to purchase inventories to fulfill those orders. If this occurs, we may have to draw on this facility in order to maintain our liquidity. As of December 31, 2010, we had borrowed $3.0 million on this line of credit.

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

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

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

We have limited control over delivery schedules, quality assurance, manufacturing yields, potential errors in manufacturing and production costs. We do not have long-term supply contracts with our third-party manufacturers, so they are not obligated to supply us with products for any specific period of time, quantity or

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price, except as may be provided in a particular purchase order. Our suppliers can increase the prices of the products we purchase from them with little notice, which may cause us to increase the prices to our customers and harm our competitiveness. Because our requirements represent only a small portion of the total production capacity of our contract manufacturers, they could reallocate capacity to other customers even during periods of high demand for our products, as they have done in the past. We expect this may occur again in the future.

Establishing a relationship with a new contract manufacturer in the event of delays or increased prices would be costly and burdensome. The lead time to make such a change would be at least nine months, and the estimated time for us to adapt a product s design to a particular contract manufacturer s process is at least four months. Additionally, we have, and may continue to choose new foundries to manufacture our wafers which may require us to modify our design methodology flow for the process technology and intellectual property cores of the new foundry. If we have to qualify a new foundry or packaging, assembly and testing supplier for any of our products or if we are unable to obtain our products from our contract manufacturers on schedule, at costs that are acceptable to us, or at all, we could incur significant delays in shipping products, our ability to satisfy customer demand could be harmed, our revenue from the sale of products may be lost or delayed and our customer relationships and ability to obtain future design wins could be damaged.

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

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

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

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

In addition, we may not be able to successfully integrate the businesses, products, technologies or personnel of any entity that we might acquire in the future, and any failure to do so could disrupt our business and seriously harm our financial condition. Our operation of any acquired business would involve numerous risks, including, but not limited to:

- problems combining the acquired operations, technologies or products;
- unanticipated costs;
- diversion of management s attention from existing operations;
- adverse effects on existing business relationships with customers;
- risks associated with entering markets in which we have no or limited prior experience;

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potential loss of key employees, particularly those of the acquired organizations; and

risks associated with implementing adequate internal control, management, financial and operating reporting systems.

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

issuance of stock that dilutes current shareholders percentage ownership;

incurrence of debt;

assumption of liabilities;

amortization expenses related to acquired intangible assets;

impairment of goodwill;

large and immediate write-offs or other charges;

loss of investment; and

decreases in cash and marketable securities that could otherwise serve as working capital.

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

We develop products based on anticipated market and customer requirements and incur substantial product development expenditures, which can include the payment of large up-front, third-party license fees and royalties, prior to generating associated revenue. Our work under these projects is technically challenging and places considerable demands on our limited resources, particularly on our most senior engineering talent. Because the development of our products incorporates not only our complex and evolving technology but also our customers specific requirements, a lengthy sales process is often required before potential customers begin the technical evaluation of our products. Our customers typically perform numerous tests and extensively evaluate our products before incorporating them into their systems. The time required for testing, evaluation and design of our products into a customer s system can take up to nine months or more. It can take an additional nine months or longer before a customer commences volume shipments of systems that incorporate our products. We cannot assure you that the time required for the testing, evaluation and design of our products by our customers would not be significantly longer than nine months.

Because of the lengthy development and sales cycles, we will experience delays between the time we incur expenditures for research and development, sales and marketing and inventory and the time we generate revenue, if any, from these expenditures. Additionally, if actual sales volumes for a particular product are substantially less than originally anticipated, we may experience large write-offs of capitalized license fees, software development tools, product masks, inventories or other capitalized or deferred product-related costs, or increased amortization of non-cancelable prepaid royalties, any of which would negatively affect our operating results. For example, our provisions for obsolete inventory and lower of cost or market write downs were $1.6 million, $1.2 million and $1.5 million in 2010, 2009 and 2008, respectively.

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

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

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

The display manufacturing market is highly concentrated and we are, and will continue to be, dependent on a limited number of customers and distributors for a substantial portion of our revenue. Sales to our top distributor represented 44%, 35% and 32% of revenue in 2010, 2009 and 2008, respectively. Revenue attributable to our top five end customers represented 58%, 56% and 55% of revenue in 2010, 2009 and 2008, respectively. As of December 31, 2010 we had two accounts that represented 10% or more of accounts receivable. As of December 31, 2009, we had three accounts that each represented 10% or more of accounts receivable. All of the orders included in our backlog are cancelable. A reduction, delay or cancellation of orders from one or more of our significant customers, or a decision by one or more of our significant customers to select products manufactured by a competitor or to use its own internally-developed semiconductors, would significantly impact our revenue. Further, the concentration of our accounts receivable with a limited number of customers increases our credit risk. The failure of these customers to pay their balances, or any customer to pay future outstanding balances, would result in an operating expense and reduce our cash flows.

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

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

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

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

Sales outside the U.S. accounted for approximately 96%, 97% and 95% of revenue in 2010, 2009 and 2008, respectively. We anticipate that sales outside the U.S. will continue to account for a substantial portion of our revenue in future periods. In addition, customers who incorporate our products into their products sell a substantial portion of their products outside of the U.S., and all of our products are manufactured outside of the U.S. We are, therefore, subject to many international risks, including, but not limited to:

- increased difficulties in managing international distributors and manufacturers due to varying time zones, languages and business customs;
- compliance with U.S. laws affecting operations outside of the U.S., such as the Foreign Corrupt Practices Act;
- foreign currency exchange fluctuations in the currencies of Japan, the People s Republic of China (PRC), Taiwan or Korea;

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reduced or limited protection of our IP, particularly in software, which is more prone to design piracy;

difficulties in collecting outstanding accounts receivable balances;

changes in tax laws and the interpretation of those laws;

difficulties regarding timing and availability of export and import licenses;

political and economic instability, particularly in the PRC, Japan, Taiwan, or Korea;

difficulties in maintaining sales representatives outside of the U.S. that are knowledgeable about our industry and products;

changes in the regulatory environment in the PRC, Japan, Taiwan and Korea that may significantly impact purchases of our products by our customers; and

outbreaks of health epidemics in the PRC or other parts of Asia.

In addition, jurisdictions in which we do business could impose more or new tariffs, quotas, trade barriers and similar trade restrictions on our sales. Moreover, economic changes, geopolitical conflicts, territory activity, political unrest, civil strife, acts of war, public corruption and other economic and political uncertainties could interrupt and negatively affect our business operations. All of these factors could result in increased costs or decreased revenues, and could materially affect our product sales, financial condition and results of operations.

The concentration of our employees, manufacturers and customers in the PRC, Japan, Korea, Taiwan and Singapore increases our risk that a natural disaster, work stoppage or economic or political instability in the region could disrupt our operations or increase .

Most of our current manufacturers and customers are located in the PRC, Japan, Korea, Taiwan or Singapore. In addition, a majority of our employees are located in this region. Disruptions from natural disasters, health epidemics and political, social and economic instability may affect the region and would have a negative impact on our results of operations. In addition, the economy of the PRC differs from the economies of many countries in respects such as structure, government involvement, level of development, growth rate, capital reinvestment, allocation of resources, self-sufficiency, rate of inflation, foreign currency flows and balance of payments position, among others. We cannot be assured that the PRC s economic policies will be consistent or effective. Our results of operations and financial position may be harmed by changes in the PRC s political, economic or social conditions.

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

Our operations in certain foreign and developing markets expose us to political, economic and regulatory risks.

Our growth strategy depends in part on our ability to expand our operations in developing markets, including Brazil, Russia, India, China and Southeast Asia. However, some developing markets have greater political and economic volatility and greater vulnerability to infrastructure and labor disruptions than established markets. In many foreign countries, particularly in those with developing economies, it is common to engage in business practices that are prohibited by laws and regulations applicable to us, such as the Foreign Corrupt Practices Act or similar local anti-bribery laws. These laws generally prohibit companies and their agents or intermediaries from making improper payments to government

officials for the purpose of obtaining or retaining business. Failure to comply with these laws could subject us to civil and criminal penalties that could materially and adversely impact our financial condition and results of operations.

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

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

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

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

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

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

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

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

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

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

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

Company Risks Related to the Semiconductor Industry and Our Markets

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

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

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

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

The manufacture of semiconductors is a complex process and many of our products are highly integrated and incorporate mixed analog and digital signal processing, multichip modules and embedded memory technology,

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further complicating the development process. In addition to the inherent difficulty of designing complex ICs, product development delays may result from:

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

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

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

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

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

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

Many of our competitors have longer operating histories and greater resources to support development and marketing efforts than we do. Some of our competitors operate their own fabrication facilities. These competitors may be able to react more quickly and devote more resources to efforts that compete directly with our own. Our current or potential customers have developed, and may continue to develop, their own proprietary technologies and become our competitors. Increased competition from both competitors and our customers internal development

efforts could harm our business, financial condition and results of operations by, for example,

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increasing pressure on our profit margin or causing us to lose sales opportunities. In 2010, for example, frame rate conversion technology similar to that used in our line of MEMC co-processors continued to be integrated into the SoC products of our competitors, particularly in lower refresh rate television products. We cannot assure you that we can compete successfully against current or potential competitors.

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

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

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

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

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

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

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

Our ability to compete effectively with other companies will depend, in part, on our ability to maintain the proprietary nature of our technology, including our semiconductor designs and software code. We provide the computer programming code for our software to customers in connection with their product development efforts, thereby increasing the risk that customers will misappropriate our proprietary software. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to help protect our proprietary technologies. We hold 138 patents and have 31 patent applications pending for protection of our significant technologies. Competitors in both the U.S. and foreign countries, many of whom have substantially greater resources than we do, may apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell our products, or they may develop similar technology independently or design around our patents. Effective patent, copyright, trademark and trade secret protection may be unavailable or limited in foreign countries.

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

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

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

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

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

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

To respond effectively to changes in technology and industry standards, we are dependent on our foundries to implement advanced semiconductor technologies and our operations could be adversely affected if those technologies are unavailable, delayed or inefficiently implemented. In order to increase performance and functionality and reduce the size of our products, we are continuously developing new products using advanced technologies that further miniaturize semiconductors and we are dependent on our foundries to develop and provide access to the advanced processes that enable such miniaturization. We cannot be certain that future

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advanced manufacturing processes will be implemented without difficulties, delays or increased expenses. Our business, financial condition and results of operations could be materially adversely affected if advanced manufacturing processes are unavailable to us, substantially delayed or inefficiently implemented.

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

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

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

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

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

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

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

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

We are subject to numerous environmental laws and regulations. Compliance with current or future environmental laws and regulations could require us to incur substantial expenses which could harm our

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

Other Risks

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

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

Future sales or other dilution of our equity could depress the market price of our common stock.

Sales of our common stock in the public market, or the perception that such sales could occur, could negatively impact the price of our common stock. We have a number of institutional shareholders that own significant blocks of our common stock. If one or more of these shareholders were to sell large portions of their holdings in a relatively short time, for liquidity or other reasons, the prevailing market price of our common stock could be negatively affected.

In addition, the issuance of additional shares of our common stock, or issuances of securities convertible into or exercisable for our common stock or other equity-linked securities, including preferred stock or warrants, will dilute the ownership interest of our common shareholders and could depress the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities.

We may need to seek additional capital. If this additional financing is obtained through the issuance of equity securities, debt convertible into equity or options or warrants to acquire equity securities, our existing shareholders could experience significant dilution upon the issuance, conversion or exercise of such securities.

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

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

- actual or anticipated fluctuations in our operating results;
- changes in expectations as to our future financial performance;
- changes in financial estimates of securities analysts;

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announcements by us or our competitors of technological innovations, design wins, contracts, standards, acquisitions or divestitures;

the operating and stock price performance of other comparable companies;

inconsistent trading volume levels of our common stock; and

changes in market valuations of other technology companies.

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

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

On June 4, 2008, we effected a one-for-three reverse split of our common stock. We effected the reverse split to regain compliance with NASDAQ Marketplace Rules, particularly the minimum $1.00 per share requirement for continued inclusion on the NASDAQ Global Market. Though the per share price of our common stock was $3.43 on February 28, 2011, the price has fluctuated significantly and was below $1.00 as recently as May 6, 2009. We cannot guarantee that it will remain at or above $1.00 per share and if the price again drops below $1.00 per share, the stock could become subject to delisting again, and we may seek shareholder approval for an additional reverse split. A second reverse split could produce adverse effects and may not result in a long-term or permanent increase in the price of our common stock. In addition to the minimum $1.00 per share requirement, NASDAQ Global Market also requires satisfaction of one of the following in addition to certain other requirements: (i) a minimum of $50.0 million in total asset value and $50.0 million in revenues (in the latest fiscal year or in two of the last three fiscal years), (ii) a minimum of $50.0 million in market value of listed securities, or (iii) or a minimum of $10.0 million in stockholders equity. At December 31, 2010, although not required because our shareholders equity was in excess of $10.0 million, we achieved a $50.0 million total asset value by making a non-formula advance on our short-term line of credit. As recently as December 31, 2008, however, our shareholders equity was below $10.0 million and in the future we may be unable to meet these continued listing requirements and our stock could become subject to delisting.

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

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

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

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our board of directors is authorized, without prior shareholder approval, to change the size of the board (our articles of incorporation provide that if the board is increased to eight or more members, the board will be divided into three classes serving staggered terms, which would make it more difficult for a group of shareholders to quickly change the composition of our board);

our board of directors is authorized, without prior shareholder approval, to create and issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us or to effect a change of control, commonly referred to as blank check preferred stock;

members of our board of directors can be removed only for cause and at a meeting of shareholders called expressly for that purpose, by the vote of 75 percent of the votes then entitled to be cast for the election of directors; and

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

Item 1B. Unresolved Staff Comments.

Not applicable.

Item 2. Properties.

We lease facilities around the world to house our engineering, sales, sales support, administrative and operations functions. We do not own any of our facilities. As a result of our prior restructuring plans we consolidated office space and sublease portions of our facilities. At December 31, 2010, our major facilities consisted of the following:

Location	Function(s)	Total Square Feet Leased	Square Feet Utilized	Square Feet Subleased	Lease Expiration	Sublease Expiration
China	Engineering; sales; customer support	48,000	48,000		Various dates through May 2013	
California	Administration; engineering; sales	37,000	23,000	14,000	June 2013	June 2013
Taiwan	Customer support; sales; operations; engineering	22,000	22,000		Various dates through November 2011	
Oregon	Administration	5,000	5,000		November 2013	
Japan	Sales; customer support	4,000	4,000		Various dates through January 2013	
Washington	None; fully subleased	10,000		10,000	October 2011	October 2011

Item 3. Legal Proceedings.

For a discussion of legal proceedings, see Note 7: Commitments and Contingencies in Part II, Item 8 of this Annual Report on Form 10-K.

Item 4. (Removed and Reserved).

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PART II

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

Market for Registrant s Common Equity and Related Stockholder Matters

Our common stock is listed for trading on the NASDAQ Global Market under the symbol PXLW . Our stock began trading on May 19, 2000. The following table sets forth, for the periods indicated, the highest and lowest sales prices of our common stock as reported on the NASDAQ Global Market.

Fiscal 2010	High	Low
Fourth Quarter	$ 3.91	$ 3.15
Third Quarter	3.62	2.62
Second Quarter	5.78	2.98
First Quarter	5.87	2.97

Fiscal 2009	High	Low
Fourth Quarter	$ 4.09	$ 2.15
Third Quarter	4.06	1.25
Second Quarter	1.97	0.56
First Quarter	0.84	0.37

As of February 28, 2011, there were 62 shareholders of record of our common stock and the last per share sales price of the common stock on that date was $3.43. The number of beneficial owners of our common stock is substantially greater than the number of shareholders of record because a significant portion of our outstanding common stock is held in broker street name for the benefit of individual investors.

Our financial covenants may limit our ability to pay dividends. There is no assurance as to the payment of future dividends as they are dependent upon future earnings, capital requirements, our operating and financial condition and approval by our board of directors. To date, we have not declared any cash dividends and we currently expect to retain any earnings to finance the expansion and development of our business.

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Performance Graph

Set forth below is a graph that compares the cumulative total shareholder return on our common stock with the cumulative total return on the NASDAQ Stock Market (U.S.) Index and the NASDAQ Electronics Components Index over the five-year period ended December 31, 2010. The graph assumes that $100 was invested on December 31, 2005 in our common stock, the NASDAQ Stock Market (U.S.) Index and the NASDAQ Electronics Components Index. In accordance with guidelines of the Securities and Exchange Commission, the shareholder return for each entity in the peer group index has been weighted on the basis of market capitalization. The stock price performance in the graph is not intended to forecast or indicate future stock price performance.

COMPARISON OF FIVE-YEAR CUMULATIVE TOTAL RETURN

AMONG PIXELWORKS, INC., THE NASDAQ STOCK MARKET (U.S.)

INDEX AND THE NASDAQ ELECTRONICS COMPONENTS INDEX

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Item 6. Selected Financial Data.

The following consolidated selected financial data is not necessarily indicative of results of future operations and should be read in conjunction with Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation, and the Consolidated Financial Statements and notes thereto in Item 8. Financial Statements and Supplementary Data.

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	(In thousands, except per share data)				
Consolidated Statement of Operations Data					
Revenue, net	$ 69,529	$ 61,093	$ 85,164	$ 105,980	$ 133,607
Cost of revenue	37,366	33,798	42,963	59,273	107,506
Gross profit	32,163	27,295	42,201	46,707	26,101
Operating expenses:					
Research and development	22,810	20,075	26,512	38,792	57,019
Selling, general and administrative	15,167	13,745	17,945	25,437	35,053
Restructuring	94	235	1,589	13,285	13,316
Amortization of acquired intangible assets			164	359	602
Impairment loss on goodwill					133,739
Impairment loss on acquired intangible assets					1,753
Total operating expenses	38,071	34,055	46,210	77,873	241,482
Loss from operations	(5,908)	(6,760)	(4,009)	(31,166)	(215,381)
Interest and other income, net	886	12,338	11,979	2,483	10,254
Income (loss) before income taxes	(5,022)	5,578	7,970	(28,683)	(205,127)
Provision (benefit) for income taxes	(5,395)	(877)	(8)	2,237	(949)
Net income (loss)	$ 373	$ 6,455	$ 7,978	$ (30,920)	$ (204,178)
Net income (loss) per share:					
Basic	$ 0.03	$ 0.48	$ 0.55	$ (1.92)	$ (12.69)
Diluted	$ 0.03	$ 0.47	$ 0.55	$ (1.92)	$ (12.69)
Weighted average shares outstanding:					
Basic	13,442	13,318	14,399	16,069	16,096
Diluted	14,384	13,687	14,410	16,069	16,096

	2010	2009	December 31, 2008	2007	2006
			(In thousands)		
Consolidated Balance Sheet Data					
Cash and cash equivalents	$ 16,872	$ 17,797	$ 53,149	$ 74,572	$ 63,095
Short-and long-term marketable securities	12,969	13,062	10,168	44,385	71,489
Working capital	8,072	25,359	61,947	112,360	108,169
Total assets	52,414	56,078	91,732	161,916	207,771
Long-term liabilities, net of current portion	5,635	26,703	73,250	151,871	147,414

Total shareholders equity (deficit)		13,931	13,073	4,711	(8,027)	21,948

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

Overview

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications and hold 138 patents related to the visual display of digital image data. Our solutions enable manufacturers of digital display and projection devices, such as large-screen flat panel televisions and digital front projectors, to manufacture their products with a consistently high level of video quality, regardless of the content s source or format. Our core technology leverages unique proprietary techniques for intelligently processing video signals from a variety of sources to ensure that all resulting images are optimized. Additionally, our products help our customers reduce costs and differentiate their display and projection devices, an important factor in industries that experience rapid innovation. Pixelworks was founded in 1997 and is incorporated under the laws of the state of Oregon.

Pixelworks flexible design architecture enables our technology to produce outstanding image quality in our customers products with a range of single-purpose integrated circuits (ICs), to system-on-chip (SoC) ICs that integrate microprocessor, memory and image processing functions. Additionally, we provide full solutions, including a software development environment and operating system, which enable our customers to more quickly develop and customize their display products, thus reducing their time to market and allowing them to incorporate differentiated features and functions.

Our primary target markets are liquid crystal display (LCD) large-screen televisions and 3LCD and digital light processing (DLP) digital front projectors, however we also target other segments within the flat panel display market, including digital signage.

We have adopted a product strategy that leverages our core competencies in video processing to address the evolving needs of the advanced flat panel display, digital projection and other markets that require superior image quality. We focus our product investments on developing video enhancement solutions for these markets, with particular focus on adding increased performance and functionality. Additionally, we look for ways to leverage our research and development investment into products that address other high-value markets where our innovative proprietary technology provides differentiation for us and our customers. We continually seek to expand our technology portfolio through internal development, co-development with business partners and evaluation of acquisition opportunities.

Historically, significant portions of our revenue have been generated by sales to a relatively small number of end customers and distributors. We sell our products worldwide through a direct sales force, distributors and manufacturers representatives. We sell to distributors in Japan, Taiwan, China, Korea, Europe, Southeast Asia and the U.S, and our manufacturers representatives support some of our Korean and European sales. Our distributors typically provide engineering support to our end customers and often have valuable and established relationships with our end customers. In certain countries in which we operate, it is customary to sell to distributors. While distributor payment to us is not dependent upon the distributor s ability to resell the product or to collect from the end customer, the distributors may provide longer payment terms to end customers than those we would offer.

Significant portions of our products are sold overseas. Sales outside the U.S. accounted for approximately 96%, 97% and 95% of revenue in 2010, 2009 and 2008, respectively. Our integrators, branded manufacturers and branded suppliers incorporate our products into systems that are sold worldwide. All of our revenue to date has been denominated in U.S. dollars.

Factors Affecting Results of Operations and Financial Condition

Financial, commercial and consumer markets experienced significant disruption during the last quarter of 2008 and throughout 2009 which adversely affected our results of operations during 2009. We responded to the

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economic downturn by initiating a restructuring plan in December 2008 to reduce our operating expenses by reducing operations, research and development and administrative headcount in our San Jose, Taiwan and China offices as well as implementing other cost reduction efforts, including company-wide salary reductions during the second and third quarters of 2009. During the first three quarters of 2010 we experienced an increase in revenue as customer demand strengthened as a result of improvements in the world wide economy. Although the macroeconomic environment and our business appeared to have stabilized since early 2009, in the fourth quarter of 2010 our revenue decreased due in part to inventory corrections by our customers as a result of weakening consumer demand. Additionally, consumer confidence and spending remain cautious and we are unable to predict how the challenging global economic environment may impact our future results of operations and financial position.

Results of Operations

Year ended December 31, 2010 compared with year ended December 31, 2009, and year ended December 31, 2009 compared with year ended December 31, 2008.

Revenue, net

Net revenue was as follows (in thousands):

	Year ended December 31,			2010 v. 2009		2009 v. 2008	
	2010	2009	2008	$ change	% change	$ change	% change
Revenue, net	$ 69,529	$ 61,093	$ 85,164	$ 8,436	14%	$ (24,071)	(28)%

2010 v. 2009

Net revenue increased $8.4 million, or 14%, from 2009 to 2010. The increase was attributable to a 10% increase in units sold and a 4% increase in average selling price (ASP). The increase in units sold resulted primarily from increased sales of our new digital projector products, including increased sales in the DLP division of the digital projector market, as customer demand strengthened during 2010 as a result of improvements in the world wide economy. The increase was partially offset by a decrease in sales of our Motion Estimation Motion Compensation (MEMC) co-processor ICs as we transitioned customers to our next generation MEMC co-processor ICs. The increase in ASP was primarily the result of an increase in the percentage of total revenue from the digital projector market, which generally has higher ASPs than our other products.

2009 v. 2008

Net revenue decreased $24.1 million, or 28%, from 2008 to 2009 as the result of a 30% decrease in units sold, partially offset by a 3% increase in ASP. The decrease in units sold during 2009 compared to 2008 resulted primarily from weakened customer demand due to the worldwide economic downturn, particularly during the first half of 2009. Decreased revenue also resulted from lower sales of our legacy products, including those we acquired in our acquisition of Equator Technologies, Inc. (Equator) in June 2005, and lower sales into markets which we no longer pursue. These decreases were partially offset by an increase in sales of our MEMC co-processor ICs, and our next generation projector image processors.

We did experience some recovery in revenue levels in the second half of 2009 compared to the first half of 2009 as the worldwide economy strengthened. Our most significant recovery was in digital projector market sales, which were up slightly from the second half of 2008 to the second half of 2009, compared with a decrease of 50% from the first half of 2008 to the first half of 2009. Revenue from our advanced television market, which includes the panel market and our MEMC co-processor ICs, was approximately flat from the second half of 2008 to the second half of 2009, an improvement over the 24% decrease from the first half of 2008 to the first half of 2009. Our revenue from other markets did not experience a recovery during the second half of 2009, compared to the second half of 2008, primarily due to consistent decreases in unit sales of legacy products in markets which we no longer pursue.

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Cost of revenue and gross profit

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

	Year ended December 31,					
	2010	% of revenue	2009	% of revenue	2008	% of revenue
Direct product costs and related overhead [1]	$ 34,629	50%	$ 30,630	50%	$ 39,362	46%
Amortization of acquired intangible assets	1,050	2	2,336	4	2,820	3
Inventory charges [2]	1,543	2	518	1	488	1
Other cost of revenue [3]	144	0	314	0	293	0
Total cost of revenue	$ 37,366	54%	$ 33,798	55%	$ 42,963	50%
Gross profit	$ 32,163	46%	$ 27,295	45%	$ 42,201	50%

[1] Includes purchased materials, assembly, test, labor, employee benefits, warranty expense and royalties.
[2] Includes the net provision for inventory reserves and lower of cost or market write-downs.
[3] Includes restructuring, stock-based compensation and additional amortization of non-cancelable prepaid royalty.

2010 v. 2009

Total cost of revenue decreased to 54% of revenue in 2010 from 55% of revenue in 2009. The decrease was primarily attributable to the decrease in amortization expense for acquired intangible assets that were fully amortized as of the second quarter of 2010. The decrease is partially offset by an increase in inventory charges as we transitioned customers to our next generation products. Direct product costs as a percentage of revenue remained flat in 2010 primarily due to favorable overhead cost absorption as a result of increased revenue without corresponding increases in our fixed costs, offset by a higher mix of our new products which have higher material costs than our legacy products.

We expect future cost improvements on our MEMC products and next generation projector processors as we continue to ramp production and realize production efficiencies; however, we are unable to predict the timing and extent of expected cost improvements.

2009 v. 2008

Total cost of revenue increased to 55% of revenue in 2009 from 50% of revenue in 2008. The increase was primarily attributable to an increase in direct product costs due to changes in the mix of products sold, including increased sales of our MEMC products and next generation projector processors and decreased sales of our legacy Equator products. Gross profit margins also decreased due to the impact of lower overhead cost absorption due to decreased revenue without corresponding reductions in our fixed costs.

Research and development

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

Research and development expense was as follows (in thousands):

	Year ended December 31,			2010 v. 2009		2009 v. 2008
	2010	2009	2008	$ change	% change	% change

						$ change	
Research and development	$ 22,810	$ 20,075	$ 26,512	$ 2,735	14%	$ (6,437)	(24)%

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2010 v. 2009

Research and development expense increased $2.7 million, or 14%, from 2009 to 2010. This increase is primarily attributable to the following:

Compensation expense increased $1.2 million as a result of:

the elimination of a Company-wide salary reduction that was in effect during the second and third quarters of 2009;

an increase in the number of research and development employees; and

annual merit salary increases granted during the year.

Depreciation and amortization expense, software maintenance expense and expensed equipment and software increased $0.7 million as a result of an increase in engineering software tools, and our purchase of additional equipment during 2010.

Non-recurring engineering and outside services increased $0.6 million due to an increase in new product development.

2009 v. 2008

Research and development expense decreased $6.4 million, or 24%, from 2008 to 2009. This decrease was primarily attributable to the restructuring efforts that we initiated in November 2006 and December 2008, and which were completed in the fourth quarter of 2008 and second quarter of 2009, respectively. These efforts resulted in the following reductions in research and development expenses:

Depreciation and amortization expense, software maintenance expense and expensed equipment and software decreased $2.7 million. This decrease resulted from fewer engineering software tools due to changes in product development strategy as well as decreased amortization from certain licensed technology which became fully amortized during the first and second quarters of 2009.

Compensation expense decreased $1.9 million as a result of:

a Company-wide 10% salary reduction that was in effect during the second and third quarters of 2009;

a reduced senior management bonus for 2009 compared to 2008; and

continuous improvement in our engineering practices to lower costs and improve efficiency.

Stock-based compensation expense decreased $0.8 million due to personnel reductions and reduced valuation of our stock options.

Facilities and information technology expense allocations decreased $0.7 million, primarily due to reductions in rent and decreased depreciation of equipment and leasehold improvements.

Selling, general and administrative

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

	Year ended December 31,			2010 v. 2009		2009 v. 2008	
	2010	2009	2008	$ change	% change	$ change	% change
Selling, general and administrative	$ 15,167	$ 13,745	$ 17,945	$ 1,422	10%	$ (4,200)	(23)%

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2010 v. 2009

Selling, general and administrative expense increased $1.4 million, or 10%, from 2009 to 2010. The increase in selling, general and administrative expense is primarily attributable to the following:

Compensation expense increased $0.7 million as a result of:

elimination of a Company-wide salary reduction in effect during the second and third quarters of 2009;

an increase in the number of sales, general and administrative employees; and

annual merit salary increases granted during the year.

Travel related expense increased $0.3 million.

2009 v. 2008

Selling, general and administrative expense decreased $4.2 million, or 23%, from 2008 to 2009. The decrease in selling, general and administrative expense from 2008 to 2009 is primarily attributable to the restructuring efforts that we initiated in November 2006 and December 2008, and which were completed in the fourth quarter of 2008 and second quarter of 2009, respectively. These efforts resulted in the following reductions in selling, general and administrative expenses:

Compensation expense decreased $1.6 million as a result of:

a Company-wide 10% salary reduction that was in effect during the second and third quarters of 2009;

a reduced senior management bonus for 2009 compared to 2008; and

headcount reductions during 2009.

Stock-based compensation expense decreased $0.7 million due to personnel reductions and reduced valuation of our stock options.

Facilities and information technology allocations decreased $0.5 million, primarily due to reductions in headcount, outsourced IT support, lower rent and decreased equipment depreciation.

Sales commissions decreased $0.5 million primarily due to lower sales volume.

Restructuring

Restructuring expense was comprised of the following amounts (in thousands):

	Year ended December 31,		
	2010	2009	2008
Termination and retention benefits [1]	$	$ 118	$ 1,172
Consolidation of leased space [2]	94	160	508
Total restructuring expenses	$ 94	$ 278	$ 1,680
Included in cost of sales	$	$ 43	$ 91
Included in operating expenses	94	235	1,589

[1] Includes severance payments for terminated employees in 2009 and 2008 and retention payments for certain continuing employees in 2008.

[2] Expenses related to the consolidation of leased space including future non-cancelable rent payments due for vacated space (net of estimated sublease income) and related professional fees.

In December 2008, we initiated a restructuring plan to reduce our operating expenses in response to decreases in current and forecasted revenue which resulted from global economic uncertainty. The plan reduced operations, research and development and administrative headcount in our San Jose, Taiwan and China offices, and was completed during the second quarter of 2009. All termination benefits recorded during 2009 were attributable to the plan initiated in December 2008.

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In November 2006, we initiated a restructuring plan that included consolidation of our operations in order to reduce compensation and rent expense, while at the same time making critical infrastructure investments in people, processes and information systems to improve our operating efficiency. Although this plan was completed in the fourth quarter of 2008, lease termination costs were recorded in 2010 and 2009 due to decreases in estimated future sublease income and related professional fees.

Other income, net

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

	Year ended December 31,			$ change	
	2010	2009	2008	2010 v. 2009	2009 v. 2008
Gain on sale of marketable securities	$ 1,397	$	$	$ 1,397	$
Interest income (expense) and other, net [1]	(511)	(522)	199	11	(721)
Gain on repurchase of long-term debt, net [2]		12,860	19,670	(12,860)	(6,810)
Other-than-temporary impairment of marketable securities, net [3]			(7,890)		7,890
Total other income, net	$ 886	$ 12,338	$ 11,979	$ (11,452)	$ 359

[1] Interest income (expense) and other, net primarily relates to interest payable on our 1.75% convertible subordinated debentures (the debentures). The decrease in 2009 is due to the reduced outstanding principal balance which resulted from our repurchases of our debentures during the first half of 2009. This line also includes interest income from our cash and investments and amortization of debt issuance costs.

[2] In 2009, we repurchased and retired $44.9 million of our debentures for a net gain of $12.9 million. In 2008, we repurchased and retired $79.4 million of our debentures for a net gain of $19.7 million.

[3] In 2008, we recognized an other-than-temporary impairment of $7.9 million on an investment in a publicly-traded equity security, due to the duration of time that the investment had been below cost, as well as decreased target price estimates, analyst downgrades and macroeconomic factors.

Benefit for income taxes

The benefit for income taxes was as follows (in thousands):