PIXELWORKS, INC
Form 10-Q
May 09, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014
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 (State or other jurisdiction of incorporation or organization)	91-1761992 (I.R.S. Employer Identification No.)
224 Airport Parkway, Suite 400 San Jose, California (Address of principal executive offices)	95110 (Zip Code)

(408) 200-9200
(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 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 x No ¨

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

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

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

Number of shares of Common Stock, par value $0.001 per share, outstanding as of April 30, 2014: 22,508,363.

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FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2014
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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.
PIXELWORKS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)
(Unaudited)

	March 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$21,920	$20,805
Accounts receivable, net	4,362	4,761
Inventories	2,027	1,663
Prepaid expenses and other current assets	1,567	2,858
Total current assets	29,876	30,087
Property and equipment, net	6,172	4,084
Other assets, net	2,122	2,573
Total assets	$38,170	$36,744
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$1,564	$1,327
Accrued liabilities and current portion of long-term liabilities	10,694	10,505
Current portion of income taxes payable	138	92
Short-term line of credit	3,000	3,000
Total current liabilities	15,396	14,924
Long-term liabilities, net of current portion	2,131	677
Income taxes payable, net of current portion	1,874	2,201
Total liabilities	19,401	17,802
Commitments and contingencies (Note 10)		
Shareholders' equity:		
Preferred stock	—	—
Common stock	364,978	362,644
Accumulated other comprehensive loss	(82)	(82)
Accumulated deficit	(346,127)	(343,620)
Total shareholders' equity	18,769	18,942
Total liabilities and shareholders' equity	$38,170	$36,744

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 March 31,	
	2014	2013
Revenue, net	$13,541	$8,271
Cost of revenue (1)	5,546	4,294
Gross profit	7,995	3,977
Operating expenses:		
Research and development (2)	6,385	5,884
Selling, general and administrative (3)	4,049	3,598
Total operating expenses	10,434	9,482
Loss from operations	(2,439)	(5,505)
Interest expense and other, net	(122)	(98)
Loss before income taxes	(2,561)	(5,603)
Benefit for income taxes	(54)	(198)
Net loss	$(2,507)	$(5,405)
Net loss per share - basic and diluted	$(0.11)	$(0.29)
Weighted average shares outstanding - basic and diluted	22,204	18,456

(1) Includes:		
Additional amortization of non-cancelable prepaid royalty	$56	$91
Stock-based compensation	89	40
(2) Includes stock-based compensation	826	258
(3) Includes stock-based compensation	788	386

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31, 2014	2013
Cash flows from operating activities:		
Net loss	$(2,507)	$(5,405)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Stock-based compensation	1,703	684
Depreciation and amortization	1,144	1,058
Reversal of uncertain tax positions	(270)	(452)
Deferred income tax expense	160	—
Other	24	38
Changes in operating assets and liabilities:		
Accounts receivable, net	399	1,374
Inventories	(364)	278
Prepaid expenses and other current and long-term assets, net	1,656	214
Accounts payable	202	(151)
Accrued current and long-term liabilities	(967)	(237)
Income taxes payable	(10)	64
Net cash provided by (used in) operating activities	1,170	(2,535)
Cash flows from investing activities:		
Purchases of property and equipment	(266)	(69)
Net cash used in investing activities	(266)	(69)
Cash flows from financing activities:		
Proceeds from issuances of common stock	631	105
Payments on asset financings	(420)	(558)
Proceeds from line of credit	—	2,300
Net cash provided by financing activities	211	1,847
Net increase (decrease) in cash and cash equivalents	1,115	(757)
Cash and cash equivalents, beginning of period	20,805	13,404
Cash and cash equivalents, end of period	$21,920	$12,647

See accompanying notes to condensed consolidated financial statements.

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

NOTE 1: BASIS OF PRESENTATION

Nature of Business

Pixelworks designs, develops and markets video and pixel processing semiconductors, intellectual property cores, software and custom ASIC solutions for high-end digital video applications. Our products allow manufacturers and developers of digital display and projection devices to manufacture screens of all sizes that display the highest video quality with minimum power consumption. Our core video display processing technology intelligently processes video signals from a variety of sources and optimizes the image for the viewer. The continued advancement of display technology and rapid growth of video consumption on digital delivery systems and mobile applications has increased the demand for video display processing technology in recent years. Our products are used in a range of devices from large flat panel displays to small low power mobile applications. Our products are designed to reduce overall system power requirements and reduce costs for our customers by minimizing bandwidth. Our primary target markets include digital projection systems, digital televisions, Ultrabook™ devices, tablets, and smartphones.

We have an intellectual property portfolio of 125 patents related to the visual display of digital image data. Pixelworks was founded in 1997 and is incorporated under the laws of the state of Oregon.

Condensed Consolidated Financial Statements

The financial information included herein for the three month periods ended March 31, 2014 and 2013 is prepared in accordance with U.S. generally accepted accounting principles ("GAAP") and is unaudited. In our opinion, such information reflects all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the Company's condensed consolidated financial statements for these interim periods. The financial information as of December 31, 2013 is derived from our audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2013, included in Item 8 of our Annual Report on Form 10-K, filed with the Securities and Exchange Commission on March 5, 2014, and should be read in conjunction with such consolidated financial statements.

The results of operations for the three month period ended March 31, 2014 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2014.

Comprehensive Loss

The Company reports comprehensive income (loss) and its components following guidance set forth by the Financial Accounting Standards Board ("FASB"), Accounting Standards Codification section 220-10, Comprehensive Income, which establishes standards for the reporting and display of comprehensive income or loss and its components in the financial statements. During the three month periods ended March 31, 2014 and 2013, aside from our net loss, there were no other items of comprehensive income or loss and therefore the Company has not included a schedule of comprehensive loss in our interim condensed consolidated financial statements.

Recent Accounting Pronouncements

In July 2013, the FASB issued Accounting Standards Update No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ("ASU 2013-11"), which will require an unrecognized tax benefit, or a portion of an unrecognized tax benefit to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, unless an exception applies. The amendments in this update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2013. The Company adopted ASU 2013-11 in the first quarter of 2014. The adoption of ASU 2013-11 did not have a material impact on the Company's financial position, results of operations or cash flows as a result of this change.

Use of Estimates

The preparation of consolidated financial statements in conformity with 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 revenue recognition, product returns, warranty obligations, bad debts, inventories, property and equipment, impairment of long-lived assets, 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.

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NOTE 2: BALANCE SHEET COMPONENTS

Accounts Receivable, Net

Accounts receivable are recorded at invoiced amount and do not bear interest when recorded or accrue interest when past due. 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 consists of the following:

	March 31, 2014	December 31, 2013
Accounts receivable, gross	$4,674	$5,076
Less: allowance for doubtful accounts	(312)	(315)
Accounts receivable, net	$4,362	$4,761

The following is the change in our allowance for doubtful accounts:

	Three Months Ended March 31, 2014	2013
Balance at beginning of period	$315	$352
Reductions credited	(3)	(5)
Balance at end of period	$312	$347

Inventories

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).

Inventories consist of the following:

	March 31, 2014	December 31, 2013
Finished goods	$674	$793
Work-in-process	1,353	870
Inventories	$2,027	$1,663

Property and Equipment, Net

Property and equipment consists of the following:

	March 31, 2014	December 31, 2013
Gross carrying amount	$24,721	$21,733
Less: accumulated depreciation and amortization	(18,549)	(17,649)
Property and equipment, net	$6,172	$4,084

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Accrued Liabilities and Current Portion of Long-Term Liabilities

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

	March 31, 2014	December 31, 2013
Current portion of accrued liabilities for asset financings	$3,255	$2,251
Accrued payroll and related liabilities	2,506	2,261
Accrued commissions and royalties	1,885	1,862
Accrued interest payable	1,177	1,087
Deferred revenue	318	1,271
Reserve for warranty returns	232	329
Other	1,321	1,444
Accrued liabilities and current portion of long-term liabilities	$10,694	$10,505

The following is the change in our reserve for warranty returns:

	Three Months Ended March 31, 2014	2013
Reserve for warranty returns:		
Balance at beginning of period	$329	$457
Benefit	(90)	(63)
Charge-offs	(7)	(31)
Balance at end of period	$232	$363

Short-Term Line of Credit

On December 21, 2010, we entered into a Loan and Security Agreement (the "Revolving Loan Agreement") with Silicon Valley Bank (the "Bank"). On December 14, 2012, we and the Bank entered into Amendment No. 1 to the Revolving Loan Agreement. The Revolving Loan Agreement, as amended, provides a secured working capital-based revolving line of credit (the "Revolving Line") in an aggregate amount of up to the lesser of (i) $10,000, or (ii) $1,000 plus 80% of eligible domestic accounts receivable and certain foreign accounts receivable. On December 4, 2013, we and the Bank entered into Amendment No. 2 (the "Amendment No. 2") to the Revolving Loan Agreement which changes the maturity date of the revolving line of credit provided pursuant to the Revolving Loan Agreement to January 1, 2016. The maturity date was previously December 14, 2014, as provided by Amendment No. 1 to the Revolving Loan Agreement. In addition, the Revolving Loan Agreement, as amended, provides for non-formula advances of up to $10,000 which may be made solely during the last five business days of any fiscal month or quarter and which must be repaid by the Company on or before the fifth business day after the applicable fiscal month or quarter end. Due to their repayment terms, non-formula advances do not provide the Company with usable liquidity. The Revolving Loan Agreement, as amended, contains customary affirmative and negative covenants as well as customary events of default. The occurrence of an event of default could result in the acceleration of the Company's obligations under the Revolving Loan Agreement, as amended, and an increase to the applicable interest rate, and would permit the Bank to exercise remedies with respect to its security interest. As of March 31, 2014, we were in compliance with all of the terms of the Revolving Loan Agreement, as amended.

Short-term borrowings outstanding under the Revolving Line consisted of non-formula advances of $3,000 as of March 31, 2014 and as of December 31, 2013, both advances were repaid within required terms. The weighted-average interest rate on short-term borrowings outstanding as of March 31, 2014 and December 31, 2013 was 3.5%.

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NOTE 3: FAIR VALUE MEASUREMENTS

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Three levels of inputs may be used to measure fair value:

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

Level 2: Valuations based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

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

The following table presents information about our assets measured at fair value on a recurring basis in the condensed consolidated balance sheets as of March 31, 2014 and December 31, 2013:

	Level 1	Level 2	Level 3	Total
As of March 31, 2014:				
Money market funds	$21,268	$—	$—	$21,268
As of December 31, 2013:				
Money market funds	$20,396	$—	$—	$20,396

We primarily use the market approach to determine the fair value of our financial assets. The fair value of our current assets and liabilities, including accounts receivable and accounts payable approximates the carrying value due to the short-term nature of these balances. We have currently chosen not to elect the fair value option for any items that are not already required to be measured at fair value in accordance with GAAP.

NOTE 4: RESEARCH AND DEVELOPMENT

During 2012, we entered into a best efforts co-development agreement (the “Co-development Agreement”) with a customer to defray a portion of the research and development expenses that would be incurred in connection with our development of an IC product to be sold exclusively to the customer. Under the Co-development Agreement, we retain ownership of any modifications or improvements that are made to our pre-existing intellectual property and may use such improvements in products sold to other customers.

At the completion of certain development milestones under the Co-development Agreement, we invoiced the customer and recognized offsets to research and development expense of $3,500 in each of 2012 and 2013. All milestones under the Co-development Agreement were completed as of December 31, 2013.

NOTE 5: INCOME TAXES

The benefit for income taxes during the 2014 and 2013 periods is primarily comprised of benefits for the reversal of previously recorded foreign tax contingencies due to the expiration of the applicable statutes of limitation, current and deferred tax expense in profitable cost-plus foreign jurisdictions and accruals for tax contingencies in foreign jurisdictions. We recorded a benefit for the reversal of previously recorded tax contingencies of $270 and $452 during the first quarter of 2014 and the first quarter of 2013, respectively.

As we do not believe that it is more likely than not that we will realize a benefit from our U.S. net deferred tax assets, including our U.S. net operating losses, we continue to provide a full valuation allowance against essentially all of those assets, therefore, we do not incur significant U.S. income tax expense or benefit. We have not recorded a valuation allowance against our other foreign net deferred tax assets as we believe that it is more likely than not that we will realize a benefit from those assets.

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As of March 31, 2014 and December 31, 2013, the amount of our uncertain tax positions was a liability of $1,536 and $1,897, respectively. A number of years may elapse before an uncertain tax position is resolved by settlement or statute of limitation. Settlement of any particular position could require the use of cash. If the uncertain tax positions we have accrued for are sustained by the taxing authorities in our favor, the reduction of the liability will reduce our effective tax rate. We reasonably expect reductions in the liability for unrecognized tax benefits and interest and penalties of approximately $207 within the next twelve months due to the expiration of statutes of limitation in foreign jurisdictions. We recognize interest and penalties related to uncertain tax positions in income tax expense in our consolidated statements of operations.

Our Chinese subsidiary was designated as an Advanced Technology Service Enterprise, allowing it to benefit from a Chinese tax holiday resulting in a reduction of its tax rate to 15%. The tax holiday expired on December 31, 2013, and therefore, our tax rate in China returned to 25% on January 1, 2014. We are currently making efforts to apply for an extension of the tax holiday. If an extension is granted, the impact of the extension of the tax holiday will be recognized in the quarter in which the extension has been approved by the tax authorities.

The American Taxpayer Relief Act of 2012, which reinstated the United States federal research and development tax credit retroactively from January 1, 2012 through December 31, 2013, was not enacted into law until the first quarter of 2013. Therefore, the deferred tax asset resulting from such reinstatement for 2012 was reflected in 2013. No additional credit has been reflected for 2014 as the credit has not been extended beyond December 31, 2013. If the credit is extended for 2014, we do not expect it to have a material impact on the financial statements.

NOTE 6: EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted net loss per share:

	Three Months Ended March 31,	
	2014	2013
Net loss	$(2,507)	$(5,405)
Shares used in computing net loss per share - basic and diluted [1]	22,204	18,456
Net loss per common share - basic and diluted	$(0.11)	$(0.29)

[1] The increase in shares from the first quarter of 2013 to the first quarter of 2014 is due primarily to the sale of approximately 3,025 shares of common stock in an underwritten registered offering during August 2013.

The following weighted average shares were excluded from the calculation of diluted net loss per share as their effect would have been anti-dilutive:

	Three Months Ended March 31,	
	2014	2013
Employee equity incentive plans	4,630	4,388

Potentially dilutive common shares from employee equity incentive plans are determined by applying the treasury stock method to the assumed exercise of outstanding stock options, the assumed vesting of outstanding restricted stock units, and the assumed issuance of common stock under the employee stock purchase plan.