PIXELWORKS, INC
Form 10-Q
August 06, 2009

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2009.

or

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

For the transition period from __________ to __________.

Commission File Number: 000-30269

PIXELWORKS, INC.

(Exact name of registrant as specified in its charter)

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

16760 SW Upper Boones Ferry Road, Suite 101
Portland, OR 97224
(503) 601-4545

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

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

Yes þ No o

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 o No o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

Number of shares of Common Stock outstanding as of July 31, 2009: 13,396,859

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FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2009
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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	June 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 18,795	$ 53,149
Short-term marketable securities	6,848	8,058
Accounts receivable, net	5,146	6,149
Inventories, net	3,720	4,981
Prepaid expenses and other current assets	3,230	3,381
Total current assets	37,739	75,718
Long-term marketable securities	2,550	2,110
Property and equipment, net	5,070	5,187
Other assets, net	5,030	5,331
Acquired intangible assets, net	2,196	3,386
Total assets	$ 52,585	$ 91,732
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 4,489	$ 4,215
Accrued liabilities and current portion of long-term liabilities	7,458	9,419
Current portion of income taxes payable	216	137
Total current liabilities	12,163	13,771
Long-term liabilities, net of current portion	1,993	2,035
Income taxes payable, net of current portion	9,040	10,581
Long-term debt	15,779	60,634
Total liabilities	38,975	87,021
Commitments and contingencies (Note 11)		
Shareholders equity:		
Common stock	334,404	333,974
Accumulated other comprehensive income	408	55
Accumulated deficit	(321,202)	(329,318)

Total shareholders equity	13,610	4,711
Total liabilities and shareholders equity	$ 52,585	$ 91,732

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended June 30, 2009	Three Months Ended June 30, 2008	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Revenue, net	$ 14,213	$ 20,793	$ 24,993	$ 44,769
Cost of revenue (1)	7,440	10,295	14,064	22,600
Gross profit	6,773	10,498	10,929	22,169
Operating expenses:				
Research and development (2)	4,532	7,193	9,308	13,915
Selling, general and administrative (3)	3,340	4,491	7,213	9,177
Restructuring	64	(158)	101	850
Amortization of acquired intangible assets		74		164
Total operating expenses	7,936	11,600	16,622	24,106
Loss from operations	(1,163)	(1,102)	(5,693)	(1,937)
Gain on repurchase of long-term debt, net	3,836		12,860	11,557
Interest expense	(145)	(419)	(396)	(992)
Interest income	75	553	173	1,536
Amortization of debt issuance costs	(26)	(125)	(87)	(271)
Other income		218		218
Other-than-temporary impairment of a marketable security				(6,490)
Interest and other income, net	3,740	227	12,550	5,558
Income (loss) before income taxes	2,577	(875)	6,857	3,621
Provision (benefit) for income taxes	358	375	(1,259)	(1,262)
Net income (loss)	$ 2,219	$ (1,250)	$ 8,116	$ 4,883
Net income (loss) per share basic	$ 0.17	$ (0.09)	$ 0.61	$ 0.33
Net income (loss) per share diluted	$ 0.16	$ (0.09)	$ 0.61	$ 0.33
Weighted average shares outstanding:				
Basic	13,291	14,577	13,321	14,753

Diluted	13,475	14,577	13,344	14,766
(1) Includes:				
Amortization of acquired developed technology	$ 573	$ 705	$ 1,190	$ 1,410
Additional amortization of non-cancelable prepaid royalty	50		118	
Restructuring	(4)		43	
Stock-based compensation	3	20	10	38
(2) Includes stock-based compensation	108	449	226	898
(3) Includes stock-based compensation	105	313	357	738

See accompanying notes to condensed consolidated financial statements.

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

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Cash flows from operating activities:		
Net income	$ 8,116	$ 4,883
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Gain on repurchase of long-term debt, net	(12,860)	(11,557)
Other-than-temporary impairment of a marketable security		6,490
Depreciation and amortization	2,299	3,375
Amortization of acquired intangible assets	1,190	1,574
Stock-based compensation	593	1,674
Deferred income tax benefit	(207)	(473)
Amortization of debt issuance costs	87	271
Amortization (accretion) on short- and long-term marketable securities	16	(295)
Loss on asset disposals	6	80
Other	24	27
Changes in operating assets and liabilities:		
Accounts receivable, net	1,003	(515)
Inventories, net	1,261	4,994
Prepaid expenses and other current and long-term assets, net	207	(535)
Accounts payable	274	(334)
Accrued current and long-term liabilities	(3,147)	(1,667)
Income taxes payable	(1,462)	(62)
Net cash provided by (used in) operating activities	(2,600)	7,930
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	4,100	36,814
Purchases of marketable securities	(2,993)	(16,659)
Purchases of property and equipment	(412)	(1,245)
Purchases of other assets	(27)	
Proceeds from sales of property and equipment		20
Net cash provided by investing activities	668	18,930
Cash flows from financing activities:		
Repurchase of long-term debt	(31,532)	(37,939)
Payments on asset financings	(727)	(2,764)
Repurchase of common stock	(167)	(1,371)
Proceeds from issuances of common stock	4	36

Net cash used in financing activities	(32,422)	(42,038)
Net change in cash and cash equivalents	(34,354)	(15,178)
Cash and cash equivalents, beginning of period	53,149	74,572
Cash and cash equivalents, end of period	$ 18,795	$ 59,394

See accompanying notes to condensed consolidated financial statements.

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

NOTE 1: BASIS OF PRESENTATION

Nature of Business

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

Condensed Consolidated Financial Statements

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

The financial information included herein for the three and six month periods ended June 30, 2009 and 2008 is unaudited; however, such information reflects all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows of the Company for these interim periods. The financial information as of December 31, 2008 is derived from our audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2008, included in Item 8 of our Annual Report on Form 10-K, filed with the SEC on March 16, 2009, and should be read in conjunction with such consolidated financial statements.

We have evaluated subsequent events through August 6, 2009, the date of issuance of the condensed consolidated financial statements.

The results of operations for the three and six month periods ended June 30, 2009 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2009.

Recent Accounting Pronouncements

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly.* This pronouncement provides additional guidance for estimating fair value in accordance with SFAS 157, *Fair Value Measurement* (SFAS 157) when the volume and level of activity for the asset or liability have significantly decreased. This FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. We do not currently have any financial assets in non-active markets. The adoption of this FSP during the current quarter did not have a material impact on our consolidated financial position or results of operations.

In April 2009, the FASB issued FSP FAS 107-1, APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments.* This pronouncement amends SFAS 107, *Disclosures about Fair Value of Financial Instruments*, (SFAS 107) to require disclosures about fair value of financial instruments not measured on the balance sheet at fair value in interim financial statements as well as in annual financial statements. Prior to this FSP, fair values for these assets and liabilities were only disclosed annually. This FSP applies to all financial instruments within the scope of SFAS 107 and requires disclosure of the methods and significant assumptions used to estimate the fair value of financial instruments. The adoption of this FSP during the current quarter did not have a material impact on our consolidated financial position or results of operations.

In April 2009, the FASB issued FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. This FSP requires the recognition of an other-than-temporary impairment if we intend to sell an impaired debt security and it is more likely than not that the security will be sold before it recovers its cost basis. This FSP also requires increased disclosure about the credit and noncredit components of impaired debt securities that are not expected to be sold and also requires increased and more frequent disclosures regarding expected cash flows, credit losses, and an aging of securities with unrealized losses. The adoption of this FSP during the current quarter did not have a material impact on our consolidated financial position or results of operations.

In June 2009, the FASB issued SFAS 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles, a replacement of FASB Statement No. 162* (SFAS 168), which establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles recognized by the FASB to be applied in the preparation of financial statements in conformity with US GAAP. SFAS 168 explicitly recognizes rules and interpretive releases of the SEC under federal securities laws as authoritative GAAP for SEC registrants. SFAS 168 will become effective for interim and annual periods ending after September 15, 2009 and is not expected to have a material impact on our consolidated financial position or results of operations.

Use of Estimates

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

As of June 30, 2009, we elected to use the simplified method to estimate the expected term used in the valuation of stock options granted after the May 19, 2009 amendment of the 2006 Incentive Stock Plan, which shortened the contractual life of newly issued stock options from ten to six years. The simplified method was used in accordance with Staff Accounting Bulletin (SAB) 107, *Share Based Payment* and SAB 110, *Certain Assumptions Used in Valuation Methods Expected Term,* as we do not have sufficient historical share option exercise experience for options granted with a six year contractual life. We will continue to use the simplified method until we have sufficient historical share option exercise experience to develop a more refined estimate of expected term.

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

NOTE 2: BALANCE SHEET COMPONENTS

Marketable Securities See Note 3

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

	June 30, 2009	December 31, 2008
Accounts receivable, gross	$ 5,688	$ 6,691
Less: allowance for doubtful accounts	(542)	(542)
Accounts receivable, net	$ 5,146	$ 6,149

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

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

	June 30, 2009	December 31, 2008
Finished goods	$ 3,325	$ 4,617
Work-in-process	3,845	5,358
	7,170	9,975
Less: reserve for slow-moving and obsolete items	(3,450)	(4,994)
Inventory, net	$ 3,720	$ 4,981

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

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	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Balance at beginning of period	$ 4,994	$ 5,950
New provision	223	1,315
Sales of previously reserved inventory	(510)	(655)
Net provision (benefit) for obsolete inventory	(287)	660
Final scrap of previously reserved inventory	(1,257)	(1,084)
Balance at end of period	$ 3,450	$ 5,526

Based upon our forecast and backlog, we do not currently expect to be able to sell or otherwise use the reserved inventory we have on hand at June 30, 2009. However, it is possible that a customer will decide in the future to purchase a portion of the reserved inventory. It is not possible for us to predict if or when this may happen, or how much we may sell. If such sales occur, we do not expect that they will have a material effect on gross profit margin.

Property and Equipment, Net

Property and equipment consists of the following:

	June 30, 2009	December 31, 2008
Gross carrying amount	$ 16,815	$ 20,227
Less: accumulated depreciation and amortization	(11,745)	(15,040)
Property and equipment, net	$ 5,070	$ 5,187

Acquired Intangible Assets, Net

Acquired intangible assets consist of the following developed technology:

	June 30, 2009	December 31, 2008
Gross carrying amount	$ 19,170	$ 19,170
Less: accumulated amortization	(16,974)	(15,784)
Acquired intangible assets, net	$ 2,196	$ 3,386

Estimated future amortization of acquired intangible assets is $1,146 for the six months ending December 31, 2009 and $1,050 for the year ending December 31, 2010.

Accrued Liabilities and Current Portion of Long-Term Liabilities

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

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	June 30, 2009	December 31, 2008
Current portion of accrued liabilities for asset financings	$ 2,155	$ 1,116
Accrued payroll and related liabilities	2,010	3,749
Accrued commissions and royalties	661	728
Reserve for warranty returns	468	593
Accrued interest payable	194	236
Accrued costs related to restructuring	167	940
Reserve for sales returns and allowances	100	100
Other	1,703	1,957
	$ 7,458	$ 9,419

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

	Six Months Ended June 30, 2009	Six Months Ended June 30, 2008
Reserve for warranty returns:		
Balance at beginning of period	$ 593	$ 932
Provision (benefit)	271	(54)
Charge offs	(396)	(152)
Balance at end of period	$ 468	$ 726
Reserve for sales returns and allowances:		
Balance at beginning of period	$ 100	$ 175
Provision	44	14
Charge offs	(44)	(14)
Balance at end of period	$ 100	$ 175

Long-Term Liabilities, Net of Current Portion

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

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	June 30, 2009	December 31, 2008
Accrued liabilities for asset financings	$ 1,011	$ 699
Deferred rent	556	617
Accrued costs related to restructuring	181	262
Payroll and related liabilities	179	182
Other	66	275
	$ 1,993	$ 2,035

Long-Term Debt

In 2004, we issued $150,000 of 1.75% convertible subordinated debentures (the debentures) due 2024. In February 2006, we repurchased and retired $10,000 of the debentures. In February 2008, we repurchased and retired $50,248 of the debentures for $37,939 in cash. We recognized a net gain of $11,557 on the repurchase, which included a $13,064 discount, offset by legal and professional fees of $755 and a write-off of debt issuance costs of $752. In August 2008, we repurchased and retired $29,118 of the debentures for $20,615 in cash. We recognized a net gain of $8,113 on the repurchase, which included an $8,503 discount, offset by a write-off of debt issuance costs of $390. In February 2009, we repurchased and retired $27,090 of the debentures for $17,778 in cash. We recognized a net gain on the repurchase of $9,024, which included a $9,346 discount, offset by a write-off of debt issuance costs of $288 and other fees of $34. In May 2009, we repurchased and retired $17,765 of the debentures for $13,754 in cash. We recognized a net gain of $3,836 on the repurchase, which included a $4,011 discount, offset by a write-off of debt issuance costs of $175. Gains on the repurchase of our long-term debt are included in other income in our statement of operations. As of June 30, 2009, $15,779 of the debentures are outstanding.

The remaining debentures are convertible, under certain circumstances, into our common stock at a conversion rate of 13.6876 shares of common stock per $1 principal amount of debentures for a total of 215,977 shares. This is equivalent to a conversion price of approximately $73.06 per share. The debentures are convertible if (a) our stock trades above 130% of the conversion price for 20 out of 30 consecutive trading days during any calendar quarter, (b) the debentures trade at an amount less than or equal to 98% of the if-converted value of the debentures for five consecutive trading days, (c) a call for redemption occurs, or (d) in the event of certain other specified corporate transactions. If our debentures are converted into common stock, they can not be settled in cash or other assets.

We may redeem some or all of the debentures for cash on or after May 15, 2011 at a price equal to 100% of the principal amount of the debentures plus accrued and unpaid interest. The holders of the debentures have the right to require us to purchase all or a portion of the $15,779 debentures outstanding at each of the following dates: May 15, 2011, May 15, 2014, and May 15, 2019, at a purchase price equal to 100% of the principal amount plus accrued and unpaid interest. The debentures are unsecured obligations and are subordinated in right of payment to all of our existing and future senior debt.