

GENESIS MICROCHIP INC /DE  
Form 10-Q  
August 14, 2003  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, DC 20549

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**FORM 10-Q**

(mark one)

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

**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2003**

**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: 000-33477**

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**GENESIS MICROCHIP INC.**

(Exact name of registrant as specified in its charter)

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**DELAWARE**  
(State or other jurisdiction of  
incorporation or organization)

**77-0584301**  
(I.R.S. Employer  
Identification No.)

**2150 GOLD STREET**

**P.O. BOX 2150**

**ALVISO, CALIFORNIA**  
(Address of principal executive offices)

**95002**  
(Zip Code)

**REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE: (408) 262-6599**

Former name, former address and former fiscal year if  
changed since last report.

Former address: N/A

Former Fiscal Year: N/A

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act):

Yes x No "

There were 31,446,335 shares of the registrant s common shares issued and outstanding as of June 30, 2003.

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**GENESIS MICROCHIP INC.**

**FORM 10-Q**

**THREE MONTHS ENDED JUNE 30, 2003**

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\* No information has been provided because this item is not applicable.

**Table of Contents****PART I: FINANCIAL INFORMATION****ITEM 1: FINANCIAL STATEMENTS****GENESIS MICROCHIP INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(amounts in thousands, except per share amounts)

	June 30, 2003	March 31, 2003
	(unaudited)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 107,202	\$ 113,138
Accounts receivable trade, net of allowance for doubtful accounts of \$472 at June 30 and \$493 at March 31	29,457	25,587
Inventories	20,012	14,269
Other	7,249	5,697
	<u>163,920</u>	<u>158,691</u>
Total current assets	163,920	158,691
Property and equipment	11,756	12,770
Acquired intangibles	34,279	36,933
Goodwill	189,579	189,579
Other	6,424	4,681
	<u>405,958</u>	<u>402,654</u>
Total assets	\$ 405,958	\$ 402,654
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 3,700	\$ 8,640
Accrued liabilities	18,995	18,164
Income taxes payable	1,244	722
Loans payable	335	334
	<u>24,274</u>	<u>27,860</u>
Total current liabilities	24,274	27,860
Long-term liabilities:		
Deferred income taxes	523	961
	<u>523</u>	<u>961</u>
Total liabilities	24,797	28,821
Stockholders' equity:		
Capital Stock:		
Preferred Stock:		
Authorized 5,000 preferred shares, \$0.001 par value		
Issued and outstanding none at June 30 or March 31		
Common Stock:		
Authorized 100,000 common shares, \$0.001 par value		

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Issued and outstanding 31,446 shares at June 30 and 31,184 shares at March 31	31	31
Additional paid-in capital	387,549	382,587
Cumulative other comprehensive loss	(94)	(94)
Deferred stock-based compensation	(5,836)	(6,809)
Deficit	(489)	(1,882)
	<u>381,161</u>	<u>373,833</u>
Total stockholders' equity	381,161	373,833
	<u>\$ 405,958</u>	<u>\$ 402,654</u>
Total liabilities and stockholders' equity	\$ 405,958	\$ 402,654

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****GENESIS MICROCHIP INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(amounts in thousands, except per share amounts)

(unaudited)

	<b>Three Months Ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>
Revenues	\$ 53,887	\$ 41,559
Cost of revenues (1)	30,759	25,491
Gross profit	23,128	16,068
Operating expenses:		
Research and development (including non-cash stock-based compensation of \$656 in 2003 and \$1,339 in 2002)	9,676	9,429
Selling, general and administrative (including non-cash stock-based compensation of \$180 in 2003 and \$446 in 2002)	9,316	8,697
Amortization of acquired intangibles	2,654	2,665
Total operating expenses	21,646	20,791
Income (loss) from operations	1,482	(4,723)
Interest income	171	388
Imputed interest on lease liability		(165)
Net interest income	171	223
Income (loss) before income taxes	1,653	(4,500)
Provision for (recovery of) income taxes	260	(463)
Net income (loss)	\$ 1,393	\$ (4,037)
Earnings (loss) per share:		
Basic	\$ 0.04	\$ (0.13)
Diluted	\$ 0.04	\$ (0.13)
Weighted average number of common shares outstanding:		
Basic	31,289	31,062
Diluted	32,800	31,062
(1) Amount excludes amortization of acquired developed technology included in amortization of acquired intangibles	\$ 1,925	\$ 1,925

See accompanying notes to condensed consolidated financial statements.

**Table of Contents****GENESIS MICROCHIP INCORPORATED****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(amounts in thousands)

(unaudited)

	<b>Three Months Ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 1,393	\$ (4,037)
Adjustments to reconcile net income (loss) to cash used in operating activities:		
Depreciation and amortization	1,439	1,333
Amortization of acquired intangibles	2,654	2,665
Non-cash stock-based compensation	836	1,785
Deferred income taxes	(438)	(1,268)
Other		194
Change in operating assets and liabilities:		
Accounts receivable trade	(3,870)	9,674
Inventories	(5,743)	(10,734)
Other current assets	(452)	(1,300)
Accounts payable	(4,940)	829
Accrued liabilities	831	(3,434)
Income taxes payable	522	715
<b>Net cash used in operating activities</b>	<b>(7,768)</b>	<b>(3,578)</b>
<b>Cash flows from investing activities:</b>		
Purchase of short-term investments		(3,034)
Proceeds on sales and maturities of short-term investments		2,047
Additions to property and equipment	(399)	(3,083)
Other	(2,868)	(176)
<b>Net cash used in investing activities</b>	<b>(3,267)</b>	<b>(4,246)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from issue of common stock	5,099	2,550
Repayment of loans payable		(55)
<b>Net cash provided by financing activities</b>	<b>5,099</b>	<b>2,495</b>
Effect of currency translation on cash balances		5
<b>Decrease in cash and cash equivalents</b>	<b>(5,936)</b>	<b>(5,324)</b>
Cash and cash equivalents, beginning of period	113,138	106,564
<b>Cash and cash equivalents, end of period</b>	<b>\$ 107,202</b>	<b>\$ 101,240</b>

See accompanying notes to condensed consolidated financial statements.



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**GENESIS MICROCHIP INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**1. Basis of presentation**

We have prepared the accompanying unaudited condensed consolidated financial statements in accordance with United States generally accepted accounting principles and according to the rules and regulations of the Securities and Exchange Commission for interim financial reporting. Consequently, they do not include all of the information and footnotes required by United States generally accepted accounting principles for a complete set of annual financial statements. These condensed financial statements should be read in conjunction with our financial statements and notes thereto for the year ended March 31, 2003 that are included in our most recent Annual Report on Form 10-K/A filed with the Securities and Exchange Commission. We believe that the accompanying financial statements reflect all adjustments, consisting solely of normal, recurring adjustments, that are necessary for fair presentation of the results for the interim periods presented. The results of operations for the period ended June 30, 2003 are not necessarily indicative of the results to be expected for the full fiscal year or for any other period.

**2. Stock-based compensation**

We have elected to follow Accounting Principles Board Opinion No. 25 ( APB 25 ), Accounting for Stock Issued to Employees and related interpretations, in accounting for employee stock options. Under APB 25, deferred stock-based compensation is recorded at the option grant date in an amount equal to the excess, if any, of the market value of a share of common stock over the exercise price of the option. Deferred stock-based compensation is amortized on a straight-line basis over the vesting period of the individual options, generally two to four years, in accordance with FASB Interpretation No. 44.

We apply the fair value method of FASB Statement No. 123 ( SFAS 123 ), Accounting for Stock-based Compensation for valuing options granted to non-employees. Stock compensation expense resulting from the issuance of options to non-employees is recognized as services are performed and the options are earned. There have been no options issued to non-employees during the periods presented. The issuance of shares for consideration that is less than the market value of the shares results in compensation expense equal to the excess of the market value of the shares over the fair value of the consideration received.

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements.

SFAS 123 requires the disclosure of pro forma net income and earnings per share had Genesis adopted the fair value method for all stock option grants as of the beginning of its 1996 fiscal year. Under SFAS 123, the fair value of stock-based awards to employees is calculated through the use of option pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from Genesis's stock option awards. These models also require subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. Genesis's calculations were made

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using the Black-Scholes option-pricing model using a dividend yield of 0% and the assumptions noted in the following tables.

### Stock Option Plans:

	Three Months Ended	
	June 30,	June 30,
	2003	2002
Risk-free interest rates	2.5%	4.4%
Volatility	108%	109%
Expected life of option in years	5	5

### Employee Stock Purchase Plan:

	Three Months Ended	
	June 30,	June 30,
	2003	2002
Risk-free interest rates	2.7%	4.4%
Expected life years	0.5	0.5
Volatility	111%	103%

The weighted average fair values of options granted during the three months ended June 30, 2003 and June 30, 2002 were \$12.13 and \$8.39, respectively.

Had compensation expense been determined based on the fair value of awards at the grant dates in accordance with the methodology prescribed in SFAS 123, Genesis's net income and earnings per share for the three months ended June 30, 2003 and June 30, 2002 would approximate the pro forma disclosure as follows:

	Three Months Ended	
	June 30,	June 30,
	2003	2002
As reported	\$ 1,393	\$ (4,037)
Stock compensation, as reported	702	1,785
Stock compensation, under SFAS 123	(3,620)	(5,764)
Pro forma	\$ (1,525)	\$ (8,016)

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Basic earnings (loss) per share:		
As reported	\$ 0.04	\$ (0.13)
Pro forma	\$ (0.05)	\$ (0.26)
Diluted earnings (loss) per share:		
As reported	\$ 0.04	\$ (0.13)
Pro forma	\$ (0.05)	\$ (0.26)

The effects on pro forma disclosure of applying SFAS 123 are not likely to be representative of the effects on pro forma disclosure in future years.

### 3. Earnings (loss) per share

Basic earnings (loss) per share is computed by dividing the net income (loss) in a period by the weighted average number of shares of common stock outstanding during that period. Diluted earnings per share is calculated in order to give effect to all potential shares of common stock issuable during the period on the exercise of outstanding options or warrants. The weighted average number of diluted shares outstanding is calculated by assuming that any proceeds from potential shares of common stock, such as stock options, are used to repurchase shares of common stock at the average market share price in the period.

Per share information calculated on this basis is as follows (in thousands, except per share amounts):

	Three Months Ended	
	June 30, 2003	June 30, 2002
Numerator:		
Net income (loss)	\$ 1,393	\$ (4,037)
Denominator for basic earnings (loss) per share-		
Weighted average common shares outstanding	31,289	31,062
Basic earnings (loss) per share	\$ 0.04	\$ (0.13)
Denominator for diluted earnings (loss) per share-		
Weighted average common shares outstanding	31,289	31,062
Stock options and warrants	1,511	
Shares used in computing diluted earnings (loss) per share	32,800	31,062
Diluted earnings (loss) per share	\$ 0.04	\$ (0.13)
Anti-dilutive potential common shares excluded from above calculation	5,465	4,235

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Had we been profitable during the three months ended June 30, 2002, the number of weighted average securities outstanding that would have been added to weighted average shares for purposes of calculating diluted earnings per share would have been (in thousands):

	<b>Three Months Ended</b>
	<b>June 30, 2002</b>
Stock options	<b>\$ 1,813</b>

**Table of Contents****4. Segmented information****Market information**

Genesis operates and tracks its results in one operating segment. Genesis designs, develops and markets integrated circuits that process digital video and graphic images. The target market is divided into two major categories: flat panel monitors and other. Revenues by major category were as follows (in thousands):

	<b>Three Months Ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>
Flat panel monitors	\$ 42,306	\$ 33,935
Other	11,581	7,624
	<b>\$ 53,887</b>	<b>\$ 41,559</b>

Other revenue includes \$50,000 of sub-lease rental income for the three months ended June 30, 2003. No sub-lease rental income was included in other revenue for the three months ended June 30, 2002.

**Geographic information**

Geographic revenue information is based on product shipment destination. Long-lived assets include property and equipment, as well as intangible assets. Property and equipment information is based on the physical location of the asset while the intangible assets are based on the location of the owning entity.

Genesis invoices its customers in U.S. dollars. Revenues from unaffiliated customers by geographic region were as follows (in thousands):

	<b>Three Months Ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>
United States	\$ 3,572	\$ 3,580

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China	16,913	6,509
Japan	4,194	7,147
South Korea	13,479	14,126
Taiwan	8,869	7,541
Rest of world	6,860	2,656
	<u>53,887</u>	<u>41,559</u>

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Net long-lived assets by country of location were as follows (in thousands):

	<b>June 30, 2003</b>	<b>March 31, 2003</b>
United States	\$ 230,103	\$ 233,053
Canada	4,009	4,637
Rest of world	1,502	1,592
	<b>\$ 235,614</b>	<b>\$ 239,282</b>

Long-lived assets include patents, property and equipment, acquired intangible assets and goodwill.

**Customer concentration information**

The following table shows the percentage of our revenues in each period that was derived from customers who individually accounted for more than 10% of revenues in that period:

	<b>Three Months Ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>
Customer A	14%	25%
Customer B	12%	

The following table shows customers accounting for more than 10% of accounts receivable trade at June 30, 2003 and March 31, 2003:

	<b>June 30, 2003</b>	<b>March 31, 2003</b>
Customer A	14%	26%
Customer B	12%	19%
Customer C		15%
Customer D		11%

**Supplier arrangements**

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Genesis subcontracts portions of its semiconductor manufacturing from several suppliers and no single product is fabricated by more than one supplier. Genesis has a fixed-term sole source arrangement with a wafer manufacturer for the supply of wafers for its semiconductor products. Should that wafer supplier or any of Genesis's packaging or testing subcontractors cease to be available, management believes that this would have a material adverse effect on Genesis's business, financial condition and results of operations. Genesis has no guarantee of minimum capacity from its suppliers and is not liable for minimum purchase commitments.

### 5. Inventories

Inventories consist of the following (in thousands):

	<b>June 30, 2003</b>	<b>March 31, 2003</b>
	<u>          </u>	<u>          </u>
Finished goods	\$ 17,573	\$ 11,082
Work-in-process	6,270	6,817
	<u>          </u>	<u>          </u>
	23,843	17,899
Less: Inventory reserve	(3,831)	(3,630)
	<u>          </u>	<u>          </u>
	<b>\$ 20,012</b>	<b>\$ 14,269</b>
	<u>          </u>	<u>          </u>

The following table presents a roll forward for the inventory obsolescence reserve for the indicated periods:

	<b>Three Months Ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>
	<u>          </u>	<u>          </u>
Balance as at beginning of period	\$ 3,630	\$ 2,385
Charged to cost of revenues (net)	201	770
Charge offs	<u>          </u>	<u>          </u>
Balance as at end of period	<b>\$ 3,831</b>	<b>\$ 3,155</b>
	<u>          </u>	<u>          </u>



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The company's product warranty accrual is included in accrued liabilities and reflects management's best estimate of probable liability under its product warranties. Management estimates the accrual based on known product failures (if any), historical experience, and other currently available evidence.

The following table presents a roll forward for the warranty returns for the three months ended June 30, 2003:

Balance as of March 31, 2003	\$ 500
Provision	215
Charge offs	(215)
	<hr/>
Balance as of June 30, 2003	\$ 500
	<hr/>

**7. Contingent liabilities**

On April 24, 2001, Silicon Image, Inc. ( "Silicon Image" ) filed a patent infringement lawsuit against Genesis in the United States District Court for the Eastern District of Virginia and simultaneously filed a complaint before the United States International Trade Commission ( "ITC" ) in Washington, D.C. The complaint and suit alleged that certain Genesis products that contain digital receivers infringe various Silicon Image patent claims. Silicon Image was seeking an injunction to halt the sale, manufacture and use of Genesis's DVI receiver products and unspecified monetary damages. On December 7, 2001 Silicon Image formally moved to withdraw its complaint before the United States ITC and those proceedings have terminated. The trial in the case before the United States District Court for the Eastern District of Virginia was set for January 2003, but the trial was taken off the calendar of the court in December 2002. Beginning in January 2003, the parties filed case dispositive motions, which were heard by the court in March 2003. On July 15, 2003, the court issued a memorandum opinion, followed by a final judgment on August 6, 2003. In its opinion, the court ruled that Genesis and Silicon Image have settled their disputes based on a Memorandum of Understanding, or MOU, signed on December 18, 2002. The court's opinion states that the MOU is a binding settlement agreement. The MOU states that Genesis has received a license for the right to use non-necessary claims under the Digital Visual Interface (DVI) Adopters Agreement and allows Genesis to receive a license to the non-necessary claims under the High-Definition Multimedia Interface (HDMI) Adopters Agreement. In addition, the MOU provides that Genesis has been granted a license to expand use of necessary claims in the DVI Adopters Agreement to the consumer electronics marketplace. The court's opinion states that Genesis will pay Silicon Image a monetary settlement, license fee and running royalties on all DVI and HDMI products. The MOU further states that the companies will cooperate support and promote interoperability of DVI and HDMI. We made provision for costs associated with the settlement of this patent litigation in the year ended March 31, 2003 of \$9,671,000. We do not expect to incur any running royalties for at least the next year as a result of the court's ruling. However, the future financial impact arising from any appeal or other legal actions related to the dispute is not yet determinable and no other provision has been made in our consolidated financial statements for any future costs associated with this claim.

On March 14, 2002, Genesis filed a patent infringement lawsuit against Media Reality Technologies, Inc. ( "MRT" ), SmartASIC Inc., and Trumpion Microelectronics, Inc. ( "Trumpion" ) in the United States District Court for the Northern District of California. The complaint alleges that certain MRT and Trumpion products, which are sold as video/graphics display controllers, infringe various claims of a Genesis U.S. patent. This patent has also been issued in Japan and Korea and is pending in Taiwan. As part of this lawsuit, Genesis is seeking monetary damages and a permanent injunction that bars MRT and Trumpion from making, using, importing, offering to sell, or selling the allegedly infringing products in the United States. On September 17, 2002, Genesis filed a similar patent infringement complaint against the three companies in the United States International Trade Commission ( "ITC" ), as discussed below. Except for the counterclaims by MRT discussed below, the Northern District of California case has been stayed pending the outcome of the ITC action. On January 8, 2003, Genesis announced a settlement of its litigation

against SmartASIC Inc.; the litigation with respect to the other defendants has not been settled.

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MRT has asserted counterclaims against Genesis, alleging trade secret misappropriation, interference with economic advantage, and unfair practices and competition. Genesis intends to vigorously defend against these claims. The future financial impact of these claims is not yet determinable and no provision has been made in our consolidated financial statements for any future costs associated with these claims.

On September 17, 2002, Genesis filed a patent infringement complaint against MRT, SmartASIC Inc., and Trumpion in the ITC. The Genesis legal action alleges that MRT's Mascot series products, and Trumpion's ZURAC and Zipro series products infringe Genesis's patented technology. Genesis is seeking an order from the ITC to exclude MRT and Trumpion's products and other products containing MRT or Trumpion's products from entry into the United States. On October 15, 2002, the ITC voted to institute an investigation into the complaint. On January 8, 2003, Genesis announced a settlement of its litigation against SmartASIC Inc.; the litigation with respect to the other defendants has not been settled. The future financial impact of these claims is not yet determinable and no provision has been made in our consolidated financial statements for any future costs associated with these claims.

On March 10, 2003, Genesis filed a second patent infringement complaint against MRT and Trumpion in the ITC. The Genesis legal action alleges that MRT's Mascot series products, and Trumpion's ZURAC and Zipro series products, infringe Genesis's patented technology. Genesis is seeking an order from the ITC to exclude MRT and Trumpion's products and other products containing MRT or Trumpion's products from entry into the United States. On April 8, 2003, the ITC voted to institute an investigation into the complaint. On May 30, 2003, Genesis filed an amended complaint to add Mstar Semiconductor, Inc. ( Mstar ) as a respondent. On July 22, 2003, the ITC released its order adding Mstar to that complaint. The future financial impact of this claim is not yet determinable and no provision has been made in our consolidated financial statements for any future costs associated with these claims.

On November 7, 2002, a putative securities class action captioned Kuehbeck v. Genesis Microchip et al., Civil Action

No. 02-CV-05344, was filed against Genesis, former Chief Executive Officer Amnon Fisher, and Interim Chief Executive Officer and Chief Financial Officer Eric Erdman, and amended on July 3, 2003 to include Chief Operating Officer Anders Frisk (collectively the Individual Defendants ) in the United States District Court for the Northern District of California. The complaint alleges violations of Section 10(b) of the Securities and Exchange Act of 1934 (the Exchange Act ) and Rule 10b-5 promulgated thereunder against Genesis and the Individual Defendants, and violations of Section 20(a) of the Exchange Act against the Individual Defendants. The complaint seeks unspecified damages on behalf of a purported class of purchasers of Genesis's common stock between April 29, 2002 and June 14, 2002. Genesis believes that it has meritorious defenses to these lawsuits and will defend the litigation vigorously. The future financial impact of these claims is not yet determinable and no provision has been made in our consolidated financial statements for any future costs associated with this claim.

On September 20, 2002, Genesis received a letter from a lawyer representing former executive officer Arun Johary alleging, among other things, that he was wrongly precluded from exercising his options and selling his shares of Sage, Inc. and later Genesis in connection with the acquisition of Sage by Genesis. Mr. Johary alleges that as a combined result of certain decisions not to allow him to sell his shares, he suffered a total economic loss of approximately \$4.1 million dollars. On April 25, 2003, Mr. Johary filed a demand for arbitration with the American Arbitration Association regarding the same issues raised in his letter. The demand for arbitration alleges fraud, deceit and misrepresentation, omission of material fact, breach of fiduciary duty, negligence and breach of contract against Genesis, Sage and former Chief Executive Officer Amnon Fisher. Genesis believes Mr. Johary's claims are without legal merit. The company is currently in settlement negotiations with Mr. Johary.

## **8. Deferred merger-related costs**

On March 17, 2003, Genesis entered into an agreement to merge with Pixelworks, Inc. ( Pixelworks ). Under the terms of that agreement, each outstanding share of Genesis



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common stock would automatically convert into the right to receive 2.3366 shares of Pixelworks common stock, all Genesis stock options would be assumed by Pixelworks at the same exchange ratio of 2.3366 and Genesis would become a wholly owned subsidiary of Pixelworks. The transaction would be subject to approvals by the shareholders of Genesis and Pixelworks, receipt of necessary approvals under United States and applicable foreign antitrust laws and other customary closing conditions.

On August 5, 2003, Genesis and Pixelworks entered into an agreement to terminate the proposed merger. Under the terms of the agreement, each of the parties agreed to a mutual release of claims, and Pixelworks agreed to immediately pay Genesis \$5.5 million as a reimbursement for its estimated expenses to the date of termination. Costs incurred by Genesis related to this transaction to June 30, 2003 were \$4.2 million, and have been deferred and included in other long-term assets.

### **9. Recent accounting pronouncements**

In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, which changes the way a company will report the expenses related to restructuring. SFAS 146 is required to be adopted for exit or disposal activities initiated after December 31, 2002. The adoption of SFAS 146 did not have a material effect on our financial position or results of operations.

In November 2002, the FASB reached consensus on Emerging Issues Task Force EITF Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*. In general, this issue addresses certain aspects of the accounting by a vendor for arrangements under which it will perform multiple revenue-generating activities. Specifically, this issue addresses how to determine whether an arrangement involving multiple deliverables contains more than one earnings process and, if so, how to divide the arrangement into separate units of accounting consistent with the identified earnings processes for revenue recognition purposes. This issue also addresses how arrangement consideration should be measured and allocated to the separate units of accounting in the arrangement. EITF Issue No. 00-21 is applicable to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. We do not believe the application of EITF Issuer No. 00-21 will have any material impact on our consolidated financial statements.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others*, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The initial recognition and measurement provisions of the Interpretation are applicable to guarantees issued or modified after December 31, 2002. We have no guarantees to which this interpretation applies. However, we have included disclosure of product warranty information in the notes to the condensed consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, an amendment of FASB Statement No. 123. This Statement amends FASB Statement No. 123, *Accounting for Stock-Based Compensation*, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosure modifications are required for fiscal years ending after December 15, 2002 and are included in the notes to our condensed consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities*, an interpretation of ARB No. 51. This Interpretation addresses the consolidation by business enterprises of variable interest entities as defined in the Interpretation. The Interpretation

applies immediately to variable interests in variable interest entities created after January 31, 2003, and to variable

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interests in variable interest entities obtained after January 31, 2003. The application of this Interpretation is not expected to have a material effect on our financial statements. The Interpretation requires certain disclosures in financial statements issued after January 31, 2003 if it is reasonably possible that the company will consolidate or disclose information about variable interest entities when the Interpretation becomes effective.

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

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity. SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. The provisions of SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. We do not expect that the adoption of SFAS No. 150 will have a material effect on our financial position or results of operations.

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

### **RESULTS OF OPERATIONS**

This Quarterly Report on Form 10-Q contains numerous statements of a forward-looking nature relating to potential future events or to our future financial performance. The forward-looking statements are the company's targets, not predictions of actual performance. You should consider the various factors identified under the caption "Factors that may affect future operating results" in evaluating those statements.

#### **Overview**

We design, develop and market integrated circuits that receive and process digital video and graphic images. We also supply reference boards and designs that incorporate our proprietary integrated circuits. We are focused on developing and marketing image-processing solutions. We are currently targeting the flat panel computer monitor market, flat panel television and progressive scan cathode ray tube, or CRT, television applications and other potential high-volume applications. We market and sell our products through authorized distributors, directly to customers and with the support of regional sales representatives. Average selling prices to distributors are typically less than average selling prices to direct customers. Sales to distributors comprise less than 10% of revenue. Average selling prices and product margins of our products are typically highest during the initial months following product introduction and decline over time and as volume increases.

We also sell finished systems primarily to the high-end video market under the Faroudja brand. These products are generally sold through retail channels.

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We recognize revenue from product sales upon shipment, other than shipments to distributors, where we recognize revenue upon the distributors shipment to end customers. We comply 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. To date we have not experienced any significant product returns.

We also earn revenues from leasing out portions of our premises that are not required for our own operations, and from license fees and royalties. To date these amounts have not been material.



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We have limited ability to reschedule purchase orders we place with suppliers and, therefore, we generally have to place purchase orders for products before we receive purchase orders from our customers. This restricts our ability to react to fluctuations in demand for our products and exposes us to the risk of having either too much or not enough of a particular product. We regularly evaluate the carrying value of inventory held. For the three months ended June 30, 2003, we recorded net provisions totaling \$200,000, primarily related to inventory where expected net realizable value was lower than cost. We have agreements with suppliers in Asia such that we are dependent on the suppliers' manufacturing yields.

The recovery of income taxes for the three months ended June 30, 2003 is calculated based on our expected effective tax rate for the entire fiscal year. We have investment tax credits and non-capital losses available to reduce taxes payable or taxable income. Future income tax provisions will depend on our effective tax rates and the distribution of taxable income between taxation jurisdictions, the amount of research and development performed in Canada, and the likelihood of being able to utilize available tax credits or losses.

On February 19, 2002, we acquired all of the outstanding shares of Sage, Inc. in exchange for shares of our common stock. Sage, a public company, designed, developed and marketed digital display and video processors. In addition to bringing additional image processing and mixed signal technologies to address the flat panel monitor market, Sage was developing significant expertise in technologies addressing other emerging display applications. In connection with our acquisition of Sage, we changed our domicile from Nova Scotia, Canada, to Delaware.

On March 22, 2002, we acquired substantially all the assets of VM Labs, Inc., including all patents, trademarks and other intellectual property. In connection with that acquisition, we hired several former employees of VM Labs until a new business development vehicle, Nuon Semiconductor, Inc., could be formed. We intended to transfer those employees to Nuon, as well as to grant Nuon a license to certain technologies and patents for development by Nuon in the DVD player market. In July 2002, the decision was made to discontinue both the ongoing product development projects associated with VM Labs at the time of the acquisition, and the plans to license technologies to Nuon. As a result of the decision to discontinue that ongoing development, we terminated the employment of a number of the former VM Labs employees. However, certain former VM Labs employees were retained to focus on incorporating the acquired technologies into existing and new Genesis display products, and we continue to invest in the further development of the acquired technologies.

We accounted for the acquisitions of Sage and the assets of VM Labs using the purchase method of accounting.

We believe that these acquisitions will improve our product offerings into the flat panel monitor market and improve our ability to diversify our business into other emerging display markets, such as flat panel television and progressive scan CRT television markets and other potential mass markets.

On March 17, 2003, we entered into an Agreement and Plan of Merger with Pixelworks, Inc., an Oregon corporation, and Display Acquisition Corporation, a Delaware corporation and a wholly owned subsidiary of Pixelworks. Pursuant to the Agreement, and subject to its terms and conditions, Display Acquisition Corporation would be merged with and into Genesis with Genesis continuing as the surviving corporation and as a wholly owned subsidiary of Pixelworks. As a result of the merger, each issued and outstanding share of Genesis common stock, par value \$0.001 per share, would be automatically converted into the right to receive 2.3366 validly issued, fully paid and nonassessable shares of common stock, par value \$0.001 per share, of Pixelworks. The consummation of the merger would be subject to the approval of the stockholders of Genesis and Pixelworks, receipt of necessary approvals under United States and applicable foreign antitrust laws, SEC clearance and other customary closing conditions. The merger was intended to be a tax-free reorganization under the Internal Revenue Code of 1986, as amended. All of the directors of Genesis who were directors on March 17, 2003 entered into voting agreements with Pixelworks obligating them to vote in favor of adoption of the Agreement. On August 5, 2003, Genesis and Pixelworks entered into an agreement to terminate the proposed merger. Under the terms of the agreement, each of the parties agreed to a mutual release of claims, and Pixelworks agreed to immediately pay Genesis \$5.5 million as a reimbursement for its estimated expenses to the date of termination.



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We operate through subsidiaries and offices in the United States, Canada, China, India, Japan, South Korea, and Taiwan. Our business is conducted globally, with the majority of our suppliers and customers located in China, Japan, South Korea or Taiwan.

### **Critical accounting policies and estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. As described below, significant estimates are used in determining the allowance for doubtful accounts, inventory valuation, costs associated with patent litigation and the useful lives of intangible assets. We evaluate our estimates on an on-going basis, including those related to product returns, bad debts, inventories, investments, intangible assets, income taxes, warranty obligations and contingencies and litigation and other contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We regularly review the carrying values of our property and equipment by comparing the carrying amount of the asset to the expected future cash flows to be generated by the asset. If the carrying value exceeds the estimated amount recoverable, a write-down equal to the excess of the carrying value over the asset's fair value is charged to our consolidated statement of operations.

In July 2001, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 142, Goodwill and Other Intangible Assets ( SFAS 142 ), which requires goodwill to be tested for impairment under certain circumstances, and written down when impaired, rather than being amortized as previous standards required. Furthermore, SFAS 142 requires purchased intangible assets other than goodwill to be amortized over their useful lives unless their lives are determined to be infinite. The Sage and VM Labs acquisitions have been accounted for in accordance with SFAS 142. Intangible assets are comprised of acquired core technology, acquired developed product technology, patents, trademarks and trade names and are being amortized over their estimated useful lives. Goodwill represents the excess purchase price over the fair value of net assets acquired and has not been amortized, but will be periodically tested for impairment, with the next impairment test to be conducted in the fourth quarter of our current fiscal year. In arriving at the balances for goodwill arising out of the acquisitions of Sage, Inc. and the assets of VM Labs, Inc., estimates were made as to the fair values of assets purchased and liabilities assumed, including the lease liability for vacated premises. Adjustments to those estimates during the year ended March 31, 2003, resulted in a change in the reported amount of goodwill.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our financial statements:

We record estimated reductions to revenue for customer returns and warranty claims based on historical experience. If actual customer returns or warranty claims increase as a result of future product introductions or changes in product quality, we may be required to recognize additional reductions to revenue.

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

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We provide for valuation reserves against our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the

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cost of inventory and the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those we project, additional inventory valuation reserves may be required.

We hold minority equity interests in other companies. We may record an investment impairment charge if we believe an investment has experienced a decline in value that is other than temporary. Future adverse changes in market conditions or poor operating results of underlying investments could result in losses or our inability to recover the carrying value of the investments that may be less than an investment's current carrying value, possibly requiring an impairment charge in the future.

We provide for costs associated with patent litigation when we believe that we have a reasonable basis for estimating those costs. If actual costs associated with patent litigation differ from our estimates, we may be required to recognize additional costs.

We perform impairment tests on the carrying value of intangible assets and goodwill. These tests are based on numerous assumptions as to potential future results of our business that we consider to be reasonable at the time those assumptions are made. If any of these assumptions later prove to be incorrect or if we change our assessment as to their reasonability because of changing business conditions, we may record an impairment charge.

We record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. Should we determine that we would not be able to realize all or part of our net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

From time to time, we incur costs related to potential merger activities. When we assess that we will be the acquirer for accounting purposes in such transactions and we expect to complete the transaction, direct costs associated with the acquisition are deferred and form part of the final purchase price. In the event these assessments change, any such deferred costs would be expensed. Costs associated with other merger activities are expensed as incurred.

**Results of operations**

The following table shows unaudited statement of operations data for the three-month periods ended June 30, 2003 and June 30, 2002, expressed as a percentage of revenues:

	<b>Three months ended</b>	
	<b>June 30, 2003</b>	<b>June 30, 2002</b>
Revenues	100.0%	100.0%
Cost of revenues	57.1	61.3
<b>Gross profit</b>	<b>42.9</b>	<b>38.7</b>
Operating expenses:		
Research and development	17.9	22.7
Selling, general and administrative	17.3	20.9
Amortization of acquired intangibles	4.9	6.4
<b>Total operating expenses</b>	<b>40.1</b>	<b>50.0</b>

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Income (loss) from operations	2.8	(11.3)
Net interest income	0.3	0.5
Income (loss) before income taxes	3.1	(10.8)
Provision for (recovery of) income taxes	0.5	(1.1)
Net income (loss)	2.6%	(9.7)%

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### **Three months ended June 30, 2003**

**Revenues:** Revenues for the three months ended June 30, 2003 increased to \$53.9 million from \$41.6 million in the three months ended June 30, 2002, an increase of 29.7%. This resulted from a 92% increase in units shipped offset in part by a 32% decline in average selling prices.

During these periods, revenue from the flat panel monitor market increased to \$42.3 million from \$33.9 million, an increase of 24.7%. This increase was a result of higher unit volumes and overall growth of that market offset in part by declining average selling prices. Revenue from other markets increased to \$11.6 million from \$7.6 million, an increase of 51.9% primarily resulting from overall growth of that market.

Revenue is highly dependent on a number of factors, including, but not limited to, the growth rate of the flat panel monitor and video markets, the rate of decline in product pricing, the company's ability to maintain design wins with customers, timely new product introductions, supply of products from the company's third party foundries and general economic conditions. We expect that revenue will continue to be dominated by shipments of products into flat panel monitor applications, although other applications such as video are beginning to become more significant. Consequently, revenue may also be affected by the availability and price of LCD panels, or other components used in these devices. We currently anticipate that revenues in the quarter ended September 30, 2003 will be between \$44 and \$48 million.

**Gross Profit:** Gross profit for the three months ended June 30, 2003 increased to \$23.1 million from \$16.1 million in the three months ended June 30, 2002. As a percentage of revenues, gross profit represented 42.9% of revenues in the three months ended June 30, 2003, up from 38.7% of revenues in the three months ended June 30, 2002. The increase in gross profit percentage in 2003 over 2002 was attributable primarily to reductions in our average manufacturing cost offset in part by declining average selling prices. The gross profit percentage in the three months ended June 30, 2003 for sales into the flat panel market was 39.5% and 55.5% for other markets. We expect gross profit margins in the second quarter of fiscal 2004 to be in the range of 36 to 38 percent for the company as a whole. Gross profit margins may be higher or lower than expected due to many factors including, but not limited to, competitive pricing actions, changes in estimated product costs or manufacturing yields, revenue levels, and changes in estimated product mix.

**Research and Development:** Research and development expenses include costs associated with research and development personnel, development tools and prototyping costs. Research and development expenses for the three months ended June 30, 2003 increased to \$9.7 million from \$9.4 million in the three months ended June 30, 2002. The increase in absolute dollars reflects higher costs associated with patent litigation, offset in part by lower stock-based compensation costs. These expenses represented 17.9% of revenues in the 2003 period and 22.7% of revenues in the 2002 period.

The decrease in these expenses as a percentage of total revenues resulted from the significant growth in total revenues with no corresponding increase in overall research and development expenses.

**Selling, General and Administrative:** Selling, general and administrative expenses consist of personnel and related overhead costs for selling, marketing, customer support, finance, human resources, legal and general management functions and of commissions paid to regional sales representatives. Selling, general and administrative expenses increased to \$9.3 million in the three months ended June 30, 2003 from \$8.7 million in the three months ended June 30, 2002. The dollar increase in 2003 from 2002 reflects increased personnel costs related to increased administrative, marketing, selling and customer support personnel, offset in part by lower stock-based compensation costs. These expenses represented 17.3% of revenues in the 2003 period and 20.9% of revenues in the 2002 period.

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The decrease in these expenses as a percentage of total revenues resulted from the significant growth in total revenues with no corresponding increase in selling, general and administrative expenses.



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**Amortization of Acquired Intangibles:** Amortization of intangible assets acquired in connection with the Sage, Inc. and the VM Labs businesses was \$2.7 million for the three months ended June 30, 2003 and 2002. We anticipate the quarterly amortization of acquired intangibles to remain constant over the estimated lives of those assets.

**Total Operating Expenses:** Total operating expenses for the three months ended June 30, 2003 increased slightly to \$21.7 million from \$20.8 million in the three months ended June 30, 2002. We expect total combined operating expenses of approximately \$22.5 million to \$23.3 million in the second quarter of fiscal 2004, including approximately \$4.0 million of non-cash charges for the amortization of deferred stock-based compensation and acquired intangibles, and costs associated with intellectual property defense of between \$2.5 and \$2.8 million.

**Net Interest Income:** Net interest income for the three months ended June 30, 2003 was \$171,000, compared with \$223,000 in the three months ended June 30, 2002. The decrease in net interest income resulted from a decrease in prevailing interest rates, offset in part by an imputed interest charge on our long-term lease obligation in the three months ended June 30, 2002. Future interest income will depend on the amount of funds available to invest and on future interest rates.

**Provision for (recovery of) Income Taxes:** The provision for (recovery of) income taxes for the three months ended June 30, 2003 is calculated based on our expected effective tax rate for the entire fiscal year. We have investment tax credits and non-capital losses available to reduce taxes payable or taxable income. Future income tax provisions will depend on our effective tax rates and the distribution of taxable income between taxation jurisdictions, the amount of research and development performed in Canada, and the likelihood of being able to utilize available tax credits or losses.

**Liquidity and capital resources**

Cash and cash equivalents were \$107.2 million at June 30, 2003. Net cash used in operations for the three months ended June 30, 2003, was \$7.8 million, resulting entirely from increases in working capital balances.

Net cash used in investing activities was \$3.3 million in the three months ended June 30, 2003, which included \$1.5 million for costs associated with our proposed merger with Pixelworks and capital spending of \$0.4 million. The proposed merger has since been terminated.

Net cash provided by financing activities in the three months ended June 30, 2003 was \$5.1 million. This represented funds received for the purchase of shares under the terms of our stock option plans and employee stock purchase plan.

As of June 30, 2003, our principal commitments consisted of obligations outstanding under operating leases. These commitments include leases for two premises in the United States, located in Sunnyvale and Alviso, California, two in China and one location in each of Canada, India, Japan, South Korea and Taiwan. In addition we have obligations under operating leases for equipment. The aggregate estimated annual payments required under our lease obligations, excluding expected sub-lease income, by fiscal year are as follows, in thousands of dollars:

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2004	3,234
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2005	2,819
2006	2,721
2007	2,376
2008	844
Thereafter	683
	<hr/>
	\$ 12,677
	<hr/>

Our lease agreements expire at various dates through 2009. Further information on lease obligations and commitments can be found in notes 9 and 16 to our consolidated financial statements included in Item 8 of our most recent Annual Report on Form 10-K/A.

We are involved in certain litigation that we believe may settle in the second quarter of fiscal year 2004 for total settlement payments

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by us of \$1 to \$2 million. We are currently in settlement discussions with those parties and can give no assurances as to whether any settlements will be reached and, if reached, at what cost.

Since inception we have satisfied our liquidity needs primarily through cash generated from operations and sales of equity securities. We believe that our existing cash balances together with any cash generated from our operations will be sufficient to meet our capital and operating requirements on a short-term basis.

On a long-term basis, we may be required to raise additional capital to fund investments in operating assets such as accounts receivable or inventory to assist in the growth of our business, or for capital assets such as land, buildings or equipment. Because we do not have our own semiconductor manufacturing facility, we may be required to make deposits to secure supply in the event there is a shortage of manufacturing capacity in the future. Although we currently have no plans to raise additional funds for such uses, we could be required or could elect to seek to raise additional capital in the future.

We may continue to repurchase our stock in the open market if we believe this is an effective use of our funds. In addition, from time to time we evaluate acquisitions of businesses, products or technologies that complement our business. Any such transactions, if consummated, may use a portion of our working capital or require the issuance of equity securities that may result in further dilution to our existing shareholders.

### **Factors that may affect future operating results**

A number of our statements in this report, including those concerning our anticipated revenues, gross profit margins, amortization of intangibles and stock-based compensation, liquidity and business strategy, are forward looking and subject to various risks and uncertainties.

The following factors may have a harmful impact on our business:

### **Our success will depend on the growth of the flat panel computer monitor market and other electronics markets**

Our ability to generate increased revenues will depend on the growth of the flat panel computer monitor market. Our continued growth will also depend upon emerging markets for consumer electronics markets such as home theater, flat panel and digital television, and HDTV. The potential size of these markets and the timing of their development are uncertain and will depend in particular upon:

A significant reduction in the costs of products in the respective markets,

The availability, at a reasonable price, of components required by such products, (such as LCD panels), and

The emergence of competing technologies.

For the three months ended June 30, 2003, 78.5% of our revenues were derived from sales to customers in the flat panel computer monitor market. This and other potential markets may not develop as expected, which would harm our business.

**A large percentage of our revenues come from sales to a small number of customers**

The markets for our products are highly concentrated. Our sales are derived from a limited number of customers. Sales to our largest five customers accounted for 51% of our revenues, and for our largest customer 14%, for the three months ended June 30, 2003. We expect that a small number of customers will continue to account for a large amount of our revenues. All of our sales are made on the basis of purchase products at any time without penalty. The decision by any large customer to decrease or cease using our products could harm our business.

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### **The sales of our products are highly concentrated and our products may not continue to be accepted in the flat panel computer monitor market and other emerging markets**

Our sales are derived from a limited number of products. Three of our products accounted for 36.0% of our revenues for the three months ended June 30, 2003. There were no other products accounting for more than ten percent of our revenues. We expect that a small number of products will continue to account for a large amount of our revenues.

Our success in the flat panel computer monitor market, as well as the markets for home theater, DVD, flat panel and digital television, and HDTV will depend upon the extent to which manufacturers of those products incorporate our integrated circuits into their products. Our ability to sell products into these markets will depend upon demand for the functionality provided by our products and their pricing. We typically need to determine the functionality of our products and to complete their design in advance of our customers completing the designs of their products. As a result, we may not be able to react to changes in our customers' desired functionality in a timely manner.

The failure of our products to be accepted in the flat panel computer monitor market in particular would harm our business.

### **We must develop new products and enhance our existing products to react to rapid technological change**

We must develop new products and enhance our existing products with improved technologies to meet rapidly evolving customer requirements and industry standards. We need to design products for customers that continually require higher functionality at lower costs. This requires us to continue to add features to our products and to include all of these features on a single chip. The development process for these advancements is lengthy and will require us to accurately anticipate technological innovations and market trends. Developing and enhancing these products is time-consuming, costly and complex. There is a risk that these developments and enhancements will be late, fail to meet customer or market specifications, and will not be competitive with other products using alternative technologies that offer comparable functionality. We may be unable to successfully develop new products or product enhancements. Any new products or product enhancements may not be accepted in new or existing markets. If we fail to develop and introduce new products or product enhancements, that failure will harm our business.

### **We face intense competition and may not be able to compete effectively**

The markets in which we operate are intensely competitive and are characterized by technological change, evolving industry standards and rapidly declining average selling prices. We compete with both large companies and start-up companies, including Micronas AG, Macronix International Co., Ltd., Media Reality Technologies, Inc., Mstar Semiconductor, Inc., Philips Semiconductors, a division of Philips Electronics N.V., Pixelworks, Inc., Realtek Semiconductor Corp., Silicon Image, Inc., SmartASIC Inc., ST Microelectronics, Inc., Topro Technology Inc., Trident Microsystems, Inc. and Trumpion Microelectronics, Inc. We anticipate that as the markets for our products develop, our current customers may develop their own products and competition from diversified electronic and semiconductor companies will intensify. Some competitors are likely to include companies with greater financial and other resources than us. Increased competition could harm our business, by, for example, increasing pressure on our profit margins or causing us to lose customers. Also, the federal district court for the Eastern District of Virginia has issued a memorandum opinion and final judgment which states that we have received a license from Silicon Image, Inc. for certain of their DVI and HDMI patents, and must pay Silicon Image royalties on all of our DVI and HDMI products. This judgment, if not overturned on appeal or otherwise challenged, could hinder our ability to compete with unlicensed competitors that are not required to pay royalties on competing products.



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### **Our future operating results are highly dependent upon how well we manage our business**

Our future operating results will depend in large part on how well we manage our business, including our ability to:

Develop profitable products and meet milestones by accurately forecasting revenues and costs and allocating resources effectively;

Develop strategies to protect our brands and to realize their potential value;

Manage our inventory levels by accurately predicting sales volumes;

Maximize our gross margins by negotiating favorable yet competitive prices with customers, and by leveraging volume to reduce costs with our suppliers;

Develop effective selling tools; and

Monitor and manage expenses.

Any failure by us to effectively manage our business could have a material adverse effect on our results of operations.

### **We may be unable to adequately protect our intellectual property. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as non-disclosure agreements and other methods to protect our proprietary technologies**

We have been issued patents and have pending United States and foreign patent applications. However, we cannot assure you that any patent will be issued as a result of any applications or, if issued, that any claims allowed will be sufficiently broad to protect our technology. It may be possible for a third party to copy or otherwise obtain and use our products, or technology without authorization, develop similar technology independently or design around our patents. Effective copyright, trademark and trade secret protection may be unavailable or limited in foreign countries. In addition, it is possible that existing or future patents may be challenged, invalidated or circumvented. In particular, we have brought patent infringement suits against third parties. An unfavorable outcome in these suits could result in invalidation of the patents we assert in these suits.

### **Intellectual property infringement suits brought against us may significantly harm our business**

We defended claims brought against us by Silicon Image, Inc., alleging that certain of our products that contain digital receivers infringe various Silicon Image patent claims. On August 6, 2003, the court issued its final judgment in the proceeding; see the developments set forth in this report under Part II, Item 1, Legal Proceedings.

We may become subject to additional intellectual property litigation in the future, which could subject us to an injunction preventing us from selling our products or could cause us to incur significant monetary damages. In addition, intellectual property lawsuits, regardless of their success, would likely be time-consuming and expensive to resolve and would divert management time and attention. Intellectual property litigation also could force us to do one or more of the following:

Stop selling products or using technology that contain the allegedly infringing intellectual property;

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

Incur substantial settlement costs; and

Attempt to redesign those products that contain the allegedly infringing intellectual property.

If we are forced to take any of these actions, we may be unable to manufacture and sell some of our products, which could harm our business.

**We may lose our customers or be required to make payments to them in connection with patent infringement litigation**

Our customers typically buy our components and integrate them into their products for resale. As a result of patent infringement litigation, our customers may decide to stop buying from us to ensure that their products do not include the allegedly infringing components, even if the patent litigation is ultimately decided in our favor. Any such action could have a material adverse effect on our revenues and market share.



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In addition, from time to time, we enter into agreements with our customers that may contain indemnification provisions in connection with sales of our components that are the subject of patent litigation. If one of our customers incurs a loss because of a patent infringement suit brought against them or us, we may be required, under those agreements or otherwise, to reimburse those customers for their loss. Any such indemnification obligations could result in significant payments by us that would have a material adverse effect on our financial position.

### **We may become subject to judgments for securities class action suits**

We are a defendant in a securities class action suit. We believe that we have meritorious defenses to the claims in the securities class action suit as well as adequate insurance coverage to cover any likely unfavorable outcome. However, this or any future securities class action suit could subject us to judgments in excess of our insurance coverage and could harm our business. In addition, this kind of lawsuit, regardless of its outcome, is likely to be time-consuming and expensive to resolve and may divert management time and resources.

### **The processes used to manufacture our semiconductor products are periodically retired**

As semiconductor manufacturing technologies advance, manufacturers typically retire their older manufacturing processes in favor of newer processes. When this occurs, the manufacturer generally provides notice to its customers of its intent to discontinue a process, and its customers will either retire the affected part or design a newer version of the part that can be manufactured on the more advanced process. Consequently, our products may become unavailable from their current manufacturers if the processes on which they are produced are discontinued. Our devices are mainly 0.25 and 0.18 micron technology and these geometries will likely be available for the next two to three years. We must manage the transition to new parts from existing parts. We have commitments from our suppliers to provide notice of any discontinuance of their manufacturing processes in order to assist us in managing these types of product transitions.

### **Our semiconductor products are complex and are difficult to manufacture cost-effectively**

The manufacture of semiconductors is a complex process. It is often difficult for semiconductor foundries to achieve acceptable product yields. Product yields depend on both our product design and the manufacturing process technology unique to the semiconductor foundry. Since low yields may result from either design or process difficulties, identifying yield problems can only occur well into the production cycle, when a product exists which can be physically analyzed and tested.

### **Defects in our products could increase our costs and delay our product shipments**

Although we test our products, they are complex and may contain defects and errors. In the past we have encountered defects and errors in our products. Delivery of products with defects or reliability, quality or compatibility problems may damage our reputation and our ability to retain existing customers and attract new customers. In addition, product defects and errors could result in additional development costs, diversion of technical resources, delayed product shipments, increased product returns, and product liability claims against us which may not be fully covered by insurance. Any of these could harm our business.

**We subcontract our manufacturing, assembly and test operations**

We do not have our own fabrication facilities, assembly or testing operations. Instead, we rely on others to fabricate, assemble and test all of our products. Most of our products use silicon wafers manufactured by Taiwan Semiconductor Manufacturing Corporation, with whom we have a fixed-term sole source arrangement, the loss of which could result in a material increase in the price we must pay for silicon wafers. None of our products are fabricated by more than one supplier. There are many risks associated with our dependence upon outside manufacturing, including:

Reduced control over manufacturing and delivery schedules of products;

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Potential political or environmental risks in the countries where the manufacturing facilities are located;

Reduced control over quality assurance;

Difficulty of management of manufacturing costs and quantities;

Potential lack of adequate capacity during periods of excess demand; and

Potential misappropriation of intellectual property.

We depend upon outside manufacturers to fabricate silicon wafers on which our integrated circuits are imprinted. These wafers must be of acceptable quality and in sufficient quantity and the manufacturers must deliver them to assembly and testing subcontractors on time for packaging into final products. We have at times experienced delivery delays and long manufacturing lead times. These manufacturers fabricate, test and assemble products for other companies. We cannot be sure that our manufacturers will devote adequate resources to the production of our products or deliver sufficient quantities of finished products to us on time or at an acceptable cost. The lead-time necessary to establish a strategic relationship with a new manufacturing partner is considerable. We would be unable to readily obtain an alternative source of supply for any of our products if this proves necessary. Any occurrence of these manufacturing difficulties could harm our business.

**Our third-party wafer foundries, third-party assembly and test subcontractors and significant customers are located in an area susceptible to earthquakes**

Most of our outside foundries, third-party assembly and test subcontractors are located in Taiwan, which is an area susceptible to earthquakes. In addition, some of our significant customers are located in Taiwan. Damage caused by earthquakes in Taiwan may result in shortages of water or electricity or cause transportation difficulties that could limit the production capacity of our outside foundries or the ability of our subcontractors to provide assembly and test services. Any reduction in production capacity or the ability to provide assembly and test services could cause delays or shortages in our product supply, which would harm our business. Foundries located in Taiwan were responsible for most of our semiconductor product revenue for the three months ended June 30, 2003. Customers located in Taiwan were responsible for 17% of our revenue for the three months ended June 30, 2003. If future earthquakes damage our customers' facilities or equipment they could reduce their purchases of our products, which would harm our business. In addition, the operations of suppliers to our outside foundries and our Taiwanese customers could be disrupted by future earthquakes, which could in turn harm our business by resulting in shortages in our product supply or reduced purchases of our products.

**We do not have long-term commitments from our customers, and we allocate resources based on our estimates of customer demand**

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

**Our lengthy sales cycle can result in uncertainty and delays in generating revenues**

Because our products are based on new technology and standards, a lengthy sales process, typically requiring several months or more, is often required before potential customers begin the technical evaluation of our products. This technical evaluation can then exceed six months. It can take an additional six months before a customer commences volume shipments of systems that incorporate our products. However, even when a manufacturer decides to design our products into its systems, the manufacturer may never ship systems incorporating our products. Given our lengthy sales cycle, we experience a delay between the time we increase expenditures for research and development, sales and marketing efforts and inventory and the time we generate revenues, if any, from these expenditures. As a result, our business could be harmed if a significant customer reduces or delays its orders or chooses not to release products incorporating our products.

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### **Our business depends on relationships with industry leaders that are non-binding**

We work closely with industry leaders in the markets we serve to design products with improved performance, cost and functionality. We typically commit significant research and development resources to such design activities. We often divert financial and personnel resources from other development projects without entering into agreements obligating these industry leaders to continue the collaborative design project or to purchase the resulting products. The failure of an industry leader to complete development of a collaborative design project or to purchase the products resulting from such projects would have an immediate and serious impact on our business, financial condition and results of operations. Our inability to establish such relationships in the future would, similarly, harm our business.

### **A large percentage of our revenues will come from sales outside of the United States, which creates additional business risks**

A large portion of our revenues will come from sales to customers outside of the United States, particularly to equipment manufacturers located in South Korea, China, Japan and Taiwan. For the three months ended June 30, 2003, sales to regions outside of the United States represented 93% of revenues. For that same period, sales to China and South Korea alone constituted 31% and 25%, respectively of revenues. These sales are subject to numerous risks, including:

Fluctuations in currency exchange rates, tariffs, import restrictions and other trade barriers;

Unexpected changes in regulatory requirements;

Political and economic instability;

Exposure to litigation in these countries;

Longer payment periods;

Ability to enforce contracts or payment terms;

Potentially adverse tax consequences;

Export license requirements; and

Unexpected changes in diplomatic and trade relationships.

Because our sales are denominated in United States dollars, increases in the value of the United States dollar could increase the price of our products in non-U.S. markets and make our products more expensive than competitors' products denominated in local currencies.

**We are subject to risks associated with international operations, which may harm our business**

We depend on product design groups located outside of the United States, primarily in Canada and in India. We also rely on foreign third-party manufacturing, assembly and testing operations.

These foreign operations subject us to a number of risks associated with conducting business outside of the United States, including the following:

Unexpected changes in, or impositions of, legislative or regulatory requirements,

Delays resulting from difficulty in obtaining export licenses for certain technology, tariffs, quotas and other trade barriers and restrictions,

Imposition of additional taxes and penalties,

The burdens of complying with a variety of foreign laws, and

Other factors beyond our control, including acts of terrorism, which may delay the shipment of our products, impair our ability to travel or our ability to communicate with foreign locations.

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In addition, the laws of certain foreign countries in which our products are or may be designed, manufactured or sold may not protect our products or intellectual property rights to the same extent as the laws of the United States. This increases the possibility of piracy of our technology and products.

### **The cyclical nature of the semiconductor industry may lead to significant variances in the demand for our products.**

In the past, significant downturns and wide fluctuations in supply and demand have characterized the semiconductor industry. Also, the industry has experienced significant fluctuations in anticipation of changes in general economic conditions, including economic conditions in Asia. These cycles have led to significant variances in product demand and production capacity. They have also accelerated the erosion of average selling prices per unit. We may experience periodic fluctuations in our future financial results because of changes in industry-wide conditions.

### **We have grown rapidly, which strains our management and resources**

We are experiencing a period of significant growth that will continue to place a great strain on our management and other resources. To manage our growth effectively, we must:

Implement and improve operational and financial systems;

Train and manage our employee base, including our sales force; and

Attract and retain qualified personnel with relevant experience.

We must also manage multiple relationships with customers, business partners, and other third parties, such as our foundry and test partners. Moreover, we will spend substantial amounts of time and money in connection with our rapid growth and may have unexpected costs. Our systems, procedures or controls may not be adequate to support our operations and we may not be able to expand quickly enough to exploit potential market opportunities. Our future operating results will also depend on expanding sales and marketing, research and development and administrative support. If we cannot attract qualified people or manage growth effectively, our business would be seriously harmed.

### **We may not be able to attract or retain the key personnel we need to succeed**

Competition for qualified management, engineering and technical employees is intense. As a result, employees could leave with little or no prior notice. We cannot assure you that we will be able to attract and retain employees. In particular, we may need to expand the depth of our management team in the future by hiring additional management personnel, who may have specific experience in our company's field. We recently expanded the role of our senior vice president of marketing so that he now serves also as our chief operating officer.

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If we cannot attract and retain key employees, our business would be harmed, particularly if the departure of any key employee results in a business interruption or if we are not successful in preserving any material knowledge of our departing employees.

### **A breakdown in our information technology systems could cause a business interruption, impair our ability to manage our business or report results, or result in the unauthorized disclosure of our confidential and proprietary information**

Our information technology systems could suffer a sudden breakdown as a result of factors beyond our control, such as earthquakes, insecure connections or problems with our outside consultants who provide information technology services to us. If our information technology systems were to fail and we were not able to gain timely access to adequate alternative systems or back-up information, this could have a negative impact on our ability to operate and manage our business and to report results in a timely manner. Also, any breach of our information systems by an unauthorized third party could result in our confidential information being made public or being used by a competitor, which could have a material adverse effect on our ability to realize the potential of our proprietary rights.



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### **General economic conditions may reduce our revenues and harm our business**

As our business has grown, we have become increasingly subject to the risks arising from adverse changes in domestic and global economic conditions. Because of the recent economic slowdown in the United States and in Europe, many industries are delaying or reducing technology purchases. As a result, if economic conditions in the United States and Europe worsen or if a wider or global economic slowdown occurs, reduced orders and shipments may cause us to fall short of our revenue expectations for any given period and may result in us carrying increased inventory. These conditions would negatively affect our business and results of operations. If our inventory builds up as a result of order postponement, we would carry excess inventory that is either unusable or that must be sold at reduced prices which will harm our revenues. In addition, weakness in the technology market could negatively affect the cash flow of our customers who could, in turn, delay paying their obligations to us. This would increase our credit risk exposure, which could harm our financial condition.

In addition, political conditions, terrorist acts or acts of war (wherever located around the world) may cause damage or disruption to our business, employees, supplies, distributors and resellers, and customers which could have a material adverse effect on our operations and financial results.

### **We may make acquisitions where advisable, and acquisitions involve numerous risks**

Our growth is dependent upon market growth and our ability to enhance our existing products and introduce new products on a timely basis. One of the ways we may address the need to develop new products is through acquisitions of other companies or technologies, such as our recent acquisitions of Sage and the assets of VM Labs. The recent acquisitions and potential future acquisitions involve numerous risks, including the following:

We may experience difficulty in assimilating the acquired operations and employees,

We may be unable to retain the key employees of the acquired operations,

The acquisitions may disrupt our ongoing business,

We may not be able to incorporate successfully the acquired technologies and operations into our business and maintain uniform standards, controls, policies and procedures, and

We may lack the experience to enter into new markets, products or technologies.

Acquisitions of high-technology companies are inherently risky, and no assurance can be given that our recent or that potential future acquisitions will be successful and will not adversely affect our business, operating results or financial condition. We must also maintain our ability to manage growth effectively. Failure to manage growth effectively and successfully integrate acquisitions made by us could materially harm our business and operating results.

**Our stock price and business may be adversely affected because the proposed merger with Pixelworks has been terminated.**

Because the proposed merger with Pixelworks, Inc. has been terminated, the price of our common stock may decline to the extent that the current market price our common stock reflects the market assumption that the merger will be completed. In addition, our businesses may be harmed to the extent that customers, suppliers and others believe the company cannot effectively compete in the marketplace without the merger, or there is customer or employee uncertainty surrounding the future direction of our product and service offerings and strategy on a stand-alone basis.

**Other factors to consider**

You should also consider the following factors:

**The price of our stock fluctuates substantially and may continue to do so**

The stock market has experienced large price and volume fluctuations that have affected the market price of many technology companies that have often been

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unrelated to the operating performance of these companies. These factors, as well as general economic and political conditions, may materially adversely affect the market price of our common stock in the future. The market price of our common stock may fluctuate significantly in response to a number of factors, including:

Actual or anticipated fluctuations in our operating results;

Changes in expectations as to our future financial performance;

Changes in financial estimates of securities analysts;

Changes in market valuations of other technology companies;

Announcements by us or our competitors of significant technical innovations, design wins, contracts, standards or acquisitions;

Charges and costs related to litigation and other extraordinary events;

The operating and stock price performance of other comparable companies; and

The number of our shares that are available for trading by the public and the trading volume of our shares.

Due to these factors, the price of our stock may decline and the value of your investment would be reduced. In addition, the stock market experiences volatility often unrelated to the performance of particular companies. These market fluctuations may cause our stock price to decline regardless of our performance.

### **Terrorist acts and acts of war may seriously harm our business, revenues, costs, expenses and financial condition**

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

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to financial market risks including changes in interest rates and foreign currency exchange rates.

The fair value of our investment portfolio or related income would not be significantly impacted by either a 10% increase or decrease in interest rates due mainly to the short-term nature of the major portion of our investment portfolio.

We carry out a significant portion of our operations outside of the United States, primarily in Canada and in India and to a lesser extent China, Japan, South Korea and Taiwan. Although virtually all of our revenues and costs of revenues are denominated in U.S. dollars, portions of our operating revenue and expenses are denominated in foreign currencies. Accordingly, our operating results are affected by changes in the exchange rate between the U.S. dollar and those currencies. Any future strengthening of those currencies against the U.S. dollar could negatively impact our operating results by increasing our operating expenses as measured in U.S. dollars. We do not currently engage in any hedging or other transactions intended to manage the risks relating to foreign currency exchange rate fluctuations, other than natural hedges that occur as a result of holding both assets and liabilities denominated in foreign currencies. We may in the future undertake hedging or other such transactions if we determine that it is necessary to offset exchange rate risks. Based on our overall currency rate exposure at June 30, 2003, a near-term 10% appreciation or depreciation in the U.S. dollar relative to a pool of our foreign currencies would not have a material effect on our operating results or financial condition.

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**ITEM 4. CONTROLS AND PROCEDURES**

- (a) *Evaluation of disclosure controls and procedures.* Our management evaluated, with the participation of our Interim Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, our Interim Chief Executive Officer and Chief Financial Officer has concluded that our disclosure controls and procedures as of the end of the period covered by this report are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

Our disclosure controls and procedures provide our Interim Chief Executive Officer and Chief Financial Officer reasonable assurances that our disclosure controls and procedures will achieve their objectives. However, company management, including our Interim Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal controls will prevent all human error. A control system, no matter how well designed and implemented, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Furthermore, the design of a control system must reflect the fact that there are internal resource constraints, and the benefit of controls must be weighed relative to their corresponding costs. Because of the limitations in all control systems, no evaluation of controls can provide complete assurance that all control issues and instances of error, if any, within our company are detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur due to human error or mistake. Additionally, controls, no matter how well designed, could be circumvented by the individual acts of specific persons within the organization. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated objectives under all potential future conditions.

- (b) *Changes in internal control over financial reporting.* There was no change in our internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II: OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

On April 24, 2001, Silicon Image, Inc. ( Silicon Image ) filed a patent infringement lawsuit against Genesis in the United States District Court for the Eastern District of Virginia and simultaneously filed a complaint before the United States International Trade Commission ( ITC ) in Washington, D.C. The complaint and suit alleged that certain Genesis products that contain digital receivers infringe various Silicon Image patent claims. Silicon Image was seeking an injunction to halt the sale, manufacture and use of Genesis's DVI receiver products and unspecified monetary damages. On December 7, 2001 Silicon Image formally moved to withdraw its complaint before the United States ITC and those proceedings have terminated. The trial in the case before the United States District Court for the Eastern District of Virginia was set for January 2003, but the trial was taken off the calendar of the court in December 2002. Beginning in January 2003, the parties filed case dispositive motions, which were heard by the court in March 2003. On July 15, 2003, the court issued a memorandum opinion, followed by a final judgment on August 6, 2003. In its opinion, the court ruled that Genesis and Silicon Image have settled their disputes based on a Memorandum of Understanding, or MOU, signed on December 18, 2002. The court's

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opinion states that the MOU is a binding settlement agreement. The MOU states that Genesis has received a license for the right to use non-necessary claims under the Digital Visual Interface (DVI) Adopters Agreement and allows Genesis to receive a license to the non-necessary claims under the High-Definition Multimedia Interface (HDMI) Adopters Agreement. In addition, the MOU provides that Genesis has been granted a license to expand use of necessary claims in the DVI Adopters Agreement to the consumer electronics marketplace. The court's opinion states that Genesis will pay Silicon Image a monetary settlement, license fee and running royalties on all DVI and HDMI products. The MOU further states that the companies will cooperate support and promote interoperability of DVI and HDMI. We made provision for costs associated with this patent litigation in the year ended March 31, 2003 of \$9,671,000. We do not expect to incur any running royalties for at least the next year as a result of the court's ruling. However, the future financial impact arising from any appeal or other legal actions related to the dispute is not yet determinable and no other provision has been made in our consolidated financial statements for any future costs associated with this claim.

On March 14, 2002, Genesis filed a patent infringement lawsuit against Media Reality Technologies, Inc. ( MRT ), SmartASIC Inc., and Trumpion Microelectronics, Inc. ( Trumpion ) in the United States District Court for the Northern District of California. The complaint alleges that certain MRT and Trumpion products, which are sold as video/graphics display controllers, infringe various claims of a Genesis U.S. patent. This patent has also been issued in Japan and Korea and is pending in Taiwan. As part of this lawsuit, Genesis is seeking monetary damages and a permanent injunction that bars MRT and Trumpion from making, using, importing, offering to sell, or selling the allegedly infringing products in the United States. On September 17, 2002, Genesis filed a similar patent infringement complaint against the three companies in the United States International Trade Commission ( ITC ), as discussed below. Except for the counterclaims by MRT discussed below, the Northern District of California case has been stayed pending the outcome of the ITC action. On January 8, 2003, Genesis announced a settlement of its litigation against SmartASIC Inc.; the litigation with respect to the other defendants has not been settled. MRT has asserted counterclaims against Genesis, alleging trade secret misappropriation, interference with economic advantage, and unfair practices and competition. Genesis intends to vigorously defend against these claims. The future financial impact of these claims is not yet determinable and no provision has been made in our consolidated financial statements for any future costs associated with these claims.

On September 17, 2002, Genesis filed a patent infringement complaint against MRT, SmartASIC Inc., and Trumpion in the ITC. The Genesis legal action alleges that MRT's Mascot series products, and Trumpion's ZURAC and Zipro series products infringe on Genesis's patented technology. Genesis is seeking an order from the ITC to exclude MRT and Trumpion's products and other products containing MRT or Trumpion's products from entry into the United States. On October 15, 2002, the ITC voted to institute an investigation into the complaint. On January 8, 2003, Genesis announced a settlement of its litigation against SmartASIC Inc.; the litigation with respect to the other defendants has not been settled. The future financial impact of these claims is not yet determinable and no provision has been made in our consolidated financial statements for any future costs associated with these claims.

On March 10, 2003, Genesis filed a second patent infringement complaint against MRT and Trumpion in the ITC. The Genesis legal action alleges that MRT's Mascot series products, and Trumpion's ZURAC and Zipro series products, infringe Genesis's patented technology. Genesis is seeking an order from the ITC to exclude MRT and Trumpion's products and other products containing MRT or Trumpion's products from entry into the United States. On April 8, 2003, the ITC voted to institute an investigation into the complaint. On May 30, 2003, Genesis filed an amended complaint to add Mstar Semiconductor, Inc. ( Mstar ) as a respondent. On July 22, 2003, the ITC released its order adding Mstar to that complaint. The future financial impact of these claims is not yet determinable and no provision has been made in our consolidated financial statements for any future costs associated with these claims.

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On November 7, 2002, a putative securities class action captioned Kuehbeck v. Genesis Microchip et al., Civil Action

No. 02-CV-05344, was filed against Genesis, former Chief Executive Officer Amnon Fisher, and Interim Chief Executive Officer and Chief Financial Officer Eric Erdman, and amended on July 3, 2003 to include Chief Operating Officer Anders Frisk (collectively the Individual Defendants ) in the United States District Court for the Northern District of California. The complaint alleges violations of Section 10(b) of the Securities and Exchange Act of 1934 (the Exchange Act ) and Rule 10b-5 promulgated thereunder against Genesis and the Individual Defendants, and violations of Section 20(a) of the Exchange Act against the Individual Defendants. The complaint seeks unspecified damages on behalf of a purported class of purchasers of Genesis's common stock between April 29, 2002 and June 14, 2002. Genesis believes that it has meritorious defenses to these lawsuits and will defend the litigation vigorously. The future financial impact of this claim is not yet determinable and no provision has been made in our consolidated financial statements for any future costs associated with this claim.

On September 20, 2002, Genesis received a letter from a lawyer representing former executive officer Arun Johary alleging, among other things, that he was wrongly precluded from exercising his options and selling his shares of Sage, Inc. and later Genesis in connection with the acquisition of Sage by Genesis. Mr. Johary alleges that as a combined result of certain decisions not to allow him to sell his shares, he suffered a total economic loss of approximately \$4.1 million dollars. On April 25, 2003, Mr. Johary filed a demand for arbitration with the American Arbitration Association regarding the same issues raised in his letter. The demand for arbitration alleges fraud, deceit and misrepresentation, omission of material fact, breach of fiduciary duty, negligence and breach of contract against Genesis, Sage and former Chief Executive Officer Amnon Fisher. Genesis believes Mr. Johary's claims are without legal merit. The company is currently in settlement negotiations with Mr. Johary.

An unfavorable resolution of any of these lawsuits could have a material adverse effect on Genesis's business, results of operations or financial condition.

We are not a party to any other material legal proceedings.

## **ITEM 5. OTHER INFORMATION**

On August 5, 2003, we agreed to terminate our merger agreement with Pixelworks, Inc. For more information, please see the Form 8-K we filed on August 6, 2003.

On July 29, 2003, we furnished a Report on Form 8-K related to the announcement of our financial results for our fiscal quarter ended June 30, 2003.

On July 20, 2003, we announced that James E. Donegan had resigned as our Chairman of the Board and Chief Executive Officer, effective immediately, and that Eric Erdman will serve as our Interim Chief Executive Officer until Mr. Donegan's successor is determined. During this period, Mr. Erdman will continue as our Chief Financial Officer. We also stated that our Board of Directors had elected Jeffrey Diamond, a current member of our Board of Directors, to be our Chairman of the Board.

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On May 12, 2003, the audit committee of the board of directors approved the use of the company's auditors, KPMG LLP, for certain tax planning and compliance services, and for services in connection with the merger with Pixelworks, Inc.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits

- 3.1<sup>(1)</sup> Certificate of Incorporation of the Registrant.
- 3.2<sup>(2)</sup> Amended and Restated Bylaws of the Registrant.
- 3.3<sup>(3)</sup> Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Registrant.
- 4.1<sup>(1)</sup> Form of Common Stock Certificate of the Registrant.
- 4.2<sup>(3)</sup> Preferred Stock Rights Agreement, dated as of June 27, 2002, between the Registrant and Mellon Investor Services, L.L.C.
- 10.21<sup>(4)</sup> Settlement Agreement and Release with James E. Donegan.
- 10.22<sup>(5)</sup> Termination and Release Agreement, dated as of August 5, 2003, among Genesis Microchip Inc., Display Acquisition Corporation and Pixelworks, Inc.



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- 31 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- (<sup>1</sup>)Incorporated by reference to the Registrant's Registration Statement on Form S-4 (File No. 333-72202) filed with the Securities and Exchange Commission on October 25, 2001, as amended.
- (<sup>2</sup>)Incorporated by reference to the Registrant's Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on July 29, 2002.
- (<sup>3</sup>)Incorporated by reference to the Registrant's Registration Statement on Form 8-A12G filed with the Securities and Exchange Commission on August 5, 2002, as amended by the Registrant's Statement on Form 8-A12G/A filed with the Securities and Exchange Commission on March 31, 2003.
- (<sup>4</sup>)Incorporated by reference to the Registrant's Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on July 29, 2003.
- (<sup>5</sup>)Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on August 6, 2003.

**(b) Reports on Form 8-K**

We furnished a Report on Form 8-K on May 1, 2003 related to the announcement of our financial results for our fiscal fourth quarter ended March 31, 2003.

**SIGNATURE**

Our authorized representative has signed this report on our behalf as required by the Securities Exchange Act of 1934.

GENESIS MICROCHIP INC.

By: /s/ ERIC ERDMAN

Eric Erdman

Interim Chief Executive Officer;

Chief Financial Officer

(Authorized Officer &

Principal Financial Officer)

Date: August 14, 2003