

GENESIS MICROCHIP INC /DE
Form 10-K/A
July 29, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Mark one)

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

For the fiscal year ended March 31, 2003

OR

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

Commission file number: 000-31376

GENESIS MICROCHIP INC.

(Exact name of registrant as specified in its charter)

DELAWARE
(State of incorporation)

77-0584301
(IRS employer identification number)

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2150 GOLD STREET

P.O. BOX 2150

ALVISO, CALIFORNIA
(Address of principal executive offices)

95002
(Zip Code)

(408) 262-6599

(Registrant's telephone number)

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

Shares of Common Stock, \$0.001 par value

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 No

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of shares of common stock held by non-affiliates at September 30, 2002 was \$236,441,165, based on the last reported sale price of our common stock on The Nasdaq National Market on that date of \$7.67 per share. We had 31,259,621 shares of common stock outstanding at September 30, 2002.

We had 31,276,061 shares of common stock outstanding at May 21, 2003.

DOCUMENTS INCORPORATED BY REFERENCE

This Amendment to Form 10-K includes the information required by Items 10, 11, 12 and 13 pursuant to General Instruction G(3). Part II, Item 7 incorporates by reference information from the Form S-4 filed by Pixelworks, Inc. with the Securities and Exchange Commission on April 18, 2003, as amended on July 3, 2003, a copy of which information is attached as an exhibit to this Amendment to Form 10-K.

Statement regarding forward-looking statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements relate to expectations concerning matters that are not historical facts. Words such as projects, believes, anticipates, plans, expects, intends and similar words and expressions are intended to identify forward-looking statements. We believe that the expectations reflected in the forward-looking statements are reasonable but we cannot assure you that those expectations will prove to be correct. Important factors that could cause our actual results to differ materially from those expectations are disclosed in this report, including, without limitation, in the Risk Factors described in Item 7. All forward-looking statements are expressly qualified in their entirety by these factors and all related cautionary statements. We do not undertake any obligation to update any forward-looking statements.

Trademarks

Genesis with its logo, Genesis Display Perfection, SmartSCAN[®], RealColor[®], Real Recovery, Ultra-Reliable DVI[®], Faroudja[®], Nuon[®] and DCDi by Faroudja[®] are our trademarks or registered trademarks. This report also refers to the trademarks of other companies.

Internet Site

Our Internet address is www.genesis-microchip.com. We make publicly available free of charge on our Internet website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

PART I

Item 1. *Business:*

Overview

We design, develop and market integrated circuits that receive and process digital video and graphic images. Our integrated circuits are typically located inside a display device and process incoming images for viewing on that display. We are currently targeting flat-panel computer monitor, flat-panel television and progressive scan cathode ray tube, or CRT, television applications and other potential high-volume applications.

The transition from analog display systems, such as most televisions and computer monitors that use cathode ray tubes, to digital display systems that use a fixed matrix of pixels to represent an image, requires sophisticated digital image-processing solutions. Our products solve input, resolution, format and frame refresh rate conversion problems while maintaining critical image information and improving perceived image quality. Our products utilize patented algorithms and integrated circuit architectures as well as advanced integrated circuit design and system design expertise.

We began business as a Canadian company in 1987, and changed our domicile to become a Delaware corporation in February 2002. Until 1999 we were focused primarily on developing digital image processing technologies. In May 1999 we acquired a private U.S. corporation, Paradise Electronics, Inc., which, in addition to developing digital image processing technologies, was developing analog and mixed signal communications technologies. We have now combined analog and mixed signal technologies with digital image processing technologies into more comprehensive semiconductor solutions.

In February 2002, we acquired a public U.S. corporation, Sage, Inc. 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 March 2002 we acquired the technology assets of VM Labs, Inc. Those technologies include digital video decoding and audio technologies. We believe that these recent 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 will 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, will 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 is 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 is 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 have entered into voting agreements with Pixelworks obligating them to vote in favor of adoption of the Agreement.

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 and Taiwan. For a geographical

breakdown of our revenues and long-lived assets, see note 17 to our consolidated financial statements included in Item 8 of this report.

Markets and applications

Our targeted applications include the following:

Flat Panel Computer Monitors. Flat panel computer monitors using liquid crystal displays, or LCDs, are increasingly replacing monitors that use CRTs. For the year ended March 31, 2003, the flat panel computer monitor market represented 84% of our total revenues. Companies whose flat panel computer monitors incorporate our products include BenQ, Dell, Fujitsu, Gateway, Hewlett-Packard, IBM, Legend, NEC, Philips, Samsung, Sony, ViewSonic and many other leading brands.

Consumer Digital Television. We are leveraging our technologies and continue to produce products for consumer digital television applications. These potential applications include home theater, DVD, flat panel and digital television and HDTV. We have secured a number of design wins with leading manufacturers for these applications.

Products

The following table shows our principal integrated circuit product families at March 31, 2003:

| <u>Product Family</u> | <u>Description</u> | <u>Markets</u> | <u>Product Features</u> |
|-----------------------|--|--|---|
| FLI22xx/FLI23xx | Video format conversion and image enhancement processors | CRT TV, flat panel TV, DVD player, video projectors | Motion adaptive de-interlacing; film mode control; noise reduction; image enhancement |
| gm15xx/gm16xx | Graphics/TV video processors for SXGA-WUXGA resolutions | Flat panel monitors, flat panel TV, video projectors | Integrated analog-to-digital converters; image scaling; advanced color controls; advanced OSD controller; LCD panel timing controller; motion adaptive de-interlacing; film mode control; picture in picture controller |
| gm21xx | Integrated analog LCD monitor controllers (for XGA and SXGA-resolution monitors) | LCD monitors and other fixed-resolution pixelated displays | Integrated analog-to-digital converters; image scaling; advanced color controls; advanced OSD controller; LCD panel timing controller (select models) |
| gm31xx | DVI interface LCD monitor controllers for XGA and SXGA resolutions | LCD monitors and other fixed-resolution pixelated displays | Integrated DVI receiver; image scaling; advanced color controls; advanced OSD controller; LCD panel timing controller (select models) |
| gm50xx | Dual interface analog and DVI LCD monitor controllers (for XGA to UXGA resolutions) | Multi-synchronous LCD monitors and other fixed-resolution pixelated displays | Integrated DVI receiver; analog-to-digital converter; image scaler; RealColor color adjustment technology; advanced OSD controller |
| gm51xx | Dual interface Analog and DVI LCD monitor controllers (for XGA and SXGA-resolution monitors) | LCD monitors and other fixed-resolution pixelated displays | Integrated DVI receiver; analog-to-digital converters; Image scaling; advanced color controls; advanced OSD controller; LCD panel timing controller (select models) |
| gm60xx | Digital TV video processors | CRT TV, Flat panel TV, Video projectors | Motion adaptive de-interlacing; film mode control; picture-in-picture controller |
| gm7030 | Digital CRT interface controller | Digital CRT displays | Integrated DVI interface; analog to digital converters; High-Bandwidth Digital Content Protection (HDCP); color controls; image format conversion; digital to analog converter |
| gmZANx | Analog interface LCD monitor controllers (for XGA-resolution monitors) | LCD monitors and other fixed-resolution pixelated displays | Integrated analog-to-digital converter; Image scaler; OSD controller |

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JagASM

Analog and digital interface
LCD monitor controllers (for
SXGA to UXGA-resolution
monitors)

Multi-synchronous LCD
monitors and other
fixed-resolution pixelated
displays

Integrated analog-to-digital
converter (JagASM); Image
scaler; picture in picture
controller; Advanced OSD
controller

Jag200

Research and development

Our research and development efforts are performed within the following specialized groups:

Algorithm Development Group: focuses on developing high-quality image processing technologies and their implementation in silicon.

Product Development Group: focuses on developing standard semiconductor components to service our monitor and computer OEM customers and providing them with a complete turnkey solution, which reduces their time to market. In addition we develop semiconductor components to serve customers who are designing products for new market applications, such as flat-panel television and progressive scan CRT television markets and other potential mass markets.

Applications Engineering Group: produces evaluation boards and reference designs for both LCD monitors and LCD television applications that facilitate the integration of our products into the end products manufactured by our customers.

Software Engineering Group: develops the software environment required for our products to work within target systems. Software is now embedded in many of our products. The other major role of software engineering is tool development. We provide sophisticated software tools to help our customers develop their applications and customize their software to improve the productivity of those engineers involved in the process of getting their products into production.

As of March 31, 2003, we had 185 full-time employees engaged in research and development. Expenditures for research and development, including non-cash stock-based compensation, were \$38.1 million for the year ended March 31, 2003, \$21.8 million for the year ended March 31, 2002 and \$17.4 million for the year ended March 31, 2001.

Customers, sales and marketing

We sell and market our products directly to customers, through regional sales representatives and through distributors. Our sales and marketing personnel work closely with customers, industry leaders, sales representatives and our distributors to define features, performance, price and market timing of new products. In China, South Korea and Taiwan we sell our products through our local sales and technical support offices. In North America we sell through technically trained sales representatives and distributors. In Europe, we sell our products through distributors. In Japan, we sell our products through both technically trained sales representatives and through distributors. Regardless of the sales channels used, we provide technical support and design assistance directly to our customers. We focus on developing long-term customer relationships with both system manufacturers and equipment manufacturers.

We provide direct service and support to our customers through our offices in the United States, Canada, Japan, South Korea, China and Taiwan. Our sales representatives and our distributors also provide ongoing support and service on our behalf. We provide customer support through both on-site customer service and through remote support from our various facilities. We generally provide a one-year warranty for our integrated circuit products.

Our revenues are derived primarily from sales of our semiconductor components into the flat panel monitor market. For the year ended March 31, 2003, 84% of our revenues came from this market. As a result, we derive a substantial portion of our revenues from a limited number of products. For the year ended March 31, 2003, our gm5020 dual interface product contributed 26% of our revenues and our top five products

contributed 52% of our total revenues.

Our sales are also derived from a limited number of customers, with our largest five customers accounting for 55% of total revenues in fiscal 2003, 53% of total revenues in fiscal 2002 and 31% of total revenues in fiscal 2001.

For the year ended March 31, 2003, two customers, Samsung Electronics Co. and LG Electronics, Inc. each accounted for more than 10% of our total revenues. For the year ended March 31, 2002, two customers, Samsung Electronics Co. and Top Victory Electronics Co., each accounted for more than 10% of our total revenues. For the year ended March 31, 2001, no customer accounted for more than 10% of our total revenues. At March 31, 2003, four customers each represented more than 10% of accounts receivable trade. At March 31, 2002, no customer represented more than 10% of accounts receivable trade. The loss of any significant customer could have a material adverse impact on our business.

We sell our products primarily outside of the United States. For the year ended March 31, 2003, 86% of our revenues were from sales to China, Japan, South Korea and Taiwan, and 7% of our revenues were from customers in the United States.

Additional information on the concentration of our revenues by geography, customers and markets can be found in note 17 to our consolidated financial statements included in Item 8 of this report.

As of March 31, 2003, our sales and marketing force totaled 129 people. This included 46 field applications engineers whose role is to create reference designs and assist our customers to incorporate our integrated circuits into their products.

Manufacturing

Third parties with state-of-the-art fabrication equipment and technology manufacture our products. This approach enables us to focus on product design and development, minimizes capital expenditures and provides us with access to advanced manufacturing facilities. Most of our products use silicon wafers manufactured by Taiwan Semiconductor Manufacturing Corporation, with whom we have a fixed-term sole source arrangement. Currently, our products are being fabricated, assembled or tested by Advanced Semiconductor Engineering, International Semiconductor Engineering Labs, Siliconware Precision Industries Ltd., ST Microelectronics, Taiwan Semiconductor Manufacturing Corporation and United Microelectronics Corporation.

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 produced using 0.25 or 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.

All of our products are sourced such that we have only one supplier for any one device. Based on our current production volumes, this approach of single sourcing is reasonable. As our volumes grow, we intend to secure sufficient fabrication capacity and diversify our sources of supply. Any inability of a current supplier to provide adequate capacity would require us to obtain products from alternate sources. There is a considerable amount of time required to change wafer fabrication suppliers for any single product, as well as substantial costs to bring that supplier into volume production. Should a source of a product cease to be available, we believe that this would have a material adverse effect on our business, financial condition and results of operations. We have no guarantees of minimum capacity from our suppliers and are not liable for minimum purchase commitments.

Intellectual property and licenses

We protect our technology through a combination of patents, copyrights, trade secret laws, trademark registrations, confidentiality procedures and licensing arrangements. We have over 140 United States and foreign patents with additional patent applications pending. In addition to the United States, we apply for and have been granted numerous patents in other jurisdictions, including Europe, Canada, Japan, Taiwan and South Korea. Our patents relate to various aspects of algorithms, product design or architectures. To supplement our proprietary technology, we also license several patents from third parties.

We have patents in the areas of scaling and format detection that are material to our monitor business that expire in 2017. We believe that our patents are enforceable and have significant value to our business. However, we do not believe that our patents prohibit third parties from competing with us, as other parties may be able to design competing products without relying on our patents. In addition, our ability to enforce our patents is subject to general litigation risks. In protecting our patents, we may need to litigate to assure our patents are not infringed. Litigation can be time-consuming and expensive, and there can be no assurance that we will be successful in any litigation we undertake. In addition, an unfavorable outcome in litigation could result in invalidation of the patents we assert.

Competition

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 face competition from 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.

We believe that the principal competitive factors in our markets are:

product design features and performance,

product price,

the time to market of our products, and

the quality and speed of customer support.

Backlog

Our customers typically order products by way of purchase orders that may be canceled or rescheduled without significant penalty. These purchase orders are subject to price negotiations and to changes in quantities of products and delivery schedules in order to reflect changes in their requirements and manufacturing availability. Historically, most of our sales have been made pursuant to short lead-time orders. In addition, our actual shipments depend on the manufacturing capability of our suppliers and the availability of products from those suppliers. As a result of the foregoing factors, we do not believe the backlog at any given time is a meaningful indicator of our future revenues.

Employees

As of March 31, 2003, we employed a total of 393 full-time employees, including 185 in research and development, 129 in sales and marketing, 36 in manufacturing operations and 43 in finance and administration. We employ a number of temporary and part-time employees and consultants on a contract basis. Our employees are not represented by a collective bargaining organization. We believe that relations with our employees are satisfactory.

Executive Officers

The following table lists the names and positions held by each of our executive officers as of July 20, 2003:

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|--------------------|------------|--|
| Eric Erdman | 45 | Interim Chief Executive Officer; Chief Financial Officer, Secretary and Director |
| Tzoyao Chan | 50 | Senior Vice President, Engineering |
| Anders Frisk | 47 | Chief Operating Officer |
| Ken Murray | 52 | Vice President, Human Resources |
| Matthew Ready | 44 | Senior Vice President, Sales |
| Mohammad Tafazzoli | 43 | Vice President, Operations |

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Eric Erdman was named Interim Chief Executive Officer effective July 20, 2003. Mr. Erdman has served as Chief Financial Officer since March 2002 and previously held the position from December 1997 to February 2002. Mr. Erdman has served as Secretary since June 2002 and in the period from October 1995 to February 2002. Mr. Erdman became a Director on May 13, 2003 and previously served as a Director from October 1995 to September 1996. From March 2002 to June 2002 Mr. Erdman served as Assistant Secretary. Mr. Erdman joined Genesis in July 1995 as Director, Finance and Administration and served as Vice President, Finance and Administration from July 1996 to May 1999. Mr. Erdman holds a Bachelor of Mathematics degree from the University of Waterloo, and he is a member of the American Institute of Certified Public Accountants and of the Canadian Institute of Chartered Accountants.

Tzoyao Chan joined Genesis in May 1999 as the result of the merger with Paradise Electronics. Before joining Paradise in 1997, Dr. Chan was Director of Engineering at Cirrus Logic. He has also held various engineering and management positions at leading chip-design companies including Bell Labs (now Lucent Technology), Intel Corp, LSI Logic, Chips & Technologies and S3. Dr. Chan holds a Ph.D. degree from the University of Arizona (Electrical Engineering).

Anders Frisk has been Chief Operating Officer since January 2003. He joined Genesis in March 2000 as Vice President, Marketing. Prior to then, he served as Director of Technology Planning with Nokia from February 1998 to March 2000, and as PC Architecture Manager with Fujitsu ICL Computers from April 1991 to January 1998. Mr. Frisk has served on the board of the Video Electronics Standards Association, or VESA, and chaired VESA's Monitor Committee for four years. Mr. Frisk holds a Master's degree in Electrical Engineering from Stockholm's Royal Institute of Technology.

Ken Murray joined Genesis in August 2000 as Vice President, Human Resources. He served as Vice President, Human Resources at Chordiant Software from November 1999 to August 2000 and at NeoMagic Corp. from July 1997 to November 1999. Mr. Murray holds a B.S. degree in Business Administration from San Jose State University.

Matthew Ready joined Genesis in April 2000. Prior to then, he served as General Manager of the Global PC Business Unit for Brooks Technical Group from July 1997. Mr. Ready was Vice President of Worldwide Sales for Array Microsystems from September 1996 to June 1997 and Vice President Sales with OPTi Computer from March 1991 to August 1996. Mr. Ready holds a B.S. degree in Business Administration from San Jose State University.

Mohammad Tafazzoli has served as Vice President, Operations since June 2000. He was previously the Director of Operations at Genesis and joined the company as a result of the merger with Paradise Electronics. Prior to joining Paradise, Mr. Tafazzoli was a Senior Manager, Product Engineering for Cirrus Logic's Graphics Business Unit from October 1993 to March 1998. Mr. Tafazzoli holds a B.S.E.E. degree from San Jose State University.

Item 2. *Properties:*

We lease offices in Alviso and Sunnyvale, California; Thornhill, Ontario, Canada; Bangalore, India; Taipei, Taiwan; Seoul, South Korea; Shenzhen, China; Suzhou, China; and Tokyo, Japan. We believe our existing facilities are adequate to meet our needs for the immediate future and that future growth can be accomplished by leasing additional or alternative space on commercially reasonable terms. Further information on our lease commitments can be found in note 16 to our consolidated financial statements included in Item 8 of this report.

Item 3. *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 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 have made provision for costs associated with 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 Trumpton Microelectronics, Inc. (Trumpton) 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; 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; 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.

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 Microchip 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 Microchip in connection with the acquisition of Sage by Genesis Microchip. 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 Microchip 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 4. Submission of Matters To a Vote of Security Holders:

None.

PART II**Item 5. Market for Our Common Stock and Related Stockholder Matters:****Market information**

Our common stock trades on the Nasdaq National Market under the symbol GNSS. We have not listed our stock on any other markets or exchanges. The following table shows the high and low closing prices for our common stock as reported by the Nasdaq National Market:

| | <u>High</u> | <u>Low</u> |
|----------------------------|-------------|------------|
| 2001 Calendar year | | |
| First Quarter | \$ 18.88 | \$ 9.31 |
| Second Quarter | \$ 37.40 | \$ 8.38 |
| Third Quarter | \$ 36.00 | \$ 19.70 |
| Fourth Quarter | \$ 69.81 | \$ 26.70 |
| 2002 Calendar year | | |
| First Quarter | \$ 72.51 | \$ 23.49 |
| Second Quarter | \$ 28.40 | \$ 7.72 |
| Third Quarter | \$ 9.31 | \$ 5.64 |
| Fourth Quarter | \$ 21.41 | \$ 6.40 |
| 2003 Calendar year | | |
| First Quarter | \$ 18.15 | \$ 10.49 |
| Second Quarter | \$ 19.02 | \$ 13.05 |
| Third Quarter (to July 15) | \$ 16.16 | \$ 14.26 |

As of July 15, 2003, we had approximately 215 common stockholders of record and a substantially greater number of beneficial owners.

Dividend policy

We have never declared or paid dividends on our common stock. We intend to retain our earnings for use in our business and therefore we do not anticipate declaring or paying any cash dividends in the foreseeable future. In addition, our Agreement and Plan of Merger with Pixelworks, Inc. prohibits us from paying dividends on our common stock without the written consent of Pixelworks.

Item 6. Selected Consolidated Financial Data:

Selected consolidated financial data for the last five fiscal years appears below (in thousands, except per share data):

| | Year Ended March 31 | | | | Ten Months Ended March 31, |
|--|---------------------|------------|-----------|-----------------|----------------------------------|
| | 2003 | 2002 | 2001 | 2000 | 1999 |
| Statements of Operations Data: | | | | | |
| Revenues | \$ 194,325 | \$ 163,370 | \$ 63,627 | \$ 53,332 | \$ 37,738 |
| Cost of revenues | 119,410 | 89,287 | 32,416 | 17,021 | 14,062 |
| Gross profit | 74,915 | 74,083 | 31,211 | 36,311 | 23,676 |
| Operating expenses: | | | | | |
| Research and development | 38,108 | 21,762 | 17,413 | 16,065 | 10,261 |
| Selling, general and administrative | 36,231 | 21,469 | 15,947 | 12,364 | 10,307 |
| Amortization of acquired intangibles | 10,627 | 1,032 | | | |
| Provision for costs associated with patent litigation | 9,671 | | | | |
| Restructuring | | 1,858 | | | |
| In-process research and development | | 4,700 | | | |
| Merger-related costs | | | | 3,455 | |
| Total operating expenses | 94,637 | 50,821 | 33,360 | 31,844 | 20,568 |
| Income (loss) from operations | (19,722) | 23,262 | (2,149) | 4,427 | 3,108 |
| Interest and other income, net | 946 | 1,463 | 2,328 | 1,941 | 1,436 |
| Income (loss) before income taxes | (18,766) | 24,725 | 179 | 6,368 | 4,544 |
| Provision for (recovery of) income taxes | (4,140) | 6,729 | (2,483) | 360 | (986) |
| Net income (loss) | \$ (14,636) | \$ 17,996 | \$ 2,662 | \$ 6,008 | \$ 5,530 |
| Earnings (loss) per share: | | | | | |
| Basic | \$ (0.47) | \$ 0.82 | \$ 0.14 | \$ 0.32 | \$ 0.31 |
| Diluted | \$ (0.47) | \$ 0.74 | \$ 0.13 | \$ 0.30 | \$ 0.29 |
| Weighted average number of shares of common stock outstanding: | | | | | |
| Basic | 31,248 | 22,025 | 19,406 | 18,756 | 18,027 |
| Diluted | 31,248 | 24,177 | 19,884 | 19,922 | 19,365 |
| | | | | March 31 | |
| | 2003 | 2002 | 2001 | 2000 | 1999 |
| Balance Sheets Data: | | | | | |
| Cash and cash equivalents | \$ 113,138 | \$ 106,564 | \$ 32,827 | \$ 42,942 | \$ 38,479 |
| Working capital | 131,931 | 139,633 | 53,190 | 50,661 | 50,131 |
| Total assets | 402,654 | 428,391 | 81,446 | 71,791 | 64,815 |
| Total long-term liabilities, net of current portion | | 328 | 410 | 518 | 504 |
| Stockholders' equity | 373,833 | 383,571 | 70,389 | 65,247 | 55,408 |

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Results of operations for the fiscal years ended March 31, 2002 and March 31, 2003 include the financial impacts of the acquisitions of Sage, Inc. and the assets of VM Labs, Inc. from the dates they were acquired. Both acquisitions occurred in the fourth quarter of the fiscal year ended March 31, 2002, as described in Item 7 below.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations:

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 and other potential mass markets. We market and sell our products through authorized distributors and directly to customers with the support of regional sales representatives. Average selling prices to distributors are typically less than average selling prices to direct customers. 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.

We recognize revenue from product sales upon shipment, other than to distributors where we recognize revenue upon the distributor's 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.

We have limited ability to reschedule purchase orders to our suppliers and we 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 year ended March 31, 2003, we recorded inventory provisions totaling \$2.1 million (2002 \$666,000). We have agreements with suppliers in Asia such that we are dependent on the suppliers' manufacturing yields.

We earn investment tax credits under the provisions of the Income Tax Act (Canada) because we carry out qualifying research and development activities in Canada. These tax credits are earned at a rate of 20% of those qualifying expenditures. The tax credits earned may only be applied to reduce income taxes payable in Canada. We currently have losses and deductions available to reduce future years' taxable income in both Canada and the United States. Most of these losses and deductions can be carried forward for periods in excess of seven years, and in some cases, indefinitely. Details of these losses and deductions can be found in note 14 to our consolidated financial statements, which are included in Item 8 of this report.

On May 28, 1999, we merged with Paradise Electronics, Inc., a private company, and adopted a new fiscal year effective April 1, 1999. The merger with Paradise was accounted for using the pooling-of-interests method of accounting.

On February 19, 2002, we acquired all of the outstanding shares of Sage, Inc. in exchange for 8,819,120 of our shares of common stock. Sage, a public company, designed, developed and marketed digital display and video processors. We also assumed the remaining outstanding stock

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options of Sage, which were converted to options to purchase 1,407,128 shares of our common stock. The aggregate purchase price was approximately \$296.7 million, consisting of our common stock valued at approximately \$241.5 million, our stock options valued at approximately \$31.9 million, and direct acquisition costs estimated at approximately \$23.3 million.

On March 22, 2002, we acquired substantially all of the assets of VM Labs, Inc., including all patents, trademarks and other intellectual property, for cash and the assumption of certain liabilities. The aggregate purchase price, including associated costs, was \$14.2 million. We won a public auction of those assets that culminated in a federal Bankruptcy Court proceeding held on February 28, 2002. In connection with that acquisition, we hired former employees of VM Labs. Because the date of closing on the purchase of VM Labs assets was late in our 2002 fiscal year, that acquisition had a negligible impact on our fiscal 2002 results of operations.

We accounted for the acquisitions of Sage and the assets of VM Labs using the purchase method of accounting. Those acquisitions gave rise to several expenses in fiscal 2002 and subsequent periods that were not present in prior years, including in-process research and development costs, restructuring expenses and the amortization of acquired intangibles. For example, we recorded a \$4.7 million charge for in-process research and development in fiscal 2002 related to the Sage acquisition and we have recorded amortization of acquired intangible assets of \$10.6 million in fiscal 2003 and \$1.0 million in fiscal 2002. In addition, costs resulting from the acquisition of Sage related to the amortization of deferred stock compensation are included in research and development and in selling, general and administrative expenses. Amortization of deferred stock-based compensation totaled \$6.8 million in fiscal 2003 and \$850,000 in fiscal 2002. We expect that there will be ongoing amortization expense for acquired intangibles

and deferred stock-based compensation in future years. Further details on these amounts can be found in note 4 to our consolidated financial statements included in Item 8 of this report.

On January 8, 2003, we entered into a settlement agreement with SmartASIC Technology, Inc. with respect to patent infringement complaints filed by us against SmartASIC in the U.S. International Trade Commission and the Federal District Court of the Northern District of California. The settlement agreement allows SmartASIC to make limited use of our patented technology as part of our cooperative relationship. The settlement agreement does not affect ongoing patent infringement complaints we have filed against other companies.

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 will 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, will 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 is 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 is 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 have entered into voting agreements with Pixelworks obligating them to vote in favor of adoption of the Agreement.

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, 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, prepaid expenses, 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 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.

We provide for valuation reserves against our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the 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 for patent litigation when we believe 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.

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 the percentage of total revenues represented by each category of cost or expense in our consolidated statements of operations for the years indicated:

| | Year Ended March 31, | | |
|---|----------------------|--------|---------|
| | 2003 | 2002 | 2001 |
| Revenues | 100.0 % | 100.0% | 100.0 % |
| Cost of revenues | 61.4 | 54.7 | 50.9 |
| Gross profit | 38.6 | 45.3 | 49.1 |
| Operating expenses: | | | |
| Research and development | 19.6 | 13.3 | 27.4 |
| Selling, general and administrative | 18.6 | 13.1 | 25.1 |
| Amortization of acquired intangibles | 5.5 | 0.6 | |
| Provision for costs associated with patent litigation | 5.0 | | |
| Restructuring | | 1.2 | |
| In-process research and development | | 2.9 | |
| Total operating expenses | 48.7 | 31.1 | 52.5 |
| Income (loss) from operations | (10.1) | 14.2 | (3.4) |
| Interest and other income, net | 0.5 | 0.9 | 3.7 |
| Income (loss) before income taxes | (9.6) | 15.1 | 0.3 |
| Provision for (recovery of) income taxes | (2.1) | 4.1 | (3.9) |
| Net income (loss) | (7.5)% | 11.0% | 4.2 % |

Total Revenues. Total revenues for the year ended March 31, 2003 increased by \$30.9 million to \$194.3 million from total revenues of \$163.4 million in the year ended March 31, 2002, an increase of 19%. Total revenues for the year ended March 31, 2002 increased by \$99.8 million, or 157%, from total revenues of \$63.6 million for the year ended March 31, 2001. The increase in total revenues over the last two fiscal years is primarily because of increased demand for our products in the flat panel monitor market. Revenues of Sage, Inc. are included in our total revenues from the date of acquisition, February 19, 2002. Those revenues amounted to \$8.3 million of the increase in total revenues for the year ended March 31, 2002.

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Revenues from the flat panel monitor market increased to \$163.2 million or 84% of total revenues in the year ended March 31, 2003 from \$145.0 million or 89% of total revenues in the year ended March 31, 2002, and from \$45.9 million, or 72%, of total revenues in the year ended March 31, 2001. These increases were a result of increased unit shipments into that market, partially offset by declining average selling prices. In fiscal 2003 our unit shipments increased 55% and our average selling prices declined 28% compared to fiscal 2002. In fiscal 2002, our unit shipments increased 311% and our average selling prices declined 23% compared to fiscal 2001.

The overall year-to-year growth of unit sales of flat panel monitors is attributable to decreases in their retail selling prices. This decline was primarily a result of reductions in the cost of LCD panels, which are the most expensive components used in flat panel monitors, resulting from additional manufacturing capacity and improved manufacturing yields for LCD panels. In fiscal 2003 and 2002, retail prices of flat panel computer monitors continued to decline due to competitive pressures, among other factors, increasing overall demand for flat panel computer monitors, however this trend was not uniform throughout those years. There were shortages of LCD panels in part of calendar 2002, which in turn caused significant increases in LCD panel costs and flat panel monitors before additional supply became available later in the 2002 calendar year.

Revenue from other markets increased to \$31.1 million in the year ended March 31, 2003, from \$18.4 million in the year ended March 31, 2002 and from \$17.7 million in the year ended March 31, 2001. Increases in revenue in these markets in fiscal 2003 are primarily attributable to our acquisition of Sage, Inc. in February 2002.

Gross Profit. Gross profit for the year ended March 31, 2003 increased to \$74.9 million from \$74.1 million in the year ended March 31, 2002, and from \$31.2 million in the year ended March 31, 2001. Gross profit represented 38.6% of total revenues in the 2003 fiscal year, 45.3% of total revenues in the 2002 fiscal year and 49.1% of total revenues in the 2001 fiscal year. The decrease in gross profit percentage in fiscal 2003 and fiscal 2002 was primarily due to our average selling prices declining faster than our average manufacturing costs in those years. The decrease in gross profit percentage in the fiscal 2001 year was primarily attributable to costs incurred in the fourth quarter of the 2001 fiscal year. These costs, which totaled \$5.5 million in that year, included costs attributable to the write down of our prior-generation products and initial low manufacturing yield associated with the line buffer sections in one of our products. \$1.3 million of these costs related to the write down of inventory on hand at March 31, 2001. Excluding these costs, our gross margin would have been 57.7% in fiscal 2001.

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 year ended March 31, 2003 increased to \$38.1 million from \$21.8 million in the year ended March 31, 2002 and from \$17.4 million in the year ended March 31, 2001. These expenses represented 19.6% of total revenues in the 2003 fiscal year, 13.3% of total revenues in the 2002 fiscal year and 27.4% of total revenues in fiscal 2001. The increase in absolute dollars in each year reflects greater personnel costs associated with an expansion in our research and development activities, increased prototype and pre-production expenses of new products. In particular, the increase in expenses in fiscal 2003 and to a lesser extent in fiscal 2002 resulted from increased research and development activities following our acquisition of Sage, including an increase in non-cash stock-based compensation charges. These charges amounted to \$5.4 million in fiscal 2003 and \$510,000 in fiscal 2002. The increase in expenses as a percentage of total revenues in fiscal 2003 resulted from the faster rate of growth in research and development expenses compared to growth in total revenues.

Selling, General and Administrative. Selling, general and administrative expenses consist of personnel, commissions and related overhead costs for selling, marketing, customer support, finance, human resources and general management functions. Selling, general and administrative expenses were \$36.2 million in the year ended March 31, 2003, \$21.5 million in the year ended March 31, 2002, and \$15.9 million in the year ended March 31, 2001. These expenses represented 18.6% of total revenues in the 2003 fiscal year, 13.1% of total revenues in the 2002 fiscal year and 25.1% of total revenues in the 2001 fiscal year. The dollar increase in selling, general and administrative expenses reflects increased personnel costs related to increased selling, administrative and customer support activities and increased commissions associated with higher sales volumes, as well as an increase in non-cash stock-based compensation charges arising from the acquisition of Sage of \$1.4 million in fiscal 2003 and \$460,000 in fiscal 2002. In addition, in fiscal 2001 we incurred \$0.9 million in costs of employee terminations and for professional fees and expenses associated with strategic initiatives that we terminated due to economic and market conditions. Excluding those costs, selling, general and administrative costs in fiscal 2001 would have been 23.6% of total revenues.

Interest and Other Income, net. Interest and other income in the year ended March 31, 2003 was \$946,000, compared with \$1.5 million in the year ended March 31, 2002 and \$2.3 million in the year ended March 31, 2001. The decline in interest income resulted from the decline in prevailing interest rates, offset in part by holding increased cash balances. Future interest income will depend on the amount of funds available to invest and on future interest rates. In addition, we incurred imputed interest expense on our long-term lease liability that was assumed in connection with our acquisition of Sage in fiscal 2002. This expense amounted to \$73,000 in fiscal 2002 and \$592,000 in fiscal 2003. Because we settled the obligation in the fourth quarter of fiscal 2003, we do not expect to incur this expense in the future.

Provision for (Recovery of) Income Taxes. Our tax provision is a combination of taxes on income offset by the research and development tax credits earned in Canada and the United States. 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.

Quarterly results of operations

The following table shows our unaudited quarterly statement of operations data for the most recent eight quarters reported. This unaudited data has been prepared on the same basis as our audited consolidated financial statements that are included in Item 8 of this report, and includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of such information for the periods presented. The statement of operations data should be read in conjunction with our consolidated financial statements and their related notes. Amounts in this table are in thousands, except per share data.

| | Three months ended | | | | | | | |
|--|--------------------|------------|------------|------------|-----------|-----------|-----------|-----------|
| | Mar. 2003 | Dec. 2002 | Sep. 2002 | Jun. 2002 | Mar. 2002 | Dec. 2001 | Sep. 2001 | Jun. 2001 |
| Revenues | \$ 54,780 | \$ 51,682 | \$ 46,304 | \$ 41,559 | \$ 56,104 | \$ 49,823 | \$ 36,137 | \$ 21,306 |
| Cost of revenues | 31,127 | 32,623 | 30,169 | 25,491 | 31,268 | 27,109 | 19,465 | 11,445 |
| Gross profit | 23,653 | 19,059 | 16,135 | 16,068 | 24,836 | 22,714 | 16,672 | 9,861 |
| Operating expenses: | | | | | | | | |
| Research and development | 10,194 | 8,493 | 9,992 | 9,429 | 7,085 | 5,292 | 5,161 | 4,224 |
| Selling, general and administrative | 9,479 | 8,942 | 9,113 | 8,697 | 7,335 | 5,380 | 4,538 | 4,216 |
| Amortization of acquired intangibles | 2,654 | 2,654 | 2,654 | 2,665 | 1,032 | | | |
| Provision for costs associated with patent litigation | | 9,671 | | | | | | |
| In-process research and development | | | | | 4,700 | | | |
| Restructuring | | | | | 1,858 | | | |
| Total operating expenses | 22,327 | 29,760 | 21,759 | 20,791 | 22,010 | 10,672 | 9,699 | 8,440 |
| Income (loss) from operations | 1,326 | (10,701) | (5,624) | (4,723) | 2,826 | 12,042 | 6,973 | 1,421 |
| Interest and other income, net | 14 | 430 | 279 | 223 | 332 | 378 | 399 | 354 |
| Income (loss) before income taxes | 1,340 | (10,271) | (5,345) | (4,500) | 3,158 | 12,420 | 7,372 | 1,775 |
| Provision for (recovery of) income taxes | 321 | (3,244) | (754) | (463) | 3,494 | 2,317 | 740 | 178 |
| Net income (loss) | \$ 1,019 | \$ (7,027) | \$ (4,591) | \$ (4,037) | \$ (336) | \$ 10,103 | \$ 6,632 | \$ 1,597 |
| Earnings (loss) per share: | | | | | | | | |
| Basic | \$ 0.03 | \$ (0.22) | \$ (0.15) | \$ (0.13) | \$ (0.01) | \$ 0.47 | \$ 0.32 | \$ 0.08 |
| Diluted | \$ 0.03 | \$ (0.22) | \$ (0.15) | \$ (0.13) | \$ (0.01) | \$ 0.42 | \$ 0.29 | \$ 0.08 |
| Weighted average number of shares of common stock outstanding: | | | | | | | | |
| Basic | 31,386 | 31,306 | 31,238 | 31,062 | 26,124 | 21,623 | 20,697 | 19,719 |
| Diluted | 32,815 | 31,306 | 31,238 | 31,062 | 26,124 | 23,798 | 22,617 | 21,244 |

Results of operations in fiscal 2003 and in the March 2002 quarter include the impacts of the acquisitions of Sage and the assets of VM Labs, both of which occurred in the March 2002 quarter and which were accounted for using the purchase method of accounting. Most of our revenues come from sales of semiconductors to manufacturers of flat panel computer monitors. In the June 2002 quarter, the price of LCD panels increased substantially which reduced demand for flat panel monitors and, in turn, for our products. Sales of semiconductor products to manufacturers of flat panel computer monitors is extremely price competitive. While we experienced significant increases in our unit volumes in the period June 2002 to March 2003, declines in average selling prices, or ASPs, to a large part offset revenue growth in that time period. Gross margins declined through the September 2002 quarter as a result of ASPs declining at a faster rate than reductions in average product costs. In the December 2002 and March 2003 quarters, ASPs declined at a lower rate than did product costs, resulting in improved gross margins.

Research and development expenses have varied from quarter to quarter primarily due to fluctuations in staff levels and the timing of non-recurring engineering charges related to new product development. In addition, since the March 2002 quarter, these expenses have increased as a result of greater staff levels, resulting from our acquisition of Sage and the hiring of former employees of VM Labs, and from costs to defend our intellectual property. Selling, general and administrative expenses have varied from quarter to quarter primarily due to increases in staffing levels for sales and customer support activities, and sales commissions. In addition, since the March 2002 quarter, we have had increases in these expenses as a result of increased staff levels resulting from our acquisition of Sage. Costs for amortization of acquired intangibles arose from the acquisition of Sage and the assets of VM Labs in the March 2002 quarter.

Our results of operations have fluctuated significantly in the past and may continue to fluctuate in the future as a result of a number of factors, many of which are beyond our control. These factors include those described under the caption Risk Factors, among others. Any one or more of these factors could result in our failure to achieve our expectations as to future operating results. Our expenditures for research and development, selling, general and administrative functions are based in part on future revenue projections. We may be unable to adjust spending in a timely manner in response to any unanticipated declines in revenues, which

may have a material adverse effect on our business, financial condition and results of operations. We may be required to reduce our selling prices in response to competitive pressure or other factors, or to increase spending to pursue new market opportunities or to defend ourselves against lawsuits that may be brought against us. Any decline in average selling prices of a particular product that is not offset by a reduction in product costs, or by sales of other products with higher gross margins, would decrease our overall gross profit and adversely affect our business, financial condition and results of operations.

Period-to-period comparisons of our operating results should not be relied upon as an indication of future performance. It is likely that in some future period our operating results or business outlook will be below the expectations of securities analysts or investors, which would likely result in a significant reduction in the market price for our shares of common stock.

Liquidity and capital resources

Cash and cash equivalents were \$113.1 million at March 31, 2003, \$106.6 million at March 31, 2002, and \$32.8 million at March 31, 2001. Cash generated from operations was \$16.3 million for the year ended March 31, 2003 and was \$16.7 million for the year ended March 31, 2002. For the year ended March 31, 2001, cash used by operations was \$10.1 million. The increase in cash flow from operations for fiscal 2003 and 2002 compared to the prior years was primarily the result of increased sales volume. The use of cash by operations in fiscal 2001 was largely the result of increased working capital balances, being principally increases in accounts receivable trade and inventory to support a growing sales volume. In the future we may require a larger inventory of products and increased levels of accounts receivable trade in order to support any expected growth in our business.

Net cash used in investing activities was \$5.1 million in the year ended March 31, 2003 and net cash generated by investing activities was \$19.4 million in the year ended March 31, 2002. Net cash used in investing activities was \$2.3 million in the year ended March 31, 2001. In fiscal 2003, cash was used for the purchase of capital assets resulting from the continued expansion of our business through the development of new products that required additional design tools and for costs associated with our proposed merger with Pixelworks, Inc. The fiscal 2002 increase in net cash was primarily provided by the cash and short-term investments of \$34.3 million acquired on the purchase of Sage, less the acquisition of the assets of VM Labs for cash of \$13.6 million. In fiscal 2001, cash was used for the purchase of capital assets, including investments in leasehold improvements for our facilities in Alviso, California and Thornhill, Ontario. At March 31, 2003, we have no significant capital spending or purchase commitments other than purchase commitments made in the ordinary course of business and costs associated with our proposed merger with Pixelworks. We currently estimate that those transaction costs will total approximately \$5.1 million, of which \$2.5 million had been incurred to March 31, 2003.

Net cash used by financing activities was \$4.6 million for the year ended March 31, 2003. Cash was used primarily for the repurchase of shares of our common stock for \$3.1 million and the repayment of a long-term lease obligation for \$7.3 million, offset by amounts received for the purchase of shares of common stock under our stock purchase and stock option plans totaling \$5.9 million. Net cash provided by financing activities for the year ended March 31, 2002 was \$37.7 million, and \$2.3 million for the year ended March 31, 2001. These consisted primarily of amounts received for the purchase of shares of common stock under our stock purchase and stock option plans.

As of March 31, 2003, our principal financial 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 locations 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 by fiscal year, excluding any expected sub-lease income, are as follows, in thousands of dollars:

| | |
|------------|-----------|
| 2004 | \$ 3,234 |
| 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 note 16 to our consolidated financial statements included in Item 8 of this report.

We are involved in certain litigation, including the litigation with Mr. Johary discussed in Item 3 above, that we believe may settle in the second quarter of fiscal year 2004 for total settlement payments by us of \$2 million or more. 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 the 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 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. 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 stockholders.

RISK FACTORS

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 known and unknown risks and uncertainties. You should carefully consider the risks described below, elsewhere in this report and in the documents that we have incorporated by reference into this report.

For risks associated with our proposed merger with Pixelworks, Inc., please see the section entitled "Risk Factors" of the Registration Statement on Form S-4 filed by Pixelworks, Inc. with the Securities and Exchange Commission on April 18, 2003, as amended on July 3, 2003. A copy of those risk factors is attached to this report as an exhibit and incorporated herein by reference. Please note that those merger risk factors concerning our litigation with Silicon Image, Inc. are qualified in their entirety by the developments set forth in this report under Item 3, "Legal Proceedings."

Factors that may affect future operating results

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 year ended March 31, 2003, 84% 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 55% of our revenues, and for our largest customer 26%, for the year ended March 31, 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 orders rather than long-term agreements so that any customer could cease purchasing products at any time without penalty. The decision by any large customer to decrease or cease using our products could harm our business.

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. Sales of our top five products accounted for 52% of our revenues for the year ended March 31, 2003. 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 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 memorandum opinion, 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.

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 have been defending 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 July 15, 2003, the court issued its order in the proceeding; see the developments set forth in this report under Item 3, Legal Proceedings. This or any future lawsuits could subject us to a permanent injunction preventing us from selling selected products or incurring significant monetary damages. Based on our revenue for the year ended March 31, 2003, approximately 42% of our revenues could be impacted by this patent litigation.

We may become subject to additional intellectual property litigation in the future. 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 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. 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,

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 revenues for the year ended March 31, 2003. Customers located in Taiwan were responsible for 17% of our revenues for the year ended March 31, 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.

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 year ended March 31, 2003, sales to regions outside of the United States represented 94% of revenues. For that same period, sales to South Korea alone constituted 40% 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.

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.

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.

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 acquisitions of Sage and the assets of VM Labs. 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 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.

We may lose key customers, foundries, licensors, sales representatives, other business partners, key management and other employees because of uncertainties surrounding our proposed merger with Pixelworks

In response to uncertainty concerning our proposed merger with Pixelworks, our customers and suppliers may delay or defer purchasing decisions, elect to switch suppliers or choose to terminate supply arrangements. Foundries, licensors, sales representatives and others doing business with us may also experience uncertainty about their future role with us and may elect not to continue business with us, or may seek to modify the terms under which they do business in ways that are less attractive, more costly, or otherwise damaging to our business. Any one of those events could harm our business. In addition, current employees, including key members of management, as well as prospective employees may experience uncertainty about their future role with us as a result of the merger, which may adversely affect our ability to attract and retain key management, marketing and technical personnel. The loss of or lack of continued efforts by key personnel could impair our product development and customer relationships, which could cause a decline in our sales, and could otherwise impair our business.

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 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 7a. *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 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 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 the 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 March 31, 2003, a near-term 10% appreciation or depreciation would not have a material effect on our operating results or financial condition.

Item 8. *Financial Statements and Supplementary Data:*

Financial Statements Table of Contents

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Selected Quarterly Financial Data is incorporated by reference from "Quarterly results of operations" on page 18 in Item 7 above.

INDEPENDENT AUDITORS REPORT

The Board of Directors and Stockholders of

Genesis Microchip Inc.

We have audited the accompanying consolidated balance sheets of Genesis Microchip Inc. as of March 31, 2003 and 2002 and the related consolidated statements of operations, stockholders' equity and cash flows for each of the three years in the period ended March 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Genesis Microchip Inc. as of March 31, 2003 and 2002 and the results of its operations and its cash flows for each of the three years in the period ended March 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

April 25, 2003, except for Note 16, as to which the date is May 30, 2003
Toronto, Canada

/s/ KPMG LLP
Chartered Accountants

GENESIS MICROCHIP INC.

CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

| | March 31, 2003 | March 31, 2002 |
|--|-------------------|-------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 113,138 | \$ 106,564 |
| Short-term investments | | 4,802 |
| Accounts receivable trade, net of allowance for doubtful accounts of \$493 in 2003 and \$391 in 2002 | 25,587 | 32,326 |
| Inventory (note 5) | 14,269 | 20,046 |
| Other | 6,797 | 6,185 |
| | <u>159,791</u> | <u>169,923</u> |
| Total current assets | 159,791 | 169,923 |
| Property and equipment (note 6) | 12,770 | 11,733 |
| Acquired intangibles (notes 4 and 7) | 36,933 | 47,248 |
| Goodwill (notes 4 and 8) | 189,579 | 198,909 |
| Other (note 19) | 3,581 | 578 |
| | <u>402,654</u> | <u>428,391</u> |
| Total assets | \$ 402,654 | \$ 428,391 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 8,640 | \$ 14,318 |
| Accrued liabilities | 18,164 | 14,272 |
| Income taxes payable | 722 | 571 |
| Current portion of lease liability (note 9) | | 1,040 |
| Current portion of loan payable (note 10) | 334 | 89 |
| | <u>27,860</u> | <u>30,290</u> |
| Total current liabilities | 27,860 | 30,290 |
| Long-term liabilities: | | |
| Deferred income taxes (note 14) | 961 | 5,183 |
| Lease liability (note 9) | | 9,019 |
| Loan payable (note 10) | | 328 |
| | <u>961</u> | <u>14,530</u> |
| Total liabilities | 28,821 | 44,820 |
| Stockholders' equity (notes 3, 4 and 11): | | |
| Capital stock: | | |
| Preferred stock: | | |
| Authorized 5,000 preferred shares, \$0.001 par value | | |
| Issued and outstanding none at March 31, 2003 and at March 31, 2002 | | |
| Common stock: | | |
| Authorized 100,000 shares of common stock, \$0.001 par value | | |
| Issued and outstanding 31,184 shares at March 31, 2003 and 31,133 shares at March 31, 2002 | | |
| | 31 | 31 |
| Additional paid-in capital (note 14) | 382,587 | 388,467 |
| Cumulative other comprehensive loss | (94) | (94) |
| Deferred stock-based compensation (note 4) | (6,809) | (17,587) |
| Retained earnings (deficit) | (1,882) | 12,754 |

| | | |
|--|-------------------|-------------------|
| Total stockholders' equity | <u>373,833</u> | <u>383,571</u> |
| Total liabilities and stockholders' equity | <u>\$ 402,654</u> | <u>\$ 428,391</u> |

Commitments and contingencies (note 16)

See accompanying notes to consolidated financial statements.

GENESIS MICROCHIP INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|--|---------------------------------|---------------------------------|---------------------------------|
| Revenues | \$ 194,325 | \$ 163,370 | \$ 63,627 |
| Cost of revenues (1) | 119,410 | 89,287 | 32,416 |
| Gross profit | 74,915 | 74,083 | 31,211 |
| Operating expenses: | | | |
| Research and development (including non-cash stock-based compensation of \$5,420 in 2003, \$510 in 2002 and \$0 in 2001) | 38,108 | 21,762 | 17,413 |
| Selling, general and administrative (including non-cash stock-based compensation of \$1,427 in 2003, \$460 in 2002 and \$86 in 2001) | 36,231 | 21,469 | 15,947 |
| Amortization of acquired intangibles (note 4) | 10,627 | 1,032 | |
| Provision for costs associated with patent litigation (note 16) | 9,671 | | |
| Restructuring (note 13) | | 1,858 | |
| In-process research and development (note 4) | | 4,700 | |
| Total operating expenses | 94,637 | 50,821 | 33,360 |
| Income (loss) from operations | (19,722) | 23,262 | (2,149) |
| Interest and other income | 1,538 | 1,536 | 2,328 |
| Imputed interest on lease liability | (592) | (73) | |
| Interest and other income, net | 946 | 1,463 | 2,328 |
| Income (loss) before income taxes | (18,776) | 24,725 | 179 |
| Provision for (recovery of) income taxes (note 14) | (4,140) | 6,729 | (2,483) |
| Net income (loss) | \$ (14,636) | \$ 17,996 | \$ 2,662 |
| Earnings (loss) per share (note 15): | | | |
| Basic | \$ (0.47) | \$ 0.82 | \$ 0.14 |
| Diluted | \$ (0.47) | \$ 0.74 | \$ 0.13 |
| Weighted average number of shares of common stock outstanding (note 15): | | | |
| Basic | 31,248 | 22,025 | 19,406 |
| Diluted | 31,248 | 24,177 | 19,884 |
| (1) Amount excludes amortization of acquired developed technology included in amortization of acquired intangibles | \$ 7,700 | \$ 865 | \$ |

See accompanying notes to consolidated financial statements.

GENESIS MICROCHIP INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

| | Shares of Common Stock | | Additional Paid-In Capital | Cumulative Other Comprehensive Loss | Deferred Stock-Based Compensation | Retained Earnings/ (Deficit) | Total Stockholders Equity |
|--|---------------------------|-----------|----------------------------------|--|---|------------------------------------|---------------------------------|
| | Number | Amount | | | | | |
| Balances, March 31, 2000 | 19,140 | \$ 72,225 | \$ 1,293 | \$ (94) | \$ (273) | \$ (7,904) | \$ 65,247 |
| Net income | | | | | | 2,662 | 2,662 |
| Issued under stock option and stock purchase plans | 419 | 2,394 | | | | | 2,394 |
| Amortization of deferred stock-based compensation | | | | | 86 | | 86 |
| Balances, March 31, 2001 | 19,559 | \$ 74,619 | \$ 1,293 | \$ (94) | \$ (187) | \$ (5,242) | \$ 70,389 |
| Net income | | | | | | 17,996 | 17,996 |
| Effect of reorganization (note 3) | | (74,600) | 74,600 | | | | |
| Acquisition of Sage Inc. (note 4) | 8,819 | 9 | 273,360 | | (18,370) | | 254,999 |
| Issued under stock option and stock purchase plans | 2,755 | 3 | 37,876 | | | | 37,879 |
| Tax benefits associated with non-qualified stock option exercises and disqualifying dispositions | | | 1,338 | | | | 1,338 |
| Amortization of deferred stock-based compensation | | | | | 970 | | 970 |
| Balances, March 31, 2002 | 31,133 | \$ 31 | \$ 388,467 | \$ (94) | \$ (17,587) | \$ 12,754 | \$ 383,571 |
| Net loss | | | | | | (14,636) | (14,636) |
| Finalization of number of shares issued in connection with the acquisition of Sage, Inc. | (215) | | (5,363) | | | | (5,363) |
| Repurchase of common stock | (400) | (1) | (3,126) | | | | (3,127) |
| Issued under stock option and stock purchase plans | 666 | 1 | 5,927 | | | | 5,928 |
| Tax benefits associated with non-qualified stock option exercises and disqualifying dispositions | | | 613 | | | | 613 |
| Amortization of deferred stock-based compensation | | | | | 6,847 | | 6,847 |
| Reversal of deferred stock-based compensation related to terminations | | | (3,931) | | 3,931 | | |
| Balances, March 31, 2003 | 31,184 | \$ 31 | \$ 382,587 | \$ (94) | \$ (6,809) | \$ (1,882) | \$ 373,833 |

See accompanying notes to consolidated financial statements.

GENESIS MICROCHIP INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|--|---------------------------------|---------------------------------|---------------------------------|
| Cash flows from operating activities: | | | |
| Net income (loss) | \$ (14,636) | \$ 17,996 | \$ 2,662 |
| Adjustments to reconcile net income (loss) to cash used in operating activities: | | | |
| Depreciation and amortization | 5,570 | 3,228 | 3,534 |
| Amortization of acquired intangibles | 10,627 | 1,032 | |
| In-process research and development | | 4,700 | |
| Non-cash restructuring expenses | | 600 | |
| Non-cash stock-based compensation | 6,847 | 970 | 86 |
| Deferred income taxes | (3,609) | 5,018 | (3,537) |
| Other | 621 | 144 | (166) |
| Change in operating assets and liabilities, net of amounts acquired: | | | |
| Accounts receivable trade | 6,739 | (12,201) | (8,389) |
| Investment taxes recoverable | | 1,029 | 82 |
| Inventory | 5,777 | (5,590) | (5,791) |
| Other | (612) | (5,577) | (3,167) |
| Accounts payable | (5,678) | 6,328 | 4,888 |
| Accrued liabilities | 4,490 | (1,586) | (260) |
| Income taxes payable | 151 | 571 | |
| Net cash from (used in) operating activities | 16,287 | 16,662 | (10,058) |
| Cash flows from investing activities: | | | |
| Purchase of short-term investments | (3,034) | | |
| Proceeds on sales and maturities of short-term investments | 7,836 | 2,257 | |
| Additions to property and equipment | (6,549) | (3,519) | (5,573) |
| Proceeds on disposal of property and equipment | | 169 | 3,157 |
| Cash and short-term investments acquired on purchase of Sage, Inc. (note 4) | | 34,283 | |
| Acquisition of VM Labs assets (note 4) | | (13,600) | |
| Deferred merger-related costs (note 19) | (2,502) | | |
| Other | (900) | (225) | 80 |
| Net cash provided by (used in) investing activities | (5,149) | 19,365 | (2,336) |
| Cash flows from financing activities: | | | |
| Proceeds from issue of common stock | 5,927 | 37,879 | 2,394 |
| Repurchase of common stock | (3,127) | | |
| Repayment of loan payable | (83) | (89) | (90) |
| Principal repayments against lease liability | (7,282) | (87) | |
| Net cash provided by (used in) financing activities | (4,565) | 37,703 | 2,304 |
| Effect of currency translation on cash balances | 1 | 7 | (25) |
| Increase (decrease) in cash and cash equivalents | 6,574 | 73,737 | (10,115) |
| Cash and cash equivalents, beginning of year | 106,564 | 32,827 | 42,942 |
| Cash and cash equivalents, end of year | \$ 113,138 | \$ 106,564 | \$ 32,827 |

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Supplemental cash flow information:

| | | | |
|---|------------|-------------|----------|
| Cash received for interest | \$ 1,538 | \$ 1,536 | \$ 2,328 |
| Cash paid for income taxes | \$ 313 | \$ 719 | \$ 1,390 |
| Supplemental disclosure of non-cash investing and financing activities: | | | |
| Deferred stock-based compensation (note 4) | \$ (3,931) | \$ 18,370 | \$ |
| Capital stock (note 3) | \$ | \$ 74,600 | \$ |
| Additional paid-in capital (notes 3 and 4) | \$ (5,363) | \$ (74,600) | \$ |

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts are in thousands, except per share data)

1. Nature of operations

Genesis Microchip Inc. (Genesis or the Company) designs, develops and markets integrated circuits that receive and process digital video and graphic images.

2. Significant accounting policies

Basis of consolidation

These consolidated financial statements include the accounts of Genesis and its subsidiaries. All inter-company transactions and balances have been eliminated.

Critical accounting policies and estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. On an on-going basis, the Company evaluates its estimates, including those related to product returns, bad debts, inventories, investments, prepaid expenses, intangible assets, income taxes, warranty obligations, litigation and other contingencies. Genesis bases its 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.

Genesis believes the following critical accounting policies affect its more significant judgments and estimates used in the preparation of its consolidated financial statements. The Company records 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, the Company may be required to recognize additional reductions to revenue. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. If the financial condition of Genesis's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. The Company provides for valuation reserves against its inventory for estimated obsolescence or unmarketable inventory equal to the difference between the 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 projected by management, additional inventory valuation reserves may be required. Genesis holds minority equity interests in other companies. The Company may record an investment impairment charge if management believes 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 the 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. Genesis provides for costs associated for patent litigation when management believes there is a reasonable basis for estimating those costs. If actual costs associated with patent litigation differ from estimates, additional provision may be required. Genesis performs impairment tests on the carrying value of intangible assets and goodwill. These tests are based on numerous assumptions as to potential future results of the business that are considered to be reasonable at the time those assumptions are made. If any of these assumptions later prove to be incorrect or if management changes its assessment as to their reasonability because of changing business conditions, an impairment charge may be recorded. Genesis records a valuation allowance to reduce its deferred tax assets to the amount that is

more likely than not to be realized. Should Genesis determine that it would not be able to realize all or part of its 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.

Cash and cash equivalents

All highly liquid investments with an original maturity of three months or less at the date of acquisition are classified as cash equivalents. Cash equivalents of \$86,228,000 and \$88,592,000 as of March 31, 2003 and 2002, respectively, consist primarily of money market funds and commercial paper.

Accounts receivable

Accounts receivable are recorded based on the selling price of the item sold and are recorded at the time of shipment. An allowance for doubtful accounts is determined based on our historical and industry experience. The following table presents a roll forward of the allowance for doubtful accounts for the indicated periods:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts are in thousands, except per share data)

| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Balance as of beginning of year | \$ 391 | \$ 78 | \$ 230 |
| Provision (recovery) | 120 | 317 | (150) |
| Charge offs | (18) | (4) | (2) |
| Balance as of end of year | \$ 493 | \$ 391 | \$ 78 |

Inventory

Inventory consists of finished goods and work-in-process and is stated at the lower of standard cost (approximates actual cost on first-in, first-out basis) or market value, being net realizable value. A reserve against inventory for obsolescence or unmarketable inventory is estimated based upon assumptions about future demand and market conditions.

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

| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Balance as of beginning of year | \$ 2,376 | \$ 1,710 | \$ 940 |
| Charged to cost of revenues | 2,137 | 666 | 1,254 |
| Charge offs | (883) | | (484) |
| Balance as of end of year | \$ 3,630 | \$ 2,376 | \$ 1,710 |

No significant inventory write-offs were recorded, other than the above amounts.

Property and equipment

Property and equipment are stated at cost or fair value at the date of acquisition. Amortization is recorded using the following methods and annual rates over the estimated useful lives of the assets:

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| | |
|------------------------|--|
| Property and equipment | 20% to 30% declining balance |
| Computer software | 20% to 100% straight-line |
| Leasehold improvements | Straight line over the term of the lease |

Genesis regularly reviews the carrying values of its 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 the consolidated statements of operations.

Goodwill and acquired intangibles

In July 2001, the Financial Accounting Standards Board (FASB) issued 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. Acquisitions completed during the year ended March 31, 2002 were accounted for in accordance with SFAS 142, which was adopted by Genesis effective April 1, 2002. Genesis performed a transitional goodwill impairment test on that date which indicated no impairment, given that the acquisitions of Sage and VM Labs had been recently completed.

Intangible assets are comprised of acquired core technology, acquired developed product technology, patents, trademarks and trade names. Patents are amortized on a declining-balance basis at a rate of 10% while all other intangible assets are amortized on a straight-line basis over four to seven years. Goodwill represents the excess purchase price over the fair value of net assets acquired and has not been amortized, but is tested for impairment annually.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts are in thousands, except per share data)

In arriving at the balances for goodwill arising out of the acquisitions of Sage, Inc. (Sage) and the assets of VM Labs, Inc. (VM Labs), estimates were made at the time of the acquisitions 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 have resulted in a change in the reported amount of goodwill.

Goodwill is not subject to amortization and is tested annually for impairment, during the fourth quarter of each fiscal year, and is tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value.

Asset impairments

The Company adopted SFAS 144, Accounting for the Impairment or Disposal of Long-lived Assets, effective April 1, 2002. Prior to the adoption of SFAS 144, the Company accounted for long-lived assets in accordance with SFAS 121, Accounting for Impairment of Long-Lived Assets to be Disposed Of. The adoption of SFAS 144 has not had an impact on the Company's consolidated financial position or results of operations. As required by SFAS 144 management reviews long-lived assets and the related intangible assets for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable. Recoverability of these assets is determined by comparing the forecasted undiscounted net cash flows of the operation to which the assets relate, to the carrying amount including associated intangible assets of the operation.

If the operation is determined to be unable to recover the carrying amount of its assets, then intangible assets, other than goodwill, are written down first, followed by the other long-lived assets of the operation, to fair value. Fair value is determined based on discounted cash flows or appraised values, depending upon the nature of the assets. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented in the appropriate asset and liability sections of the balance sheet.

Deferred merger-related costs

From time to time, the Company incurs costs related to potential merger activities. When an assessment is made that Genesis will be the acquirer for accounting purposes in such transactions and the transaction is expected to be completed, 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.

Revenue recognition

Genesis generates revenues primarily from sales of semiconductor products directly to equipment manufacturers. To date, revenues from royalties or other sources have been insignificant.

Genesis recognizes revenue from semiconductor product sales to customers when a contract is established, the price is determined, shipment is made and collectibility is reasonably assured. The Company has no post-sales obligations to its customers to install or support its products, other than the replacement of defective products under its warranty agreements. Genesis' s policy on sales to distributors is to defer recognition of revenues and related cost of revenues until the distributors resell the product. To date, sales to distributors have not been significant and there have been no significant product returns.

A liability is accrued for the estimated future repair and replacement costs that may be incurred under the provisions of the Company' s warranty agreements. Product warranties typically cover a one-year period from the date of delivery to the customer. Management estimates the accrual based on known product failures (if any), historical experience, and other available evidence. The following table presents a roll forward of the reserve for warranty returns for the year ended March 31, 2003:

| | |
|---------------------------------|---------|
| Balance as of beginning of year | \$ 360 |
| Provision | 1,460 |
| Charge offs | (1,320) |
| | <hr/> |
| Balance as of end of year | \$ 500 |
| | <hr/> |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts are in thousands, except per share data)

Currency translation

The U.S. dollar is the functional currency of Genesis and of its subsidiaries. Transactions originating in foreign currencies are translated into U.S. dollars at exchange rates approximating those at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the period-end rate of exchange and non-monetary items are translated at historical exchange rates. Exchange gains and losses are included in the consolidated statements of operations for the period.

Research and development expenses

Research and development costs are expensed as incurred other than acquired developed product and core technology that has alternative future use (note 4). Research and development costs include costs associated with algorithm and semiconductor development including the costs of developing software used within our semiconductor devices. Costs of initial production mask sets related to products are deferred once technological feasibility has been achieved and expensed as product costs over the estimated remaining life of the product on a straight-line basis. Costs related to any subsequent modifications to production mask sets are expensed as incurred as research and development costs.

Financial instruments and concentration of credit risk

Financial instruments consist of cash and cash equivalents, short-term investments, accounts receivable trade, accounts payable, accrued liabilities, lease liability and loan payable. Genesis determines the fair value of its financial instruments based on quoted market values or discounted cash flow analyses. Unless otherwise indicated, the fair values of financial assets and financial liabilities approximate their recorded amounts.

Financial instruments that potentially subject Genesis to concentrations of credit risk consist primarily of cash equivalents, short-term investments and accounts receivable trade. Cash equivalents consist of deposits with or guaranteed by major commercial banks, the maturities of which are three months or less from the date of purchase. Short-term investments consist of U.S. government debt securities, corporate debt securities and equity securities. With respect to accounts receivable, Genesis performs periodic credit evaluations of the financial condition of its customers and typically does not require collateral from them. Allowances are maintained for potential credit losses consistent with the credit risk of specific customers, historical trends and other information. Credit losses have been within management's range of expectations.

Risk of technological change

The markets in which Genesis competes or seeks to compete are subject to rapid technological change, frequent new product introductions, changing customer requirements for new products and features, and evolving industry standards. The introduction of new technologies and the emergence of new industry standards could render Genesis's products less desirable or obsolete which could harm its business.

Concentration of suppliers

Genesis does not own or operate a semiconductor fabrication facility, or an assembly and test facility and does not have the resources to manufacture its products internally. Genesis relies on a small number of third parties to produce all its products. In light of these dependencies, it is reasonably possible that failure to perform by one of these suppliers could have a severe impact on the Company's growth and results of operations.

Earnings (loss) per share

Basic earnings (loss) per share has been calculated by dividing the net income (loss) for the period available to common stockholders by the weighted average number of shares of common stock outstanding during that period. Basic earnings (loss) per share excludes the dilutive effect of potential shares of common stock such as those issuable on exercise of stock options. Diluted earnings (loss) per share gives effect to all potential shares of common stock outstanding during the period. The weighted average number of diluted shares outstanding is calculated assuming that the proceeds from potential shares of common stock are used to repurchase shares of common stock at the average closing share price in the period.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts are in thousands, except per share data)

Stock-based compensation

The Company has elected to follow Accounting Principles Board Opinion No. 25 (APB 25), Accounting of Stock Issued to Employees and related interpretations, in accounting for its employee stock options. Under APB 25, deferred stock-based compensation is recorded at the option grant date in an amount equal to the excess of the market value of a common share 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.

Stock compensation expense resulting from the issuance of options to non-employees is recognized as services are performed and the options are earned. Genesis applies the fair value method of FASB Statement No. 123 for valuing options granted to non-employees. 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.

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

| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|----------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Risk-free interest rates | 2.8% | 3.5% | 4.5% |
| Volatility | 129% | 116% | 80% |
| Expected life of option in years | 5 | 5 | 5 |

The weighted average fair values of options granted during fiscal 2003, 2002, and 2001 were \$7.59, \$22.21, and \$8.79, 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 fiscal 2003 would approximate the pro forma disclosure as follows:

| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|--|---------------------------------|---------------------------------|---------------------------------|
| Net income (loss) attributable to common stockholders: | | | |

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| | | | |
|------------------------------------|-------------------|-------------------|-------------------|
| As reported | \$ (14,636) | \$ 17,996 | \$ 2,662 |
| Stock compensation, as reported | 6,847 | 970 | 86 |
| Stock compensation, under FAS 123 | (15,271) | (21,039) | (10,624) |
| | <u> </u> | <u> </u> | <u> </u> |
| Pro forma | \$ (23,060) | \$ (2,073) | \$ (7,876) |
| | <u> </u> | <u> </u> | <u> </u> |
| Basic earnings (loss) per share: | | | |
| As reported | \$ (0.47) | \$ 0.82 | \$ 0.14 |
| Pro forma | \$ (0.74) | \$ (0.09) | \$ (0.41) |
| Diluted earnings (loss) per share: | | | |
| As reported | \$ (0.47) | \$ 0.74 | \$ 0.13 |
| Pro forma | \$ (0.74) | \$ (0.09) | \$ (0.41) |

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.

Comprehensive income

Comprehensive income is defined as the change in equity of a company during a period resulting from transactions and other events and circumstances from non-owner sources. For the fiscal years ended March 31, 2003, 2002 and 2001, there was no difference for Genesis between net income (loss) and comprehensive income (loss).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts are in thousands, except per share data)

Income taxes

Genesis applies the asset and liability method of Statement of Financial Accounting Standards No. 109 Accounting for Income Taxes (SFAS 109), under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and for operating loss and tax credits carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under SFAS 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. To the extent that it is not considered to be more likely than not that a deferred tax asset will be realized, a valuation allowance is provided.

Genesis is entitled to Canadian federal and provincial investment tax credits which are earned as a percentage of eligible current and capital research and development expenditures incurred in each taxation year. Investment tax credits are available to be applied against future income tax liabilities, subject to a ten year carryforward period. Investment tax credits are classified as a reduction of income tax expense for items of a current nature and a reduction of the related asset cost for items of a long-term nature, provided that Genesis has reasonable assurance that the tax credits will be realized.

Recent accounting pronouncements

In August 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS 143 requires that the fair value of retirement obligations be recognized as a liability when they are incurred and that the associated retirement costs be capitalized as a long-term asset and expensed over its useful life. The provisions of SFAS 143 will be effective for fiscal years beginning after June 15, 2002. We do not expect that the adoption of SFAS 143 will have a material effect on our financial position or results of operations.

In April 2002, the FASB issued SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections. SFAS 145 rescinds SFAS 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. Upon adoption of SFAS 145, companies will be required to apply the criteria in APB Opinion No. 30, Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, in determining the classification of gains and losses resulting from the extinguishment of debt. Additionally, SFAS 145 amends SFAS 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. SFAS 145 will be effective for fiscal years beginning after May 15, 2002 with early adoption of the provisions related to the rescission of SFAS 4 encouraged. We do not expect that the adoption of SFAS 145 will have a material effect on our financial position or results of operations.

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. We do not expect that the adoption of SFAS 146 will have a material effect on our financial position or results of operations.

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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 arrangements entered into after June 15, 2003. The Company does not believe the application of EITF Issuer No. 00-21 will have any material impact on its 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. The Company

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts are in thousands, except per share data)

has no guarantees to which this interpretation applies. However, the Company has included disclosure of product warranty information in the notes to the 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 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 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.

3. Reorganization

Genesis Microchip Incorporated, a Nova Scotia company (Genesis Microchip), reorganized to a Delaware corporation effective February 13, 2002. In the reorganization, the holders of shares of Genesis Microchip exchanged their shares for an equal number of newly issued shares of Genesis Microchip Inc. (Genesis), a newly formed Delaware corporation. For accounting purposes, the reorganization was accounted for as a non-substantive exchange whereby Genesis recorded the net assets of Genesis Microchip in its consolidated financial statements initially at the same carrying value as recorded in the consolidated financial statements of Genesis Microchip immediately prior to the reorganization. In addition, the financial position, results of operations and cash flows previously reported by Genesis Microchip prior to the reorganization are reported unchanged in the comparative period to the consolidated financial statements of Genesis. Costs of this reorganization, which were not material, were expensed as incurred. See note 11 for a description of the capital stock of Genesis.

4. Business combinations

Sage

On February 19, 2002, Genesis issued 8,819,000 shares of common stock for all the outstanding shares of common stock of Sage, Inc. Sage designed, developed and marketed digital display and video processors. Genesis also assumed remaining outstanding stock options that were converted to options to purchase 1,407,000 shares of Genesis common stock. This business combination was accounted for under the purchase method of accounting. The purchase price was approximately \$296.7 million, consisting of Genesis common stock valued at approximately \$241.5 million, Genesis stock options valued at approximately \$31.9 million, and direct acquisition costs estimated at approximately \$23.3 million. Common stock was valued at \$27.38 per share using the average closing price of Genesis stock for a period of two trading days before and after the announcement date of acquisition, which was September 28, 2001. Stock options were valued using the Black-Scholes option pricing model, applying a weighted average expected life of five years, a weighted average risk-free rate of 2.5%, an expected dividend yield of

zero, a volatility of 104% and a deemed fair value of \$27.38 per share. The intrinsic value of unvested options, totaling approximately \$18.3 million, was recorded as deferred stock-based compensation on the acquisition.

The purchase price was allocated to assets acquired and liabilities assumed based on management's analysis and estimates of their fair values. For tangible assets acquired, management believes that book value is representative of fair value at the time of the acquisition. For other identifiable assets, primarily intangible assets, fair values are based on discounted expected future cash flows attributable to those assets. The excess of the purchase price over the net tangible and identifiable intangible assets acquired and liabilities assumed was allocated to goodwill. The allocation of the purchase price was as follows:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts are in thousands, except per share data)

| | <u>Amount</u> | <u>Annual Amortization</u> | <u>Useful Lives</u> |
|---|-------------------|--------------------------------|-------------------------|
| Net assets acquired: | | | |
| Tangible net assets (other than property and equipment) | \$ 47,302 | \$ N/A | N/A |
| Property and equipment | 1,699 | * | * |
| Intangible assets acquired: | | | |
| Acquired developed product technology | 30,800 | 7,700 | 4 |
| Acquired core technology | 4,300 | 1,075 | 4 |
| Trademarks and trade names | 500 | 125 | 4 |
| Goodwill | 197,056 | N/A | N/A |
| In-process research and development | 4,700 | N/A | N/A |
| Deferred stock-based compensation | 18,370 | 6,123 | 3 |
| Deferred income taxes | (8,064) | N/A | N/A |
| | <u>\$ 296,663</u> | <u>\$ 15,023</u> | |

The acquired developed product technology, which was comprised of products that were already technologically feasible, included products in most of Sage's product lines. These included digital video interlace/line doublers, video enhancers, decoders and integrated chips for their home theatre and multi-media products. The acquired developed product technology of \$30.8 million is being amortized on a straight-line basis over an estimated remaining useful life of four years. The value of each developed technology was based on forecasted future cash flows directly related to the existing product technology, discounted at a rate of 18%, giving consideration to the lower risks associated with the assets relative to the in-process research and development.

The acquired core technology, which was comprised of proprietary know-how that was already technologically feasible, includes projects that were expected to leverage functionality from previous developed products and technologies. The acquired core technology of \$4.3 million is being amortized on a straight-line basis over an estimated remaining useful life of four years. In valuing the core technology, an appropriate percentage of revenues were segregated from the forecast revenues associated with certain in-process technologies. From these revenue forecasts, amounts were subtracted for expenses, maintenance, research and development and returns on contributory assets to arrive at cash flow attributed to the core technology. A discount rate of 21.5% was utilized to value the core technologies.

The trademarks and trade names consisted of the Faroudja trade name and its Directional Correlational De-Interlacing, or DCDi, label. The assigned value of \$500,000 is being amortized on a straight-line basis over an estimated remaining useful life of four years. The value of the trademarks and trade names was estimated by assigning a royalty rate to products expected to use the Faroudja/DCDi trade name. The forecasted royalties were then discounted to present value employing a discount rate consistent with the risk factors applicable to each product line.

Goodwill represents the excess of the purchase price over the fair value of the underlying net identifiable assets. During the year ended March 31, 2003, goodwill was adjusted to reflect the finalization of the number of stock options and shares of common stock issued in connection with the acquisition of Sage, and the finalization of other estimates made at the time of acquisition, including the settlement of an assumed lease obligation (notes 8 and 9).

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At the time of the closing of the acquisition, Sage was developing new products that qualified as in-process research and development in multiple product areas. For the purposes of determining which products qualified as in-process research and development, technological feasibility is defined as being equivalent to completion of design verification testing when the design is finalized and ready for pilot manufacturing. Engineering efforts are focused on improving product performance, reducing product form factors integrating multiple functions into single components and component integration into modules. Products that will incorporate in-process technologies include digital video line doublers and integrated chips. Developing and enhancing these products is time-consuming, costly and complex. There is a risk that these developments and enhancements will be late, will fail to meet customer or market specifications, and will not be competitive with other products using alternative technologies that offer comparable functionality.

The value assigned to in-process research and development was related to research projects for which technological feasibility had not been established and no future alternative uses existed. The fair value of \$4.7 million was determined using the income approach, which discounts expected future cash flows from projects under development to their net present value using a risk-adjusted rate. Each project was analyzed to determine the technological innovations, which included the utilization of core technology, the complexity, cost and time to complete the development, any alternative future use or current technological feasibility and the stage of completion. Future cash flows were estimated, taking into account the expected life cycles of the product and the underlying technology, relevant market sizes and industry trends. The estimated net cash flows from these products were based on management's

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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estimates of related revenues, cost of goods sold, research and development costs, selling, general and administrative expenses, income taxes and charges for the use of contributory assets. A discount rate of 25% was utilized based on the technology of the products, the stage of completion of the projects, the complexity of the development effort and the risks associated with reaching technological feasibility of the projects. The nature of the efforts to develop the in-process technology into commercially viable products principally related to the completion of all planning, designing, prototyping, verification and testing activities that are necessary to establish that the product can be produced to meet its design specification, including function, features and technical performance requirements.

Sage had two products under development at the acquisition date, a display processor semiconductor targeting the LCD multi-media monitor market for PCs and video and next-generation decoder targeting the advanced TV and multi-media projector markets. The development projects ranged from 70% to 95% complete at the date of acquisition. Both development projects had expected completion dates within one year and an estimated cost to complete of \$340,000, and have been completed as of March 31, 2003.

The rates utilized to discount the net cash flows to their present value were based on Sage's weighted average cost of capital. Given the nature of the risks associated with the difficulties and uncertainties in completing each project and thereby achieving technological feasibility, anticipated market acceptance and penetration, market growth rates and risks related to the impact of potential changes in future target markets, the weighted average cost of capital was adjusted. Based on these factors, discount rates of 18%, 21.5%, and 25% were deemed appropriate for the acquired developed product technology, acquired core technology and in-process research and development, respectively.

The estimates used in valuing acquired intangible assets were based upon assumptions believed to be reasonable but which are inherently uncertain and unpredictable. Assumptions may be incomplete or inaccurate, and no assurance can be given that unanticipated events and circumstance will not occur. Accordingly, actual results may vary from the projected results. Any such variance may result in a material adverse effect on Genesis's financial condition and results of operations.

Acquired developed product and acquired core technology and in-process research and development were identified and valued through analysis of data provided by Sage concerning developmental products, their stage of development, the time and resources needed to complete them, if applicable, their expected income generating ability, target markets and associated risks. The income approach, which includes an analysis of the markets, cash flows and risks associated with achieving such cash flows, was the primary technique utilized in valuing the developed technology and in-process research and development.

Where developmental projects had reached technological feasibility, they were classified as either acquired developed product technology or acquired core technology, and the value assigned was capitalized. Where the developmental projects had not reached technological feasibility and had no alternative uses, they were classified as in-process research and development and were charged to expenses upon closing of the acquisition.

The intrinsic value of unvested options, totaling approximately \$18.4 million, is being amortized to expense over the remaining term of the options, categorized in the statement of operations in accordance with the nature of the service provided by the related employees. Amortization for the year ended March 31, 2003 of \$5,420,000 (2002 \$510,000) is included in research and development expense and \$1,427,000 (2002 \$340,000) is included in selling, general and administrative expense. Unamortized deferred stock-based compensation of \$3,931,000 related to stock options cancelled during the year ended March 31, 2003 has been recorded as a reduction to additional paid-in capital.

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The following unaudited pro forma information gives effect to the acquisition of Sage as if it had occurred on April 1 of each period presented:

| | Year Ended | | Year Ended | |
|---------------------------|----------------|-------------|----------------|-------------|
| | March 31, 2002 | | March 31, 2001 | |
| | Pro forma | As reported | Pro forma | As reported |
| Revenue | \$ 197,092 | \$ 163,370 | \$ 96,694 | \$ 63,627 |
| Net income (loss) | \$ (10,007) | \$ 17,996 | \$ (110,760) | \$ 2,662 |
| Earnings (loss) per share | | | | |
| Basic | \$ (0.33) | \$ 0.82 | \$ (3.92) | \$ 0.14 |
| Fully diluted | \$ (0.33) | \$ 0.74 | \$ (3.92) | \$ 0.13 |
| Weighted average shares | | | | |
| Basic | 29,877 | 22,025 | 28,225 | 19,406 |
| Fully diluted | 29,877 | 24,177 | 28,225 | 19,884 |

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(tabular amounts are in thousands, except per share data)

Unaudited pro forma information is not necessarily indicative of the results of operations that would have been achieved had the transaction actually taken place at the dates indicated and do not purport to be indicative of the effects that may be expected to occur in the future. In the opinion of management, all adjustments to present fairly such pro forma information have been made.

VM Labs

On March 25, 2002, Genesis acquired substantially all of the assets of VM Labs, Inc., a fabless semiconductor company focused on the DVD market, for \$13.6 million in cash and the assumption of certain liabilities. The total purchase price valued at \$14.2 million was comprised of the following:

| | <u>Amount</u> | <u>Annual Amortization</u> | <u>Useful Lives</u> |
|------------------------------|------------------|--------------------------------|-------------------------|
| Tangible net assets acquired | \$ 374 | \$ N/A | N/A |
| Acquired core technology | 12,000 | 1,714 | 7 years |
| Goodwill | 1,853 | N/A | N/A |
| | <u>\$ 14,227</u> | <u>\$ 1,714</u> | |

VM Labs results of operations prior to the acquisition date were not material in relation to those of Genesis for any of the periods presented herein.

5. Inventory

Inventory consists of the following:

| | <u>March 31, 2003</u> | <u>March 31, 2002</u> |
|-----------------|---------------------------|---------------------------|
| Finished goods | \$ 11,082 | \$ 17,335 |
| Work-in-process | 6,817 | 5,087 |
| | <u>17,899</u> | <u>22,422</u> |
| Less reserve | (3,630) | (2,376) |
| | <u>\$ 14,269</u> | <u>\$ 20,046</u> |

6. Property and equipment

Property and equipment consist of the following:

| | March 31, 2003 | March 31, 2002 |
|-------------------------------|-------------------------------|-------------------------------|
| Property and equipment | \$ 15,499 | \$ 11,487 |
| Computer software | 9,665 | 7,888 |
| Leasehold improvements | 3,266 | 3,755 |
| | <u>28,430</u> | <u>23,130</u> |
| Less accumulated amortization | (15,660) | (11,397) |
| | <u>\$ 12,770</u> | <u>\$ 11,733</u> |

7. Intangible assets

Intangible assets consist of the following:

| | March 31, 2003 | March 31, 2002 |
|-------------------------------|---------------------------|---------------------------|
| Acquired technology | \$ 47,100 | \$ 47,100 |
| Patents and other | 1,807 | 1,440 |
| | <u>48,907</u> | <u>48,540</u> |
| Less accumulated amortization | (11,974) | (1,292) |
| | <u>\$ 36,933</u> | <u>\$ 47,248</u> |

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8. Goodwill

Goodwill was reduced by \$5,363,000 during the year ended March 31, 2003 to reflect the finalization of the number of stock options and shares of common stock issued in connection with the acquisition of Sage (note 4), and by \$3,967,000 to reflect the finalization of other estimates made at the time of acquisition, including the settlement of an assumed lease liability (note 9).

The carrying value of goodwill is periodically reviewed by management for potential impairment. No impairment has been identified at March 31, 2003.

9. Lease liability

In connection with the acquisition of Sage, Genesis assumed a lease obligation related to premises previously used by Sage. These premises were not being used for operating purposes, consequently the liability for the estimated present value of all future payments related to the lease was included as part of the allocation of the purchase price. In February 2003, the liability was settled for less than its carrying value. The excess of the carrying value of the liability over the settlement amount was \$3,369,000 and was applied to reduce the balance of goodwill.

10. Loan payable

The loan payable is non-interest bearing and is unsecured. Genesis intends to repay the loan in full in fiscal 2004, and as such, the loan has been classified as a current liability.

11. Stockholders equity

Authorized Capital Stock

Genesis's certificate of incorporation authorizes the issuance of 105,000,000 shares of capital stock, consisting of 100,000,000 shares of common stock, \$0.001 par value per share, and 5,000,000 shares of preferred stock, \$0.001 par value per share.

Common Stock

The holders of common stock are entitled to one vote per share on all matters to be voted upon by stockholders. Upon the liquidation, dissolution or winding up of Genesis, the holders of common stock will be entitled to share ratably in the net assets legally available for distribution to stockholders after the payment of all debts and other liabilities of the Company, subject to the prior rights of preferred stock, if any, then

outstanding.

Preferred Stock

The Board of Directors of Genesis is authorized to issue shares of preferred stock in one or more series and to fix the rights, preferences, privileges and restrictions, qualifications and limitations granted to or imposed upon any unissued and undesignated shares of preferred stock and to fix the number of shares constituting any series and the designations of such series, without any further vote or action by the stockholders (subject to applicable law and applicable stock exchange rules). The Genesis Board of Directors, without stockholder approval (subject to applicable law and applicable stock exchange rules), can issue preferred stock with voting and conversion rights that could adversely affect the voting power or other rights of the holders of Genesis common stock, and the issuance of such preferred stock may have the effect of delaying, deferring or preventing a change in control of Genesis. No such preferred shares have been issued or authorized.

Stock Repurchase Program

In August 2002, the Board of Directors approved a stock repurchase program under which the Company is authorized to repurchase up to \$25 million of its common stock. 400,000 shares of common stock were repurchased for \$3.1 million during the year ended March 31, 2003.

Preferred Stock Rights Agreement

On June 26, 2002, the Board of Directors of Genesis announced that it had declared a dividend distribution pursuant to a Preferred Stock Rights Agreement, dated as of June 27, 2002, between Genesis and Mellon Investor Services, L.L.C. (the Rights Agreement). Under the Rights Agreement, Genesis issued a dividend of one Preferred Share Purchase Right (each, a Right and

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(tabular amounts are in thousands, except per share data)

collectively, the Rights) to purchase one one-thousandth of a share of the Series A Participating Preferred Stock of Genesis for each outstanding share of common stock of Genesis. The dividend became payable on July 8, 2002 to stockholders of record as of the close of business on that date.

The Rights are not immediately exercisable and will become exercisable only upon the occurrence of certain events. If a person or group acquires, or announces a tender or exchange offer that would result in the acquisition of, a certain percentage of the common stock of Genesis while the Rights Agreement remains in place, the Rights will become exercisable, unless redeemed, by all Rights holders except the acquiring person or group, for shares of Genesis or of the third party acquirer having a value of twice the Rights then-current exercise price.

Effective March 16, 2003, Genesis amended the Rights Agreement to effect the following changes:

(1) to render the Rights Agreement inapplicable to the merger and other transactions contemplated by the Agreement and Plan of Merger, dated as of March 17, 2003, by and among Genesis, Pixelworks, Inc. and Display Acquisition Corporation, a wholly owned subsidiary of Pixelworks, Inc. (the Merger); and

(2) to provide for the expiration of all outstanding rights under the Rights Agreement immediately prior to the effective time of the Merger.

12. Stock option and stock purchase plans

1987 Stock Option Plan

The 1987 Stock Option Plan (the 1987 Plan) was established for the benefit of full-time employees and directors of Genesis and consultants engaged by Genesis. Options granted under the 1987 Plan vest over periods of two to four years and expire from five to seven years from the dates of the grants, unless extended by the Board of Directors. As a result of the establishment of the 1997 Employee Stock Option Plan, no additional options will be granted under the 1987 Plan. Upon exercise, expiration or cancellation of all of the options granted under the 1987 Plan, this plan will be terminated. All options granted under the 1987 Plan are exercisable in Canadian dollars.

1997 Employee Stock Option Plan

The 1997 Employee Stock Option Plan (the 1997 Employee Plan) provides for the granting to employees of incentive stock options, non-statutory stock options and stock purchase rights for up to 800,000 shares of common stock plus an annual increase to be added on the first day of each fiscal year equal to the lesser of (i) 2,000,000 shares, (ii) 3.5% of the outstanding shares on such date, or (iii) a lesser amount determined by the Board. The exercise price of incentive stock options granted under the 1997 Employee Plan may not be less than 100% (110% in case of any options granted to a person who holds more than 10% of the total combined voting power of all classes of shares of Genesis) of

the fair market value of the shares of common stock subject to the option on the date of the grant. The term of each option does not exceed 10 years (five years in the case of any options granted to a person who holds more than 10% of the total combined voting power of all classes of shares of Genesis) and the options vest over four years. As of March 31, 2003, there were 13,000 shares available for grant under the 1997 Employee Plan.

1997 Paradise Stock Option Plan

The 1997 Paradise Stock Option Plan (the Paradise Plan) provided for the granting of incentive stock options to employees of Paradise Electronics Inc. (Paradise), a wholly owned subsidiary of Genesis, and non-statutory stock options to Paradise employees, directors, and consultants. As a result of the merger of Paradise with Genesis in May 1999, each outstanding option or right to purchase shares of Paradise common stock is exercisable for Genesis shares of common stock, adjusted to reflect the exchange ratio of Genesis shares of common stock for Paradise common stock in the merger. No additional options will be granted under the Paradise Plan. Upon exercise, expiration or cancellation of all of the options granted under the Paradise Plan, this plan will be terminated.

1997 Non-Employee Stock Option Plan

The 1997 Non-Employee Stock Option Plan (the Non-Employee Plan) provides for the granting to non-employee directors and consultants of Genesis of options for up to 500,000 shares of common stock. The exercise price of stock options granted under the Non-Employee Plan may not be less than 100% of the fair market value of the shares of common stock subject to the option on the date of the grant. Options granted under the Non-Employee Plan have a term of up to ten years and generally vest over periods of up to two years. As at March 31, 2003, there were 178,000 shares available for grant under the Non-Employee Plan.

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2000 Non-Statutory Stock Option Plan

The 2000 Non-Statutory Stock Option Plan (the 2000 Employee Plan) provides for the granting to employees of non-statutory stock options for up to 1,500,000 shares of common stock plus an annual increase to be added on the first day of each fiscal year equal to the lesser of (i) 2,000,000 shares, (ii) 3.5% of the outstanding shares on such date, or (iii) a lesser amount determined by the Board. The exercise price of stock options granted under the 2000 Employee Plan may not be less than 100% of the fair market value of the shares of common stock subject to the option at the date of grant. The term of the options may not exceed 10 years and the options generally vest over four years. As at March 31, 2003, there were 3,000 shares available for grant under the 2000 Employee Plan.

2001 Non-Statutory Stock Option Plan

The 2001 Non-Statutory Stock Option Plan (the 2001 Employee Plan) provides for the granting to employees of non-statutory stock options for up to 1,000,000 shares of common stock. The exercise price of stock options granted under the 2001 Employee Plan may not be less than 100% of the fair market value of the shares of common stock subject to the option at the date of grant. The term of the options may not exceed 10 years and the options generally vest over four years. As at March 31, 2003, there were 17,000 shares available for grant under the 2001 Employee Plan.

Sage Stock Option Plan

The Sage Stock Option Plan (the Sage Plan) provided for the granting of incentive stock options to employees of Sage, a wholly owned subsidiary of Genesis and non-statutory stock options to Sage employees, directors, and consultants. As a result of the purchase of Sage, each outstanding option or right to purchase shares of Sage common stock is exercisable for Genesis shares of common stock, adjusted to reflect the exchange ratio of Genesis shares of common stock to Sage common stock in the purchase and sale agreement.

No additional options will be granted under the Sage Plan. Upon exercise, expiration or cancellation of all of the options granted under the Sage Plan, this plan will be terminated.

Employee Stock Purchase Plan

Genesis has established an employee stock purchase plan under which employees may authorize payroll deductions of up to 15% of their compensation (as defined in the plan) to purchase shares of common stock at a price equal to 85% of the lower of the fair market values as of the beginning or the end of the offering period. The plan provides for the purchase of 500,000 shares of common stock plus an annual increase to restore the number of shares available for purchase under the plan to 500,000. As at March 31, 2003, there were 288,000 shares available for issuance under this plan.

Summary of Stock Options

Details of stock option transactions are as follows:

| | <u>Number of options</u> | <u>Option price per share</u> | <u>Weighted average exercise price per share</u> |
|--------------------------|------------------------------|---------------------------------------|--|
| Balances, March 31, 2000 | 2,516 | \$ 0.17 31.50 | \$ 13.50 |
| Issued | 3,191 | 9.25 20.56 | 14.33 |
| Exercised | (317) | 0.17 18.13 | 4.82 |
| Cancelled | (1,038) | 0.78 29.93 | 15.96 |
| | <u>4,352</u> | <u>0.17 31.50</u> | <u>14.28</u> |
| Balances, March 31, 2001 | 4,352 | 0.17 31.50 | 14.28 |
| Issued | 1,658 | 8.95 69.81 | 31.18 |
| Assumed | 1,407 | 0.99 58.38 | 17.65 |
| Exercised | (2,596) | 0.17 45.07 | 14.76 |
| Cancelled | (270) | 3.42 59.03 | 21.44 |
| | <u>4,551</u> | <u>0.17 69.81</u> | <u>21.03</u> |
| Balances, March 31, 2002 | 4,551 | 0.17 69.81 | 21.03 |
| Issued | 3,202 | 5.64 26.00 | 8.67 |
| Exercised | (356) | 0.17 26.70 | 10.39 |
| Cancelled | (913) | 0.99 68.56 | 27.48 |
| | <u>6,484</u> | <u>\$ 0.17 69.81</u> | <u>\$ 14.52</u> |
| Balances, March 31, 2003 | 6,484 | \$ 0.17 69.81 | \$ 14.52 |

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The following table summarizes information concerning outstanding and exercisable options at March 31, 2003:

| Range of exercise prices per share | Options Outstanding | | | Options Exercisable | |
|------------------------------------|---------------------|---|---|---------------------|---|
| | Number outstanding | Weighted average remaining life (years) | Weighted average exercise price per share | Number exercisable | Weighted average exercise price per share |
| \$ 0.17 - 7.44 | 593 | 8.98 | \$ 5.66 | 54 | \$ 1.84 |
| 7.45 - 11.16 | 2,565 | 8.87 | 8.13 | 526 | 9.40 |
| 11.17 - 16.74 | 1,148 | 8.52 | 13.50 | 344 | 13.89 |
| 16.75 - 25.11 | 1,332 | 7.36 | 18.90 | 760 | 18.90 |
| 25.12 - 37.67 | 553 | 8.07 | 27.72 | 271 | 27.38 |
| 37.68 - 69.81 | 293 | 8.02 | 47.49 | 131 | 47.30 |
| Total at March 31, 2003 | 6,484 | 8.40 | \$ 14.52 | 2,086 | \$ 18.13 |
| Total at March 31, 2002 | 4,551 | 8.55 | \$ 21.03 | 1,051 | \$ 16.35 |
| Total at March 31, 2001 | 4,352 | 6.95 | \$ 14.28 | 1,028 | \$ 13.39 |

13. Restructuring

In connection with the acquisition of Sage (note 4), Genesis recorded restructuring expenses of \$1,858,000 during the year ended March 31, 2002. The expenses primarily included amounts related to severance payments to terminated employees and write-offs related to redundant computer software. All costs related to restructuring were paid prior to March 31, 2003.

14. Income taxes

The provision for (recovery of) income taxes consists of:

| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|----------|---------------------------------|---------------------------------|---------------------------------|
| Current | \$ 470 | \$ 1,711 | \$ 1,054 |
| Deferred | (4,610) | 5,018 | (3,537) |

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\$ (4,140) \$ 6,729 \$ (2,483)

The provision for (recovery of) income taxes differs from the amount computed by applying the statutory federal income tax rate to income before provision for income taxes. The sources and tax effects of the differences are as follows:

| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|--|---------------------------------|---------------------------------|---------------------------------|
| Basic federal rate applied to income before provision for (recovery of) income taxes | \$ (6,384) | \$ 8,407 | \$ 61 |
| Adjustments resulting from: | | | |
| State and provincial income taxes | (1,127) | 1,483 | 15 |
| Non-deductible expenses | 1,657 | 1,534 | 280 |
| Research and development deductions and investment tax credits | (1,610) | (609) | (2,271) |
| Foreign exchange and tax rate differences | (2,043) | 189 | (472) |
| Change in valuation allowance | 4,774 | (4,594) | |
| Other items | 593 | 319 | (96) |
| | <u>\$ (4,140)</u> | <u>\$ 6,729</u> | <u>\$ (2,483)</u> |

Pretax loss from foreign operations was \$18,988,000 for the year ended March 31, 2003. Pretax income from foreign operations was \$11,783,000 for the year ended March 31, 2002 and \$4,730,000 for the year ended March 31, 2001.

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Significant components of Genesis's deferred tax assets (liabilities) are as follows:

| | March 31, 2003 | March 31, 2002 |
|------------------------------------|-------------------|-------------------|
| Acquisition-related intangibles | \$ (11,441) | \$ (16,395) |
| Net operating loss carryforwards | 31,077 | 28,299 |
| Research tax credit carryforwards | 7,795 | 7,591 |
| Net capital loss carryforwards | 3,106 | 1,249 |
| Other | 129 | 1,025 |
| | <u>30,666</u> | <u>21,769</u> |
| Net deferred tax asset (liability) | 30,666 | 21,769 |
| Less valuation allowance | (31,627) | (26,952) |
| | <u>\$ (961)</u> | <u>\$ (5,183)</u> |

The valuation allowance increased by \$4,675,000 during the year ended March 31, 2003, primarily as a result of not recognizing the full benefit of net operating losses in a year of loss. The valuation allowance decreased by \$4,594,000 during the year ended March 31, 2002 primarily as a result of recognizing the benefit of net operating losses in a year of income. There was no change in the valuation allowance during the year ended March 31, 2001.

The valuation allowance includes \$8,358,000 (2002 \$8,358,000) arising from acquired losses and research credits, which, if realized, will be credited to goodwill. The valuation allowance also includes \$15,573,000 (2002 \$15,672,000) of losses arising from stock option deductions of which subsequently recognized tax benefits will be recorded as additional paid in capital. A benefit of \$613,000 was realized in 2003 (2002 \$1,338,000, 2001 \$0) from the application of stock option deduction expense and was credited directly to additional paid-in capital.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers projected future taxable income uncertainties related to the industry in which Genesis operates and tax planning strategies in making this assessment. In order to fully realize the net deferred tax asset, Genesis would need to generate future taxable income of approximately \$26 million prior to the expiration of the net operating loss carryforwards in the years 2008 to 2022. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not Genesis will realize the benefits of these deductible differences, net of the existing valuation allowances.

15. Earnings (loss) per share

The following table reconciles the numerators and denominators of the basic and diluted earnings per share computation:

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| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|--|---------------------------------|---------------------------------|---------------------------------|
| Numerator for basic and diluted net income (loss) per share: | | | |
| Net income (loss) | \$ (14,636) | \$ 17,996 | \$ 2,662 |
| Denominator for basic net income (loss) per share: | | | |
| Weighted average shares of common stock | 31,248 | 22,025 | 19,406 |
| Basic net income (loss) per share | \$ (0.47) | \$ 0.82 | \$ 0.14 |
| Denominator for diluted net income (loss) per share: | | | |
| Weighted average shares of common stock | 31,248 | 22,025 | 19,406 |
| Stock options and warrants | | 2,152 | 478 |
| Shares used in computing diluted net income (loss) per share | 31,248 | 24,177 | 19,884 |
| Diluted net income (loss) per share | \$ (0.47) | \$ 0.74 | \$ 0.13 |
| Anti-dilutive potential shares of common stock excluded from above calculation | 5,539 | 660 | 2,626 |

Had Genesis been profitable during the year ended March 31, 2003, 1,119,000 shares would have been added to the number of weighted average shares outstanding for the purposes of calculating diluted earnings per share.

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(tabular amounts are in thousands, except per share data)

16. Commitments and contingencies**Lease commitments**

Genesis leases premises in the United States, Canada, India, Taiwan, Japan, South Korea, and China under operating leases that expire between March 2003 and January 2009. In addition, certain equipment is leased under non-cancelable operating leases expiring in various years through 2005. Future minimum lease payments by fiscal year are as follows:

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

Rental expense was \$2,689,000 for the year ended March 31, 2003, \$3,067,000 for the year ended March 31, 2002, and \$2,211,000 for the year ended March 31, 2001.

Material legal proceedings

On April 24, 2001, Silicon Image, Inc. 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 allege that certain Genesis products that contain digital receivers infringe various Silicon Image patent claims. Silicon Image is seeking an injunction to halt the sale, manufacture and use of Genesis Microchip'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 case before the United States District Court for the Eastern District of Virginia is pending. Trial was set for January 2003, but the trial was taken off the calendar of the court in December 2002 and has not been rescheduled. Since January 2003, the parties have filed case dispositive motions, which were heard by the court in March 2003. Genesis Microchip is currently awaiting the court's ruling on these motions, which ruling could result in dismissal of the case against Genesis Microchip on terms that may be favorable or unfavorable to Genesis Microchip, setting the case for trial and/or entry by the court of other orders which we cannot predict. Genesis Microchip believes it has meritorious defenses to Silicon Image's claims. However, if this suit is resolved in favor of Silicon Image, both Genesis Microchip and its customers could suffer losses. Genesis has entered into agreements, and from time to time in the future, may enter into agreements, to indemnify and hold harmless certain of its customers for damages resulting from this or other litigation. We have made provision for costs associated with this patent litigation in the year ended March 31, 2003 of \$9,671,000. However, the future financial impact of this claim is not yet determinable and no other provision has been made in our consolidated financial statements for any future costs associated with this claim.

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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 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; 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 believes MRT 's claims are without merit and intends to vigorously defend against them. 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 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; the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts are in thousands, except per share data)

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. The ITC has not yet voted to institute an investigation against Mstar. 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 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 Chief Financial Officer Eric Erdman (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.

Supply arrangements

Genesis subcontracts portions of its semiconductor manufacturing to several suppliers and no 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 guarantees of minimum capacity from its suppliers and is not liable for minimum purchase commitments.

17. Segment information

Genesis operates and tracks its results in one operating segment. Genesis designs, develops and markets integrated circuits that manipulate and process digital video and graphic images. The target market is divided into two major categories: flat panel monitors and other.

Market information

Revenues by major product category were as follows:

| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|---------------------|------------------------------------|------------------------------------|------------------------------------|
| Flat panel monitors | \$ 163,213 | \$ 145,001 | \$ 45,928 |
| Other | 31,112 | 18,369 | 17,699 |
| | <u>\$ 194,325</u> | <u>\$ 163,370</u> | <u>\$ 63,627</u> |

Other revenue includes \$92,000 of sub-lease rental income for the year ended March 31, 2003, \$829,000 for the year ended March 31, 2002 and \$1,030,000 for the year ended March 31, 2001.

Geographic information

Geographic revenue information is based on the 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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**(tabular amounts are in thousands, except per share data)**

Revenues from unaffiliated customers by geographic region were as follows:

| | Year Ended March 31, 2003 | Year Ended March 31, 2002 | Year Ended March 31, 2001 |
|---------------|---------------------------------|---------------------------------|---------------------------------|
| United States | \$ 12,760 | \$ 6,566 | \$ 9,519 |
| China | 36,854 | 24,503 | 12 |
| Japan | 19,836 | 12,760 | 9,006 |
| South Korea | 77,690 | 51,411 | 9,404 |
| Taiwan | 32,462 | 62,857 | 29,958 |
| Rest of world | 14,723 | 5,273 | 5,728 |
| | <u>\$ 194,325</u> | <u>\$ 163,370</u> | <u>\$ 63,627</u> |

Net long-lived assets by country were as follows:

| | March 31, 2003 | March 31, 2002 |
|---------------|-------------------|-------------------|
| United States | \$ 233,053 | \$ 251,571 |
| Canada | 4,637 | 5,123 |
| Rest of world | 1,592 | 1,196 |
| | <u>\$ 239,282</u> | <u>\$ 257,890</u> |

Concentration information

For the years ended March 31, 2003 and 2002, two customers each accounted for more than 10% of total revenues. For the year ended March 31, 2001, no customer accounted for more than 10% of total revenues.

At March 31, 2003, four customers each represented more than 10% of accounts receivable trade. At March 31, 2002, no customer represented more than 10% of accounts receivable trade.

Genesis subcontracts portions of its semiconductor manufacturing from several suppliers but no product is fabricated by more than one supplier (note 16).

18. Related party transactions

Genesis won a public auction of the assets of VM Labs, Inc. that culminated in a federal Bankruptcy Court proceeding held on February 28, 2002 (the Auction) and Genesis closed the transaction on March 22, 2002 (the Closing). Genesis acquired those assets for a price of \$13.6 million in cash and the assumption of certain liabilities (note 4). Three directors of Genesis had indirect interests in VM Labs as a result of their relationship with VM Labs' s secured creditor. All three directors divested their interests prior to the Closing without realizing profit except for the receipt of accrued interest on their promissory notes, as described below.

One of the parties bidding at the Auction was Paradise IV, Inc. (Paradise IV), a secured credit of VM Labs. Three directors of Genesis, Messrs. Lushtak, Diamond and C.M. Reddy, had interests in Paradise IV. In November 2001, Messrs. Lushtak, Diamond and C.M. Reddy had loaned \$1,000,000, \$750,000 and \$400,000, respectively, to Paradise IV pursuant to promissory notes due June 2002, which accrued interest at an annual rate of 6% and which included warrants to purchase 800,000 shares, 600,000 shares and 320,000 shares, respectively, of common stock of Paradise IV at a price of \$.001 per share, representing a total of 24.57% of the fully diluted equity interests in Paradise IV. Also, prior to the Auction, Mr. Lushtak was Chairman of the Board and Chief Executive Officer of Paradise IV and owned 22.86% of the common stock of Paradise IV, which he acquired for an aggregate of \$1,600.

At the time that the Genesis Board began its evaluation of the VM Labs assets, Messrs. Lushtak, Diamond and C.M. Reddy disclosed their interest in Paradise IV to the Genesis Board and recused themselves from the evaluation of the VM Labs assets. On the date that the Genesis Board approved the submission of a bid in the Auction, Mr. Lushtak resigned from his positions as Chairman and Chief Executive Officer of Paradise IV, and Paradise IV redeemed all of Mr. Lushtak' s equity interest in Paradise IV at cost. Prior to the Closing, each of Messrs. Lushtak, Diamond and C.M. Reddy (i) delivered his promissory note to Paradise IV for repayment of the face amount of such note plus accrued interest through the date of repayment and (ii) surrendered his warrant to Paradise IV for cancellation. None of Messrs. Lushtak, Diamond or C.M. Reddy received any additional consideration for the cancellation of their notes or the surrender of their warrants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(tabular amounts are in thousands, except per share data)

In November 2001, Assured Space Access Corporation (Assured Space Access) loaned \$500,000 to Paradise IV, and received a warrant to purchase 400,000 shares of common stock of Paradise IV, on similar terms as the notes and warrants discussed above. Mr. Lushtak does not control Assured Space Access, although he and his wife together own approximately 13% of the equity in Assured Space Access, and Mr. Lushtak is a director of that company. Also in November 2001, Lushtak Family Limited Partnership I loaned \$500,000 to Paradise IV, and received a warrant to purchase 400,000 shares of common stock of Paradise IV, on similar terms as the notes and warrants discussed above. The adult sons of Mr. Lushtak, none of whom reside with him, are partners in the partnership. Mr. Lushtak does not have an economic interest in the partnership and does not control any voting rights or dispositive rights with respect to the partnership.

19. 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 common stock will automatically convert into the right to receive 2.3366 shares of Pixelworks common stock, all Genesis stock options will be assumed by Pixelworks at the same exchange ratio of 2.3366 and Genesis will become a wholly owned subsidiary of Pixelworks. The transaction is 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.

It is expected that the transaction will be accounted for such that Genesis will be the acquiring entity and Pixelworks will be the acquired entity, since the stockholders of Genesis will hold approximately 62% of the shares of the combined company. Consequently, upon completion of the acquisition, costs incurred by Genesis related to this transaction will form part of the purchase price of Pixelworks for accounting purposes. Costs incurred by Genesis related to this transaction to March 31, 2003 were \$2.5 million, and have been deferred and included in other long-term assets.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure:

Not applicable.

Item 10. Directors and Executive Officers:**Executive officers**

The information required by this item with respect to executive officers is incorporated by reference from Item 1 of this report. That information can be found under the caption, Executive Officers.

Directors

The following table lists the names and positions held by each of our directors as of July 21, 2003:

| <u>Name</u> | <u>Age</u> | <u>Position</u> |
|----------------------------|------------|--|
| Eric Erdman | 45 | Interim Chief Executive Officer; Chief Financial Officer, Secretary and Director |
| Tim Christoffersen (1) (3) | 61 | Director |
| Jeffrey Diamond (3) | 50 | Chairman of the Board |
| George A. Duguay (1) (2) | 50 | Director |
| Robert H. Kidd (1) | 59 | Director |
| Alexander S. Lushtak (2) | 64 | Director |
| Chandrashekar M. Reddy (3) | 43 | Director |

- (1) Member of the audit committee.
(2) Member of the compensation committee.
(3) Member of the corporate governance committee.

For the biography of Eric Erdman, see the description under the caption, Executive Officers, in Part I, Item 1 of this report.

Tim Christoffersen was appointed as a Director in August 2002. Mr. Christoffersen served as Chief Financial Officer of NeoParadigm Labs, Inc. from 1998 to 1999 and as Chief Financial Officer of Chips & Technologies, Inc. from 1994 until its sale to Intel Corporation in 1998. Mr. Christoffersen was Executive Vice President, Director and Chief Operating Officer of Resonex, Inc. from 1991 to 1992. From 1986 to 1991, Mr. Christoffersen held several managerial positions with Ford Motor Company. Mr. Christoffersen is a Phi Beta Kappa graduate of Stanford University where he earned a B.A. in Economics. He also holds a Master's degree in Theology from Union Theological Seminary in New York City.

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Jeffrey Diamond was named Chairman of the Board effective July 20, 2003. Mr. Diamond has served as a Director since April 2001. Prior to then, he served as an executive officer and as a consultant to Genesis from its acquisition of Paradise Electronics, Inc. in May 1999 to December 2000. He served as a Director of Paradise from its inception in 1996 and as its Chief Executive Officer from September 1998 until May 1999, when it merged with Genesis.

George A. Duguay has served as a Director since May 1993. Mr. Duguay has served as the President of G. Duguay Services Inc., a partner of Duguay and Ringler Corporate Services, a business providing bookkeeping and corporate secretarial services, since January 1988 and prior to that time served with an affiliated entity from May 1985. Mr. Duguay has served on the Board of Directors of Intrinsyc Software International, Inc., a Canadian provider of software, hardware and network integration solutions, since April 2003. Mr. Duguay also serves as Secretary for MCK Mining Corp. and for European Gold Resources Inc., as Chief Financial Officer and Secretary of Titanium Corporation Inc. and as an officer or director of several private companies.

Robert H. Kidd was appointed as a Director in August 2002. He is President of Location Research Company of Canada Limited, a consulting company. Mr. Kidd served as Chief Financial Officer of Technology Convergence Inc. from 2000 to 2002, of Lions Gate Entertainment Corp. from 1997 to 1998, and of InContext Systems Inc. from 1995 to 1996. He served as Senior Vice President, Chief Financial Officer and Director of George Weston Limited from 1981 to 1995, a partner of Thorne Riddell, Chartered Accountants, a predecessor firm of KPMG LLP, from 1973 to 1981 and as a Lecturer in Finance, Faculty of Management Studies, University of Toronto, from 1971 to 1981. Mr. Kidd has served on several professional committees, including the Toronto Stock Exchange Investors & Issuers Advisory Committee from 1993 to 1998, the Canadian Institute of Chartered Accountants Emerging Issues Committee from 1992 to 1997 and the Canadian Securities Administrators Committee on Conflicts of Interest in Underwriting from 1994 to 1996. He currently serves as a director of several private entities. Mr. Kidd has a B. Commerce from the University of Toronto and an M.B.A. from York University. Mr. Kidd is a Fellow of the Institute of Chartered Accountants of Ontario.

Alexander S. Lushtak has served as a Director since May 1999 and served as our Chairman from April 2001 to June 2002. He is a founder of Paradise Electronics, Inc. and served as its Chairman of the Board from 1996 until May 1999 when it merged with Genesis. From 1993 to 1996 he was the founder and Chairman of the Board of Accent, Inc., a voice recognition company. Mr. Lushtak also serves on the Board of Directors of two private companies.

Chandrashekar M. Reddy joined Genesis as a Director upon its acquisition of Sage, Inc. in February 2002. He served as Vice Chairman and as Executive Vice President, Engineering of Genesis from February 2002 to November 2002. He served as Chairman of the Board and Chief Executive Officer of Sage from its inception in 1994 until its acquisition by Genesis in February 2002. Mr. Reddy has been the Chief Executive Officer of Athena Semiconductors, Inc., a wireless radio products business, since December 2002 and a member of its Board of Directors since January 2002. From 1986 to 1995, Mr. Reddy held several design and program management positions at Intel Corporation. Mr. Reddy received an M.S. in Electrical Engineering from the University of Wisconsin, Madison and a B.S. in Electrical Engineering from the Indian Institute of Technology.

Section 16(a) beneficial ownership reporting compliance

Section 16(a) of the Securities Exchange Act of 1934 requires our officers, directors and any person who owns more than ten percent (10%) of our shares of common stock to file reports of ownership on Forms 3, 4 and 5 with the Securities and Exchange Commission and with us. Based on our review of copies of forms and written representations, we believe that all of our officers, directors and greater than ten percent (10%) stockholders complied with all filing requirements applicable to them for the year ended March 31, 2003, except as follows: On February 18, 2003, Genesis granted Anders Frisk an option to purchase 80,000 shares of common stock, which grant was first reported on a Form 5 filed on May 14, 2003. From May 7, 2002 through May 20, 2002, Chandrashekar Reddy sold a total of 57,500 shares of Genesis common stock, which sales were first reported on a Form 5 filed on May 14, 2003.

Item 11. *Executive Compensation:*

Summary compensation table

The following table contains information about compensation paid to our Chief Executive Officers and to our four other most highly compensated executive officers for our fiscal year ended March 31, 2003 and the compensation of those individuals in fiscal years 2002 and 2001, where applicable.

| Name and Principal Position | Fiscal Year | Annual Compensation | | Securities Underlying Options (#) | All Other Compensation (1) |
|--|-------------|---------------------|---------|-----------------------------------|----------------------------|
| | | Salary | Bonus | | |
| James E. Donegan (2) Former President and Chief Executive Officer | 2003 | \$ 214,823 | \$ | 200,000 | \$ |
| Amnon Fisher (3) Former President and Chief Executive Officer | 2003 | 64,695 | | | 30,536 |
| | 2002 | 279,050 | 144,375 | | |

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| | | | | | |
|--|------|---------|--------|---------|--------|
| | 2001 | 258,333 | | 175,000 | |
| Eric Erdman (4) | 2003 | 212,709 | 28,881 | 70,000 | |
| Interim Chief Executive Officer; Chief Financial Officer | 2002 | 144,588 | 51,333 | 100,000 | 10,642 |
| | 2001 | 132,267 | | 130,000 | |
| Anders Frisk | 2003 | 242,633 | | 137,500 | |
| Senior Vice President, Marketing | 2002 | 214,050 | 74,200 | | |
| | 2001 | 200,000 | | 110,000 | |
| Matthew Ready (5) | 2003 | 204,700 | 19,682 | 53,750 | |
| Senior Vice President, Sales | 2002 | 187,793 | 80,000 | | |
| | 2001 | 167,670 | 97,000 | 195,000 | |
| Mohammad Tafazzoli (6) | 2003 | 204,075 | | 60,000 | |
| Vice President, Operations | 2002 | 189,050 | 64,750 | 25,000 | |
| | 2001 | 161,461 | 24,000 | 107,000 | |

- (1) Represents payment for accumulated vacation time.
- (2) Mr. Donegan became Chief Executive Officer on June 26, 2002. This table excludes compensation that he received as a non-employee director included under the caption, Compensation of directors. Mr. Donegan resigned from all his positions with the Company effective July 19, 2003.
- (3) Mr. Fisher resigned as Chief Executive Officer effective June 25, 2002. This table includes information only for the period up to that date. For details concerning Mr. Fisher's severance arrangements, see the description under the caption, Severance agreement with Mr. Fisher.
- (4) Mr. Erdman left Genesis in February 2002 and rejoined the Company in March 2002. Mr. Erdman was named Interim Chief Executive Officer effective July 20, 2003.
- (5) Mr. Ready was hired in April 2000.
- (6) Mr. Tafazzoli became an executive officer in June 2000. This table excludes compensation received by him prior to that date.

Employment contracts, termination of employment and change-in-control arrangements

Employment agreement with Mr. Erdman

We entered into an employment letter agreement with Eric Erdman, currently our Interim Chief Executive Officer as well as our Chief Financial Officer, dated March 18, 2002, which provides that if Mr. Erdman is removed from the position of Vice President, Finance and Chief Financial Officer for any reason other than gross misconduct or voluntary resignation, and he is not offered an alternate position that he accepts, Mr. Erdman will be entitled to the following severance benefits: 12 months base salary; the continuation of Company-provided health coverage and benefits until the earlier of 12 months from his date of termination or the date on which he secures alternative employment; immediate vesting of any unvested stock options and up to 18 months to exercise such stock options; and payment of his corporate bonus as if he had achieved 100% of the plan's objectives, such bonus to be prorated based upon the number of months he was employed by us during the then-current fiscal year.

Employment letter with Mr. Frisk

On February 15, 2000, we entered into an employment letter with Anders Frisk, currently our Chief Operating Officer. In addition to base salary, bonus, car allowance and other benefits, we granted Mr. Frisk an option for 65,000 shares of our common stock that has fully vested, as well as an option for 65,000 shares that vests over 48 months unless there is a sale or merger of Genesis in which our stockholders do not control more than 50% of the surviving entity, in which event the option will vest with respect to at least 50% of the subject shares. In the event that we terminate Mr. Frisk's employment for any reason other than just cause, we must pay him a lump-sum amount equal to one year of his then-current base salary.

Employment agreement with Mr. Ready

On April 12, 2000, we entered into an employment letter with Mr. Ready, currently our Senior Vice President, Sales. In addition to base salary, bonus, car allowance and other benefits, we granted Mr. Ready an option for 65,000 shares of our common stock that has fully vested, as well as an option for 65,000 shares that vests over 48 months.

Employment agreement with Mr. Tafazzoli

Mr. Tafazzoli, who currently serves as our Vice President, Operations, entered into an employment letter with Paradise Electronics, Inc., dated February 17, 1998, which we assumed upon our acquisition of Paradise. In addition to base salary, bonus and other benefits, Mr. Tafazzoli was granted a stock option that has since fully vested.

Severance agreement with Mr. Donegan

We entered into a Settlement Agreement and Release with Mr. James E. Donegan, our former Chief Executive Officer and President, in connection with his resignation effective July 19, 2003. Under the agreement, Mr. Donegan was entitled to receive as severance a lump-sum payment equal to six months of his base salary, as well as reimbursement for (i) six months of COBRA payments and (ii) legal fees and costs incurred in the preparation of the agreement. Mr. Donegan was also entitled to a maximum of 12 months of additional vesting on his options to purchase 200,000 shares of our common stock, which will continue to vest at the rate of 1/48th per month over a 12-month period subject to certain restrictions, and which may vest immediately upon a change in control of the Company. Mr. Donegan's right to exercise vested options was also extended to July 31, 2004. Mr. Donegan agreed to release all claims he may have had against the Company. Mr. Donegan also agreed to provisions concerning confidentiality, cooperation in litigation and non-solicitation of our employees and consultants. The agreement terminated our June 2002 employment agreement with Mr. Donegan, under which Mr. Donegan was to receive an annual base salary of \$275,000 and was granted options for 200,000 shares of our common stock.

Employment and severance agreements relating to Pixelworks Merger

In addition to certain other officers of Genesis, Messrs. Erdman, Frisk, Ready and Tafazzoli have entered into, or may enter into prior to the merger of Genesis with Pixelworks, change of control severance agreements that will provide certain benefits upon an involuntary termination of employment following the merger. The agreements generally provide that if, within 12 months after the merger, or any other change of control of the combined company following the merger, the executive's employment is involuntarily terminated and signs a release of claims, then the executive will be entitled to the following severance benefits:

12 months (6 months in the case of certain executives) of the executive's base salary, payable in lump sum;

12 months of acceleration of vesting under all stock options, and 12 months of lapsing of Genesis's right of repurchase with respect to all restricted stock, held by the executive prior to the change of control;

the ability to exercise all vested stock options being assumed by Pixelworks that were originally granted to the executive by Genesis prior to the change of control for a period of 2 years following the termination of employment; and

health coverage and benefits at the same level of coverage as was provided immediately prior to termination, for up to 12 months (6 months in the case of certain executives) following the termination of employment.

The agreements also generally provide that if, in the second year after the merger, or any other change of control of the combined company following the merger, the executive's employment is involuntarily terminated, then the executive will be entitled to the following severance benefits:

a lump sum payment equal to the product of 100% (50% in the case of certain executives) of the executive's monthly base salary, multiplied by the number of months remaining in such second year as of the employment termination date;

12 months of acceleration of vesting under all stock options, and 12 months of lapsing of Genesis's right of repurchase with respect to all restricted stock, held by the executive prior to the change of control;

the ability to exercise all vested stock options granted to the executive by Genesis prior to the change of control for a period of 2 years following the termination of employment; and

health coverage and benefits at the same level of coverage as was provided immediately prior to termination, for that number of months remaining in such second year as of the employment termination date.

The agreement between Anders Frisk and Genesis includes an additional provision stating that if Mr. Frisk's employment is involuntarily terminated at any time, Mr. Frisk will be entitled to a lump sum payment equal to 12 months of his base salary in effect as of the date of termination.

Also, Eric Erdman has been offered a position, subject to the completion of the merger with Pixelworks, with the combined company but as of yet, no definitive agreements has been reached.

Options granted in the year ended March 31, 2003

The following table contains information about stock option grants made during the year ended March 31, 2003 to our Chief Executive Officers and to our four other most highly compensated executive officers in fiscal 2003. The stock options were granted under our 1997 Employee Stock Option Plan and our 2001 Non-Statutory Stock Option Plan. They have a maximum term of ten years, subject to earlier termination upon cessation of service.

The 5% and 10% assumed annual rates of compounded stock price appreciation are mandated by rules of the Securities and Exchange Commission. There is no assurance that the actual stock price appreciation over the option terms will be at the assumed 5% and 10% levels or at any other defined level. Unless the market price of our common stock appreciates over the term of the option, no value will be realized from the option grants made to the executive officer.

Individual grants

| Name | Number of Securities Underlying Options Granted | % of Total Options Granted to Employees in Fiscal Year | Exercise Price Per Share | Expiration Date | Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term | |
|----------------------|---|--|--------------------------|-----------------|--|--------------|
| | | | | | 5% | 10% |
| James E. Donegan (1) | 200,000 | 6.5% | \$ 8.15 | 6/26/12 | \$ 2,655,098 | \$ 4,227,800 |
| Amnon Fisher (2) | | | | | | |
| Eric Erdman | 70,000 | 2.3 | 7.50 | 07/22/12 | 855,170 | 1,361,715 |
| Anders Frisk | 57,500 | 1.9 | 7.50 | 07/22/12 | 702,461 | 1,118,551 |
| | 80,000 | 2.6 | 12.39 | 02/18/13 | 1,614,560 | 2,570,918 |
| Matthew Ready | 53,750 | 1.7 | 7.50 | 07/22/12 | 656,648 | 1,045,602 |
| Mohammad Tafazzoli | 60,000 | 1.9 | 7.50 | 07/22/12 | 733,003 | 1,167,184 |

- (7) Mr. Donegan became Chief Executive Officer on June 26, 2002. This table excludes compensation that he received as a non-employee director included under the caption, Compensation of directors. Mr. Donegan resigned from all his positions with the Company effective July 19, 2003.
- (8) Mr. Fisher resigned as Chief Executive Officer effective June 25, 2002.

Aggregate option exercises in the last fiscal year and fiscal year end option values

The following table contains information about option exercises for our Chief Executive Officers and our four other most highly compensated executive officers in the year ended March 31, 2003 and their option holdings as of March 31, 2003.

The value of an in-the-money stock option represents the difference between the aggregate estimated fair market value of the underlying stock and the aggregate exercise price of the stock option. We have used the reported closing price of \$12.48 per share on The Nasdaq National Market on March 31, 2003 as the estimated fair market value of our common stock in determining the value of unexercised options.

| Name | Shares Acquired Upon Exercise | Value Realized | Number of Securities Underlying Unexercised Options At Fiscal Year End | | Value of Unexercised In-the-money Options/SARs at the Fiscal Year End (\$) | |
|----------------------|-------------------------------|----------------|--|---------------|--|---------------|
| | | | Exercisable | Unexercisable | Exercisable | Unexercisable |
| James E. Donegan (1) | | \$ | 7,500 | 200,000 | \$ | \$ 866,000 |
| Amnon Fisher (2) | 20,000 | 146,200 | 133,833 | 41,667 | 192,298 | |
| Eric Erdman | | | 92,943 | 147,500 | 108,448 | 348,600 |
| Anders Frisk | | | 78,022 | 159,480 | 111,185 | 293,550 |
| Matthew Ready | 4,792 | 66,203 | 44,688 | 71,355 | 69,034 | 267,675 |
| Mohammad Tafazzoli | 5,000 | 68,275 | 44,762 | 95,387 | 47,865 | 298,800 |

- (1) Mr. Donegan became Chief Executive Officer on June 26, 2002. This table excludes compensation that he received as a non-employee director included under the caption, Compensation of directors. Mr. Donegan resigned from all his positions with the Company effective July 19, 2003.
- (2) Mr. Fisher resigned as Chief Executive Officer effective June 25, 2002.

Compensation committee interlocks and insider participation

The members of our compensation committee during the fiscal year ended March 31, 2003 were Messrs. Duguay and Lushtak. At no time since our formation have any of the members of our compensation committee served as our officers or employees or as officers or employees of any of our subsidiaries. No interlocking relationship exists between our board of directors or its compensation committee and the board of directors or compensation committee of any other company, nor did any interlocking relationships exist during the past fiscal year.

Compensation of directors

Directors who are not our employees receive \$5,000 per quarter as a retainer, \$1,000 for each meeting of the Board of Directors or committee thereof attended in person and \$500 for each meeting attended by teleconference. Non-employee chairmen of committees receive an additional retainer of \$1,250 per quarter for serving as a committee chairman, other than the chairman of the audit committee who receives an additional quarterly retainer of \$2,500. Directors who are our employees receive no separate compensation for services rendered as a director. All directors are reimbursed for reasonable expenses to attend meetings.

Non-employee directors automatically receive stock options under the terms of our 1997 Non-Employee Stock Option Plan. Upon first joining the board, non-employee directors receive an option to purchase 15,000 shares of our common stock. Those options are granted with an exercise price equal to the closing price of our stock on the last trading day before joining the board. Grants are also made annually on the first day of the month following our annual meeting of stockholders. Each non-employee director receives an option to purchase 5,000 shares of our common stock plus 2,500 shares of our common stock for each committee on which the director serves. The options are granted with an exercise price equal to the closing price of our stock on the day preceding the date of the grant and vest over twelve months. The automatic annual option grants were made on October 1, 2002 at an exercise price of \$7.67 per share. Mr. Christoffersen's and Mr. Kidd's initial option grants were made at an exercise price of \$6.37 per share on August 8, 2002.

Non-employee directors may also be granted stock options under the terms of our 2000 Non-Statutory Stock Option Plan or our 2001 Non-Statutory Stock Option Plan. Discretionary options were granted from our 2000 Non-Statutory Stock Option Plan on October 22, 2002 at an exercise price of \$13.06 per share and vest over twelve months. No other stock option grants were made to non-employee directors in fiscal 2003.

The following table summarizes the retainers and attendance fees and the number of stock option grants that were made to our non-employee directors, in their capacity as non-employee directors, during fiscal 2003:

| Name | Initial Option Grants | Automatic Annual Grants | Discretionary Option Grants | Retainers and Attendance Fees |
|----------------------------|--------------------------|----------------------------|--------------------------------|----------------------------------|
| Tim Christoffersen | 15,000 | 7,500 | 10,000 | \$ 29,583 |
| Jeffrey Diamond | | 5,000 | 10,000 | 42,000 |
| James E. Donegan (1) | | | | 13,000 |
| George A. Duguay | | 10,000 | 10,000 | 45,250 |
| Robert H. Kidd | 15,000 | 7,500 | 10,000 | 27,333 |
| Alexander S. Lushtak | | 7,500 | 10,000 | 44,000 |
| Chandrashekar M. Reddy (2) | | 5,000 | | 19,750 |
| N. Damodar Reddy (3) | | | | 15,167 |

- (1) For the period prior to Mr. Donegan becoming an employee in June 2002. Excludes his compensation included under the caption, Compensation and other information concerning officers, for services rendered in his capacity as President and Chief Executive Officer. Mr. Donegan resigned from all his positions with the Company effective July 19, 2003.
- (2) Only for the period after Mr. C.M. Reddy ceased to be an employee in November 2002.
- (3) Mr. N.D. Reddy resigned as a director in July 2002.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters:

The following table contains information about the beneficial ownership of our common stock as of July 15, 2003, for:

each of our current directors, as well as our Chief Executive Officer as of March 31, 2003^{(1) (2)} and our other four most highly compensated executive officers during the fiscal year ended March 31, 2003;

all of our directors and executive officers as a group^{(1) (2)} and

all persons known by us to be beneficial owners of more than five percent (5%) of our outstanding stock.

The number and percentage of shares beneficially owned is determined in accordance with Rule 13d-3 of the Securities and Exchange Act of 1934 and the information is not necessarily indicative of beneficial ownership for any other purpose. Under Rule 13d-3 beneficial ownership includes any shares over which the individual or entity has voting power or investment power and any shares that the individual has the right to acquire within 60 days of July 15, 2003 through the exercise of any stock options. Unless indicated, each person or entity either has sole voting and investment power over the shares shown as beneficially owned or shares those powers with his spouse, except that all of our directors who were directors on March 17, 2003 have entered into voting agreements with Pixelworks, Inc. obligating them to vote in favor of adoption of the Agreement and Plan of Merger of the same date. See Item 1 under the caption, Overview.

The number of options exercisable within 60 days of July 15, 2003 is shown in the first column of the table and is included in the total number of shares of common stock beneficially owned shown in the second column. The percentage of shares beneficially owned is computed on the basis of 31,682,270 shares of common stock outstanding on July 15, 2003.

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Unless otherwise indicated, the principal address of each stockholder listed below is c/o Genesis Microchip Inc., 2150 Gold Street, Alviso, California 95002.

| Directors and Executive Officers (1) (2): | Number of Shares of Common Stock Issuable Pursuant to Options | Total Number of Shares of Common Stock Beneficially Owned | Percentage of Outstanding Common Stock |
|--|--|--|--|
| Barclays Global Investors, N.A. (3) 45 Fremont Street San Francisco, CA 94105-2228 | | 2,043,052 | 6.4% |
| James E. Donegan (2) | 65,833 | 65,833 | * |
| Eric Erdman | 124,817 | 129,305 | * |
| Anders Frisk | 102,865 | 105,446 | * |
| Matthew Ready | 66,017 | 69,312 | * |
| Mohammad Tafazzoli | 71,065 | 73,259 | * |
| Tim Christoffersen | 10,208 | 10,208 | * |
| Jeffrey Diamond (4) | 29,582 | 44,136 | * |
| George A. Duguay | 33,333 | 33,333 | * |
| Robert H. Kidd | 15,208 | 15,208 | * |
| Alexander S. Lushtak | 47,708 | 47,708 | * |
| Chandrashekar M. Reddy | 63,013 | 337,068 | 1.1% |
| Current Directors and Executive Officers as a group (13 persons) (1) (2) | 783,809 | 1,113,276 | 3.4% |

* Less than one percent (1%)

- (1) Mr. Fisher resigned as Chief Executive Officer effective June 25, 2002. Beneficial ownership information concerning Mr. Fisher is not included in this table.
- (2) Mr. Donegan resigned from all his positions with the Company effective July 19, 2003. Beneficial ownership information concerning Mr. Donegan is included in this table. The number of shares that Mr. Donegan will have the right to acquire within 60 days of July 15, 2003 pursuant to outstanding options will be subject to Mr. Donegan's continued compliance with the provisions of his severance agreement. See the disclosure in Item 11 under the caption, "Severance Agreement with Mr. Donegan."
- (3) The ownership information set forth in this table is based on information contained in a joint statement on Schedule 13G, filed February 12, 2003, by entities affiliated with Barclays Global Investors, NA. Barclays Global Investors, NA, is deemed to be the beneficial owner of 1,844,453 shares and has sole voting and dispositive power with respect to such shares. Barclays Global Fund Advisors is deemed to be the beneficial owner of 179,483 shares and has sole voting and dispositive power with respect to such shares. Barclays Capital Investments is deemed to be the beneficial owner of 19,116 shares and has sole voting and dispositive power with respect to such shares.
- (4) Includes 14,554 shares owned by Diamond Family Trust, a trust established for the benefit of Mr. Diamond and his family.

Changes in control

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 will 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, will 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 is 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 is 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 have entered into voting agreements with Pixelworks obligating them to vote in favor of

adoption of the Agreement. For a description of employment and severance agreements relating to the proposed merger with Pixelworks, see the description under the caption, Employment and Severance Agreements relating to Pixelworks Merger.

EQUITY COMPENSATION PLAN INFORMATION

The following table provides information as of March 31, 2003 about our common stock that may be issued upon the exercise of options, warrants and rights under our 1997 Employee Stock Purchase Plan described above as well as our seven stock option plans: the 1987 Stock Option Plan, the 1997 Employee Stock Option Plan, the 1997 Non-Employee Stock Option Plan, the 2000 Non-Statutory Stock Option Plan, the 2001 Non-Statutory Stock Option Plan the 1997 Paradise Stock Option Plan and the Sage Stock Option Plan.

The 1997 Paradise Stock Option Plan and the Sage Stock Option Plan, under which we do not grant any new options, were assumed upon our acquisitions of other companies. Our stockholders have not formally approved our 2000 Non-Statutory Stock Option Plan, although they approved an amendment to that plan at the September 14, 2000 annual meeting. Our stockholders have not approved our 2001 Non-Statutory Stock Option Plan. Our stockholders have approved all other plans.

| Plan Name and Type | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities available for issuance under equity compensation plans (excluding securities reflected in the first column) |
|--|---|---|--|
| Equity compensation plans approved by stockholders | | | |
| 1997 Employee Stock Purchase Plan | * | * | 288,429 |
| 1987 Stock Option Plan | 4,947 | \$ 6.49 | |
| 1997 Employee Stock Option Plan | 2,910,807 | 13.55 | 13,171 |
| 1997 Non-Employee Stock Option Plan | 142,813 | 17.17 | 178,175 |
| Equity compensation plans not formally approved by stockholders | | | |
| 2000 Non-Statutory Stock Option Plan | 1,798,958 | 12.88 | 3,206 |
| 2001 Non-Statutory Stock Option Plan | 712,639 | 16.08 | 16,587 |
| Equity compensation plans assumed on acquisitions | | | |
| 1997 Paradise Stock Option Plan | 14,137 | 1.17 | |
| Sage Stock Option Plan | 899,828 | 19.54 | |
| Total * | 6,484,129 | 14.52 | 499,568 |

* The number of securities to be issued upon exercise of outstanding rights under the 1997 Employee Stock Purchase Plan and the weighted average exercise price of those securities is not determinable. The 1997 Employee Stock Purchase Plan provides that shares of our common stock may be purchased at a per share price equal to 85% of the fair market value of the common stock on the beginning of the offering period or a purchase date applicable to such offering period, whichever is lower. The closing price per share of our common stock on the Nasdaq National Market on June 30, 2003 (the last trading day of the most recent offering period) was \$13.54.

Summaries of the stock option plans not formally approved by our stockholders are as follows:

2000 Non-Statutory Stock Option Plan

Purpose

The purposes of the plan are to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to employees and consultants and to promote the success of our business.

Administration

The plan provides for administration by our Board of Directors or a committee appointed by the Board and is currently administered by the Compensation Committee of the Board of Directors. All questions of interpretation or application of the plan are determined by the Board of Directors or its appointed committee, and its decisions are final and binding upon all participants. Directors receive no additional compensation for their services in connection with the administration of the plan.

Eligibility to Participate in the Plan

Nonstatutory stock options may be granted to our employees, consultants and directors.

Number of Shares Covered by the Plan

The aggregate number of shares of common stock authorized for issuance under the plan is 1,500,000 shares plus an annual increase to be added on the first day of each fiscal year equal to the lesser of (i) 2,000,000 shares, (ii) 3.5% of the Company's outstanding shares of common stock on such date, or (iii) a lesser amount determined by the Board.

Awards Permitted under the Plan

The plan authorizes the granting of nonstatutory stock options only.

Terms of Options

The plan's administrator determines the exercise price of options granted under the plan and the term of those options. The options that are currently outstanding under the plan vest and become exercisable over periods of from one to four years beginning on the grant date. Payment of the exercise price may be made by cash, check, promissory note, other shares of our common stock, cashless exercise, any other form of consideration permitted by applicable law or any combination of the foregoing methods of payment. Options may be made exercisable only under the conditions the Board of Directors or its appointed committee may establish. If an optionee's employment terminates for any reason, the option remains exercisable for a period fixed by the plan administrator up to the remainder of the option's term; if a period is not fixed by the plan administrator, the exercise period is three (3) months, or twelve (12) months in the case of death or disability.

Capital Changes

In the event of any changes in our capitalization, such as stock splits or stock dividends, resulting in an increase or decrease in the number of shares of common stock, effected without receipt of consideration by us, appropriate adjustment will be made by us in the number of shares

available for future grant and in the number of shares subject to previously granted but unexercised options.

Dissolution or Liquidation

In the event of the proposed dissolution or liquidation of our Company, the option holders will be notified of such event, and the plan administrator may, in its discretion, permit each option to fully vest and be exercisable until ten (10) days prior to such event, at which time the options will terminate.

Merger, Asset Sale or Change of Control

With respect to options granted on or before October 16, 2001 (unless the optionees have consented otherwise), in the event of a merger of our Company with or into another corporation, or any other capital reorganization in which more than fifty percent (50%) of the outstanding voting shares of the Company are exchanged (other than a reorganization effected solely for the purpose of changing the situs of the Company's incorporation), each outstanding option under the plan will fully vest and be exercisable for a period of ten (10) days prior to the closing of such transaction, and the unexercised options will terminate prior to the closing of such transaction.

With respect to options granted after October 16, 2001 (as well as certain options granted before such date, with the consent of the optionees), in the event of a merger or proposed sale of all or substantially all of the assets of our Company, each outstanding option under the plan will be assumed or an equivalent option substituted by the successor corporation or a parent or subsidiary of the successor corporation. In the event the successor corporation refuses to assume or substitute outstanding options, the plan administrator will notify each optionee that his or her options will vest and be exercisable for a period of twenty (20) days from the date of such notice, and the unexercised options will terminate upon the expiration of such period.

Nonassignability

Options may not be assigned or transferred for any reason (other than upon death), except that the plan administrator may permit options to be transferred during the optionee's lifetime to members of the optionee's immediate family or to trusts, LLCs or partnerships for the benefit of such persons.

Amendment and Termination of the Plan

The plan provides that the Board of Directors may amend or terminate the plan without stockholder approval, but no amendment or termination of the plan or any award agreement may adversely affect any award previously granted under the plan without the written consent of the optionee.

Certain United States Federal Income Tax Information

An optionee generally will not recognize any taxable income at the time he or she is granted a nonstatutory stock option. However, upon its exercise, the optionee will recognize ordinary income generally measured as the excess of the then fair market value of the shares purchased over the purchase price. Any taxable income recognized in connection with an option exercise by one of our employees is subject to tax withholding by us. Upon resale of such shares by the optionee, any difference between the sales price and the optionee's purchase price, to the extent not recognized as taxable income as described above, will be treated as long-term or short-term capital gain or loss, depending on the holding period.

Generally, we will be entitled to a tax deduction in the same amount as the ordinary income realized by the optionee with respect to shares acquired upon exercise of the nonstatutory stock option.

The foregoing is only a summary of the effect of federal income taxation upon the optionee and us with respect to the grant and exercise of options granted under the plan and does not purport to be complete. In addition, the summary does not discuss the tax consequences of an optionee's death or the income tax laws of any state or foreign country in which the optionee may reside.

2001 Non-Statutory Stock Option Plan

Purpose

The purposes of the plan are to attract and retain the best available personnel for positions of substantial responsibility, to provide additional incentive to employees, directors and consultants and to promote the success of our business.

Administration

The plan provides for administration by our Board of Directors or a committee appointed by the Board and is currently administered by the Compensation Committee of the Board of Directors. All questions of interpretation or application of the plan are determined by the Board of Directors or its appointed committee, and its decisions are final and binding upon all participants. Directors receive no additional compensation for their services in connection with the administration of the plan.

Eligibility to Participate in the Plan

Nonstatutory stock options may be granted to our employees including officers, consultants and directors.

Number of Shares Covered by the Plan

The aggregate number of shares of common stock authorized for issuance under the plan is 1,000,000 shares.

Awards Permitted under the Plan

The plan authorizes the granting of nonstatutory stock options only.

Terms of Options

The plan's administrator determines the exercise price of options granted under the plan and the term of those options. The options that are currently outstanding under the plan vest and become exercisable over periods of from two to four years beginning on the grant date. Payment of the exercise price may be made by cash, check, promissory note, other shares of our common stock, cashless exercise, a reduction in the amount of any Company liability to the optionee, any other form of consideration permitted by

applicable law or any combination of the foregoing methods of payment. Options may be made exercisable only under the conditions the Board of Directors or its appointed committee may establish. If an optionee's employment terminates for any reason, the option remains exercisable for a period fixed by the plan administrator up to the remainder of the option's term; if a period is not fixed by the plan administrator, the exercise period is three (3) months, or twelve (12) months in the case of death or disability.

Capital Changes

In the event of any changes in our capitalization, such as stock splits or stock dividends, resulting in an increase or decrease in the number of shares of common stock, effected without receipt of consideration by us, appropriate adjustment will be made by us in the number of shares available for future grant and in the number of shares subject to previously granted but unexercised options.

Dissolution or Liquidation

In the event of the proposed dissolution or liquidation of our Company, the option holders will be notified of such event, and the plan administrator may, in its discretion, permit each option to fully vest and be exercisable until ten (10) days prior to such event, at which time the options will terminate.

Merger, Asset Sale or Change of Control

In the event of a merger or proposed sale of all or substantially all of the assets of our Company, each outstanding option under the plan will be assumed or an equivalent option substituted by the successor corporation or a parent or subsidiary of the successor corporation. In the event the successor corporation refuses to assume or substitute outstanding options, the plan administrator will notify each optionee that his or her options will vest and be exercisable for a period of fifteen (15) days from the date of such notice, and the unexercised options will terminate upon the expiration of such period.

Nonassignability

Options may not be assigned or transferred for any reason (other than upon death), except that the plan administrator may permit options to be transferred during the optionee's lifetime upon such terms and conditions as the administrator deems appropriate.

Amendment and Termination of the Plan

The plan provides that the Board of Directors may amend or terminate the plan without stockholder approval, but no amendment or termination of the plan or any award agreement may adversely affect any award previously granted under the plan without the written consent of the optionee.

Certain United States Federal Income Tax Information

An optionee generally will not recognize any taxable income at the time he or she is granted a nonstatutory stock option. However, upon its exercise, the optionee will recognize ordinary income generally measured as the excess of the then fair market value of the shares purchased over the purchase price. Any taxable income recognized in connection with an option exercise by one of our employees is subject to tax withholding by us. Upon resale of such shares by the optionee, any difference between the sales price and the optionee's purchase price, to the extent not recognized as taxable income as described above, will be treated as long-term or short-term capital gain or loss, depending on the holding period.

Generally, we will be entitled to a tax deduction in the same amount as the ordinary income realized by the optionee with respect to shares acquired upon exercise of the nonstatutory stock option.

The foregoing is only a summary of the effect of federal income taxation upon the optionee and us with respect to the grant and exercise of options granted under the plan and does not purport to be complete. In addition, the summary does not discuss the tax consequences of an optionee's death or the income tax laws of any state or foreign country in which the optionee may reside.

Item 13. *Certain Relationships and Related Transactions:*

Severance and consulting agreements with Mr. Reddy

We have entered into a Separation Agreement and Release with Chandrashekar Reddy, our former Executive Vice President, Engineering. Pursuant to that agreement, Mr. Reddy resigned his employment with us effective November 11, 2002 but retained his position as a director of Genesis. As severance for his resignation, Mr. Reddy received severance for a period of six months equal to his previous base salary, as well as a lump-sum payment equal to the value of his previous medical, dental, disability, life insurance, fringe and other benefits under employee welfare plans. In addition, to the extent not already vested, Mr. Reddy was granted full acceleration on options that we assumed from Sage, Inc. with respect to 46,346 shares of our common stock and given a period of 24 months following termination in which to exercise those options. In connection with his resignation, we entered into a Consulting Agreement with Mr. Reddy, pursuant to which we retained Mr. Reddy for a period two months following his resignation, at an amount per month equaling his monthly base salary at the time of his resignation, to advise us on technical and industry-related issues. In addition, Mr. Reddy repaid in full approximately \$52,000 owed to us in connection with a loan previously granted to him by Sage.

Severance agreement with Mr. Fisher

We entered into a Settlement Agreement and Release with Mr. Amnon Fisher, our former Chief Executive Officer and President, in connection with his resignation in June 2002. Under the agreement, Mr. Fisher was entitled to receive as severance a lump-sum payment equal to one year's base salary, as well as reimbursement for (i) one year of COBRA payments, (ii) one year of premiums on a \$500,000 term life insurance policy and (iii) legal fees and costs incurred in the preparation of the agreement. Mr. Fisher was also entitled to a maximum of 12 months of additional vesting on his outstanding options to purchase our common stock, which will continue to vest over a 12-month period subject to certain restrictions, and which may vest immediately upon a change in control of the Company. Mr. Fisher's right to exercise vested options was also extended to July 30, 2003. Mr. Fisher agreed to release all claims he may have had against the Company.

PART III

Item 14. *Controls and Procedures:*

- (a) *Evaluation of disclosure controls and procedures.* Based on their evaluation of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-14(c) and 15d-14(c)) as of a date (the Evaluation Date) within 90 days before the filing date of this amendment to our annual report, our Chief Executive Officer and our Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures were adequate and designed to ensure that material information relating to us and our consolidated subsidiaries would be made known to them by others, particularly during the period in which this amendment to our annual report was being prepared.
- (b) *Changes in internal controls.* In the fourth quarter of the fiscal year ended March 31, 2003, our board of directors implemented the following significant changes in the company's internal controls that could significantly affect these controls subsequent to the date of their implementation: (i) our board of directors created a corporate governance committee of non-employee directors of the board to meet periodically during each fiscal quarter with company management to enhance communication between company management and the board, with the corporate governance committee to have ongoing oversight responsibility; and (ii) our board of directors enhanced our contract execution policy to provide for additional specificity as to the procedures company management must follow prior to entering into agreements on behalf of the company.

Our disclosure controls and procedures provide our Chief Executive Officer and our Chief Financial Officer reasonable assurances that our disclosure controls and procedures will achieve their objectives. However, company management, including our 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.

Item 15. *Principal Accountant Fees and Services:*

On November 8, 2002, 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.

PART IV

Item 16. *Exhibits, Financial Statement Schedules and Reports on Form 8-K:*

(a) Documents filed with this report:

1. Consolidated Financial Statements.

The following consolidated financial statements and related auditors' report are incorporated in Item 8 of this report:

Independent Auditors' Report.

Consolidated Balance Sheets at March 31, 2003 and 2002.

Consolidated Statements of Operations for the years ended March 31, 2003, March 31, 2002 and March 31, 2001.

Consolidated Statements of Stockholders' Equity for the years ended March 31, 2003, March 31, 2002 and March 31, 2001.

Consolidated Statements of Cash Flows for the years ended March 31, 2003, March 31, 2002 and March 31, 2001.

Notes to Consolidated Financial Statements

Selected Quarterly Financial Data is incorporated in Item 7 of this report and by reference in Item 8 of this report.

2. Consolidated Financial Statement Schedules.

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Consolidated financial statement schedules have been omitted because they are not applicable or are not required, or because the required information is included in the Consolidated Financial Statements and Notes thereto which are included herein.

3. Exhibits.

The exhibits listed in the Exhibit Index are filed as a part of this report.

(b) Reports on Form 8-K:

During the three months ended March 31, 2003 we filed the following current reports on Form 8-K:

On February 14, 2003 we filed certifications by our Chief Executive Officer and Chief Financial Officer regarding our Form 10-Q for the period ended December 31, 2002, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

On March 20, 2003 we filed an Agreement and Plan of Merger, dated as of March 17, 2003, among Genesis Microchip Inc., Display Acquisition Corporation and Pixelworks, Inc., and a joint press release of Genesis Microchip Inc. and Pixelworks, Inc. issued on March 17, 2003 in connection with a proposed business combination of Genesis and Pixelworks.

/s/ CHANDRASHEKAR M. REDDY

Director

July 29, 2003

Chandrashekar M. Reddy

CERTIFICATION

Genesis Microchip Inc.

Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Eric Erdman, Interim Chief Executive Officer and Chief Financial Officer of Genesis Microchip Inc., certify that:

1. I have reviewed this amendment to the annual report on Form 10-K of Genesis Microchip Inc.;
2. Based on my knowledge, this amendment to the annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this amendment to the annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this amendment to the annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this amendment to the annual report;
4. I am responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and I have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me by others within those entities, particularly during the period in which this amendment to the annual report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this amendment to the annual report (the "Evaluation Date"); and
 - c) presented in this amendment to the annual report my conclusions about the effectiveness of the disclosure controls and procedures based on my evaluation as of the Evaluation Date;
5. I have disclosed, based on my most recent evaluation, to the registrant's auditors and the Audit Committee of the registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
- 6.

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I have indicated in this amendment to the annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of my most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: July 29, 2003

By: s/ ERIC ERDMAN

Eric Erdman

Interim Chief Executive Officer;

Chief Financial Officer

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EXHIBIT INDEX

| Exhibit Number | Exhibit Description |
|---------------------------|---|
| 2.1(1) | Agreement and Plan of Merger and Reorganization, dated as of September 27, 2001, by and between Genesis Microchip Incorporated and Sage, Inc. |
| 2.2(1) | Share Exchange and Arrangement Agreement and Plan of Arrangement by and among the Registrant, Genesis Microchip Nova Scotia Corp., and Genesis Microchip Incorporated. |
| 2.3(2) | Agreement and Plan of Merger, dated as of March 17, 2003, among Genesis Microchip Inc., Display Acquisition Corporation and Pixelworks, Inc. (with Forms of Voting Agreements). |
| 3.1(1) | Certificate of Incorporation of the Registrant. |
| 3.2(3) | Amended and Restated Bylaws of the Registrant. |
| 3.3(4) | Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Registrant. |
| 4.1(1) | Form of Common Stock Certificate of the Registrant. |
| 4.2(4) | Preferred Stock Rights Agreement, dated as of June 27, 2002, between the Registrant and Mellon Investor Services, L.L.C., as amended on March 16, 2003. |
| 10.1(5) | Agreement, dated January 20, 1997, between Yves Faroudja and Faroudja Laboratories, Inc. |
| 10.2(3) | Employment agreement dated March 18, 2002 with Eric Erdman. |
| 10.3(6)* | Offer of employment to James E. Donegan dated June 25, 2002. |
| 10.4(6)* | Settlement Agreement and Release with Amnon Fisher. |
| 10.5(9)* | Offer Letter of Employment with Anders Frisk, dated February 15, 2000. |
| 10.6(9)* | Offer Letter of Employment with Matthew Ready, dated April 12, 2000. |
| 10.7(9)* | Offer Letter of Employment from Paradise Electronics, Inc. to Mohammad Tafazzoli, dated February 17, 1998. |
| 10.8(7)* | Form of Change of Control Severance Agreement (as entered into between Genesis and, among others, each of Anders Frisk, Matthew Ready and Mohammad Tafazzoli). |
| 10.9(9)* | Separation Agreement and Release with Chandrashekar Reddy. |
| 10.10(9)* | Consulting Agreement with Chandrashekar Reddy. |
| 10.11(8)* | 1987 Stock Option Plan. |
| 10.12(8)* | 1997 Employee Stock Option Plan. |
| 10.13*(9) | 1997 Employee Stock Purchase Plan, as last amended on September 17, 2002. |
| 10.14(8)* | 1997 Non-Employee Stock Option Plan. |
| 10.15(8)* | 2000 Nonstatutory Stock Option Plan. |
| 10.16(8)* | 2001 Nonstatutory Stock Option Plan. |
| 10.17(8)* | Paradise Electronics, Inc. 1997 Employee Stock Option Plan. |
| 10.18(8)* | Sage, Inc. Second Amended and Restated 1997 Stock Plan. |
| 10.19(9)* | 2001 Employee Stock Purchase Loan Plan (for non-officers). |
| 10.20(9) | Lease Termination Agreement with 1601 McCarthy Boulevard, L.L.C. regarding premises located in Milpitas, California. |
| 10.21 | Settlement Agreement and Release with James E. Donegan. |
| 21(9) | Subsidiaries. |

- 23.1 Consent of KPMG LLP.
- 99.1 Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by (i) James E. Donegan, Chief Executive Officer of the Company, and (ii) Eric Erdman, Chief Financial Officer of the Company.
- 99.2 Section entitled Risk Factors of the Registration Statement on Form S-4 filed by Pixelworks, Inc. with the Securities and Exchange Commission on April 18, 2003, as amended on July 3, 2003 (qualified as set forth on page 18 of this report in Item 7 under the caption, Risk Factors, second paragraph).
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- (1) 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.
- (2) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on March 20, 2003.
- (3) Incorporated by reference to the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on July 1, 2002, as amended.
- (4) 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 8-12G/A filed with the Securities and Exchange Commission on March 31, 2003.
- (5) Incorporated by reference to Faroudja Laboratories, Inc.'s Form S-1 (File No. 333-32375) filed with the Securities and Exchange Commission on July 30, 1997, as amended.
- (6) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 14, 2002.
- (7) Incorporated by reference to Registration Statement on Form S-4 filed by Pixelworks, Inc. with the Securities and Exchange Commission on April 18, 2003, as amended.
- (8) Incorporated by reference to the Registrant's Registration Statement on Form S-8 filed with the Securities and Exchange Commission on February 21, 2003.
- (9) Previously filed as an exhibit to this report on June 20, 2003.

* Identifies a management contract or compensatory plan of arrangement required to be filed as an exhibit to this report pursuant to Item 14(c) of this report.