PIXELWORKS INC
Form 10-Q/A
October 04, 2001

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A

Amendment No. 1

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

For the quarterly period ended June 30, 2001

OR

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

For the transition period from ______ to ______

Commission File Number: 000-30269

PIXELWORKS, INC.

(Exact name of registrant as specified in its charter)

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

7700 SW Mohawk
Tualatin, Oregon 97062
(503) 612-6700

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

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

Yes /x/ No / /

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

PIXELWORKS, INC.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PIXELWORKS, INC.

CONDENSED BALANCE SHEETS

(in thousands)

	June 30, 2001	December 31, 2000
	(Unaudited)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 57,224	$ 49,681
Short-term marketable securities	29,768	54,051
Accounts receivable, net	5,199	6,608
Inventories, net	5,780	3,280
Prepaid expenses and other current assets	2,521	592
Total current assets	100,492	114,212

	June 30, 2001	December 31, 2000
Property and equipment, net	4,242	3,660
Long-term marketable securities	8,574	
Goodwill and assembled workforce, net	78,711	
Other assets, net	10,909	2,422
Total assets	$ 202,928	$ 120,294
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 7,060	$ 10,724
Accrued liabilities	3,484	3,117
Total current liabilities	10,544	13,841
Shareholders' equity:		
Common stock	258,817	126,260
Deferred stock compensation	(11,312)	(2,206)
Note receivable for common stock	(159)	(172)
Accumulated deficit	(54,962)	(17,429)
Total shareholders' equity	192,384	106,453
Total liabilities and shareholders' equity	$ 202,928	$ 120,294

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

PIXELWORKS, INC.

CONDENSED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands, except share and per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	**2000**	**2001**	**2000**
Revenue	$ 22,732	$ 12,123	$ 44,075	$ 19,187
Cost of revenue(1)	11,988	7,411	24,060	11,906
Gross profit	10,744	4,712	20,015	7,281
Operating expenses:				
Research and development(2)	4,310	2,344	8,534	4,034

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

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

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

PIXELWORKS, INC.

CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

(in thousands)

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

	Six Months Ended June 30,			
Supplemental disclosure of cash flow information:				
Cash paid during the respective periods for:				
Interest	$		$	
Taxes	$	66	$	

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

PIXELWORKS, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(in thousands, except share and per share data)

Note 1: Basis of Presentation

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

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

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

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

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

Note 2: Earnings per share

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

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

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

Note 3: Inventories

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

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

Note 4: Acquisitions

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

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

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

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The allocation of purchase price was as follows:

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

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

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

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

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proforma information does not necessarily reflect the actual results that would have occurred nor is it necessarily indicative of future results of operations of the combined companies.

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

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

Note 5: Recent Accounting Pronouncements

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

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

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

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

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

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

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

RESULTS OF OPERATIONS

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

Overview

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

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

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

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

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

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

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

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

Results of Operations

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

Revenue. Revenue increased $10.6 million from $12.1 million for the three months ended June 30, 2000 to $22.7 million for the three months ended June 30, 2001, an increase of 87.6%. The increase in revenue resulted from increased shipments of PW111, PW112, PW164, PW165, and PW365 ImageProcessor ICs. All of these products, with the exception of the PW164, were products that were newly introduced and not shipping in the period ended June 30, 2000. The increase in revenue was partially offset by decreased shipments of PW264 and PW364 ImageProcessor ICs. We shipped ImageProcessors ICs into three primary categories of products, namely LCD monitors, multimedia projector