

GENESIS MICROCHIP INC /DE
Form 10-Q
February 09, 2005
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(mark one)

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2004

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER:

000-33477

GENESIS MICROCHIP INC.

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(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)
2150 GOLD STREET
P.O. BOX 2150
ALVISO, CALIFORNIA
(Address of principal executive offices)

77-0584301
(I.R.S. Employer
Identification No.)
95002
(Zip Code)

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

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

Former address: N/A

Former Fiscal Year: N/A

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

There were 33,434,311 shares of the registrant's common shares issued and outstanding as of January 31, 2005.

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GENESIS MICROCHIP INC.

FORM 10-Q

NINE MONTHS ENDED DECEMBER 31, 2004

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

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

(amounts in thousands, except per share amounts)

	December 31, 2004	March 31, 2004
	_____	_____
	(unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 39,362	\$ 19,241
Short-term investments	91,957	98,981
Accounts receivable trade, net of allowance for doubtful accounts of \$ 536 at December 31 and \$422 at March 31	26,428	28,325
Inventories	16,438	18,503
Other	5,902	6,472
	_____	_____
Total current assets	180,087	171,522
Property and equipment	17,132	17,257
Acquired intangibles	19,659	26,731
Goodwill	189,997	189,152
Deferred income taxes	7,570	3,402
Other	3,581	2,662
	_____	_____
Total assets	\$ 418,026	\$ 410,726
	_____	_____
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 7,647	\$ 9,848
Accrued liabilities	13,728	11,503
Income taxes payable	3,147	2,520
	_____	_____
Total current liabilities	24,522	23,871
Stockholders' equity:		
Capital stock:		
Preferred stock:		
Authorized - 5,000 preferred shares, \$0.001 par value Issued and outstanding - none at December 31 or March 31		
Common stock:		
Authorized - 100,000 common shares, \$0.001 par value Issued and outstanding - 33,250 shares at December 31 and 32,653 shares at March 31	33	32
Additional paid-in capital	402,919	395,837
Cumulative other comprehensive loss	(94)	(94)

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Deferred stock-based compensation	(664)	(2,833)
Deficit	(8,690)	(6,087)
	<u> </u>	<u> </u>
Total stockholders' equity	393,504	386,855
	<u> </u>	<u> </u>
Total liabilities and stockholders' equity	\$ 418,026	\$ 410,726
	<u> </u>	<u> </u>

See accompanying notes to condensed consolidated financial statements.

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

(amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended December 31		Nine Months Ended December 31	
	2004	2003	2004	2003
Revenues	\$ 48,286	\$ 56,498	\$ 151,210	\$ 158,548
Cost of revenues (1)	26,609	34,146	87,116	94,013
Gross profit	21,677	22,352	64,094	64,535
Operating expenses:				
Research and development (2)	7,928	7,417	24,677	22,522
Selling, general and administrative (3)	14,625	9,515	36,571	28,826
Provision for costs associated with patent litigation	989	3,529	2,356	9,583
Amortization of acquired intangibles	2,654	2,654	7,962	7,962
Total operating expenses	26,196	23,115	71,566	68,893
Loss from operations	(4,519)	(763)	(7,472)	(4,358)
Interest income	534	314	1,253	786
Gain on sale of investment		663		663
Earnings (loss) before income taxes	(3,985)	214	(6,219)	(2,909)
Provision for (recovery of) income taxes	(2,985)	35	(3,616)	(643)
Net earnings (loss)	\$ (1,000)	\$ 179	\$ (2,603)	\$ (2,266)
Earnings (loss) per share:				
Basic and diluted	\$ (0.03)	\$ 0.01	\$ (0.08)	\$ (0.07)
Weighted average number of common shares outstanding:				
Basic	33,151	31,948	32,969	31,655
Diluted	33,151	33,201	32,969	31,655
(1) Amount excludes amortization of acquired developed technology included in amortization of acquired intangibles	\$ 1,925	\$ 1,925	\$ 5,775	\$ 5,775
(2) Amount includes stock-based compensation expense	\$ 408	\$ 723	\$ 1,605	\$ 2,162
(3) Amount includes stock-based compensation expense	\$ 2,057	\$ 207	\$ 2,457	\$ 608

See accompanying notes to condensed consolidated financial statements.

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

(amounts in thousands)

(unaudited)

	Nine Months Ended	
	December 31	
	2004	2003
Cash flows from (used in) operating activities:		
Net loss	\$ (2,603)	\$ (2,266)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	5,281	3,569
Amortization of acquired intangibles	7,962	7,962
Non-cash stock-based compensation	4,062	2,770
Deferred income taxes	(4,168)	(3,074)
Gain on sale of investment		(663)
Other	104	(1)
Change in operating assets and liabilities:		
Accounts receivable trade	1,897	(621)
Inventories	2,065	(12,510)
Other current assets	570	(322)
Accounts payable	(2,201)	15,841
Accrued liabilities	2,225	(5,679)
Income taxes payable	627	1,753
Net cash from operating activities	15,821	6,759
Cash flows from investing activities:		
Purchase of short-term investments	(174,683)	(68,477)
Proceeds on sales and maturities of short-term investments	181,707	
Additions to property and equipment	(4,396)	(6,991)
Other	(3,518)	2,852
Net cash used in investing activities	(890)	(72,616)
Cash flows from financing activities:		
Proceeds from issue of common stock	5,190	8,569
Net cash provided by financing activities	5,190	8,569
Increase (decrease) in cash and cash equivalents	20,121	(57,288)
Cash and cash equivalents, beginning of period	19,241	113,138
Cash and cash equivalents, end of period	\$ 39,362	\$ 55,850

See accompanying notes to condensed consolidated financial statements.

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GENESIS MICROCHIP INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Basis of presentation

We have prepared the accompanying unaudited condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States (GAAP) and according to the rules and regulations of the Securities and Exchange Commission for interim financial reporting. Consequently, they do not include all of the information and footnotes required by United States generally accepted accounting principles for a complete set of annual financial statements. These condensed financial statements should be read in conjunction with our financial statements and notes thereto for the year ended March 31, 2004 that are included in our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission. We believe that the accompanying financial statements reflect all adjustments, consisting solely of normal, recurring adjustments, that are necessary for a fair presentation of the results for the interim periods presented. The results of operations for the period ended December 31, 2004 are not necessarily indicative of the results to be expected for the full fiscal year or for any other period.

2. Stock-based compensation

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

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

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

SFAS 123, as amended, requires the disclosure of pro forma net income and earnings per share as if we 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 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.

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

	Three Months Ended		Nine Months Ended	
	December 31		December 31	
	2004	2003	2004	2003
Stock Option Plans:				
Risk-free interest rates	3.6%	2.5%	3.6%	2.5%
Volatility	102%	105%	102%	108%
Expected life in years	5	5	5	5
Employee Stock Purchase Plans:				
Risk-free interest rates	2.6%	1.1%	2.6%	1.1%
Volatility	102%	108%	102%	108%
Expected life in years	1.25	1.25	1.25	1.25

The weighted average fair values of options granted during the three months ended December 31, 2004 and December 31, 2003 were \$ 11.66 and \$ 12.44 respectively. The weighted average fair values of options granted during the nine months ended December 31, 2004 and December 31, 2003 were \$ 10.71 and \$ 11.33 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 net loss and loss per share for the three and nine months ended December 31, 2004 and December 31, 2003 would approximate the pro forma disclosure as follows (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	December 31		December 31	
	2004	2003	2004	2003
Net earnings (loss) attributable to common stockholders:				
As reported	\$ (1,000)	\$ 179	\$ (2,603)	\$ (2,266)
Stock compensation, as reported	2,465	930	4,062	2,770
Stock compensation, under SFAS 123	(8,557)	(5,712)	(19,979)	(17,146)
Pro forma	\$ (7,092)	\$ (4,603)	\$ (18,520)	\$ (16,642)
Basic earnings (loss) per share:				
As reported	\$ (0.03)	\$ 0.01	\$ (0.08)	\$ (0.07)
Pro forma	\$ (0.21)	\$ (0.14)	\$ (0.56)	\$ (0.53)
Diluted earnings (loss) per share:				
As reported	\$ (0.03)	\$ 0.01	\$ (0.08)	\$ (0.07)
Pro forma	\$ (0.21)	\$ (0.14)	\$ (0.56)	\$ (0.53)

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

3. Earnings (loss) per share

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

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

	Three Months Ended December 31		Nine Months Ended December 31	
	2004	2003	2004	2003
Numerator:				
Net earnings (loss)	\$ (1,000)	\$ 179	\$ (2,603)	\$ (2,266)
Denominator for basic and diluted earnings (loss) per share:				
Weighted average common shares outstanding	33,151	31,948	32,969	31,655
Basic and diluted earnings (loss) per share:				
As reported	\$ (0.03)	\$ 0.01	\$ (0.08)	\$ (0.07)
Pro forma	\$ (0.03)	\$ 0.01	\$ (0.08)	\$ (0.07)
Anti-dilutive potential common shares excluded from above calculation	8,573	6,231	8,073	5,019

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Had we been profitable during the three and nine months ended December 31, 2004 and the nine months ended December 31, 2003, the weighted average number of shares outstanding for purposes of calculating diluted earnings per share would have been increased by (in thousands):

	Three Months Ended		Nine Months Ended	
	December 31		December 31	
	2004	2003	2004	2003
Stock options	1,430		1,232	1,195

4. Segmented information**Market information**

Genesis operates and tracks its results in one operating segment. Genesis designs, develops and markets integrated circuits that process digital video and graphic images.

Geographic information

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

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

	Three Months Ended		Nine Months Ended	
	December 31		December 31	
	2004	2003	2004	2003
United States	\$ 2,518	\$ 3,731	\$ 6,679	\$ 11,210
China	16,089	25,861	53,764	59,149
Japan	3,744	4,116	10,909	11,698
South Korea	12,757	11,838	36,725	38,751
Taiwan	7,141	5,696	22,390	20,473

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Rest of world	6,037	5,256	20,743	17,267
	<u>6,037</u>	<u>5,256</u>	<u>20,743</u>	<u>17,267</u>
	<u>\$ 48,286</u>	<u>\$ 56,498</u>	<u>\$ 151,210</u>	<u>\$ 158,548</u>

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

	December 31, 2004	March 31, 2004
	<u> </u>	<u> </u>
United States	\$ 218,537	\$ 226,849
Rest of world	8,251	6,291
	<u> </u>	<u> </u>
	<u>\$ 226,788</u>	<u>\$ 233,140</u>

Table of Contents**Customer concentration information**

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

	Three Months Ended		Nine Months Ended	
	December 31		December 31	
	2004	2003	2004	2003
Customer A	16%		12%	
Customer B		13%	11%	15%
Customer C		12%	10%	11%
Customer D		12%		
Customer E		11%		10%

The following table shows customers accounting for more than 10% of accounts receivable trade at December 31, 2004 and March 31, 2004:

	December 31, 2004	March 31, 2004
Customer 1	16%	13%
Customer 2	15%	14%
Customer 3	10%	
Customer 4	10%	
Customer 5		17%
Customer 6		11%

Supplier arrangements

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

5. Inventories

Inventories consist of the following (in thousands):

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	December 31, 2004	March 31, 2004
Finished goods	\$ 9,958	\$ 13,438
Work-in-process	9,524	8,308
	19,482	21,746
Less: Inventory reserve	(3,044)	(3,243)
	<u>\$ 16,438</u>	<u>\$ 18,503</u>

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

	Three Months Ended		Nine Months Ended	
	December 31		December 31	
	2004	2003	2004	2003
Balance at beginning of period	\$ 3,758	\$ 4,117	\$ 3,243	\$ 3,630
Charged to cost of revenues	(296)	(203)	511	284
Charge offs	(418)	(275)	(710)	(275)
Balance at end of period	<u>\$ 3,044</u>	<u>\$ 3,639</u>	<u>\$ 3,044</u>	<u>\$ 3,639</u>

6. Product warranty

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

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The following table presents a roll forward of the product warranty reserve for the indicated periods (in thousands):

	Three Months Ended		Nine Months Ended	
	December 31		December 31	
	2004	2003	2004	2003
Balance at beginning of period	\$ 200	\$ 500	\$ 200	\$ 500
Provision	18	94	135	530
Charge offs	(11)	(94)	(128)	(530)
Balance at end of period	\$ 207	\$ 500	\$ 207	\$ 500

7. Contingent liabilities*Silicon Image Litigation*

In April 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 ("District Court") and simultaneously filed a complaint before the United States International Trade Commission ("ITC"). The complaint and suit alleged that certain Genesis products that contain digital receivers infringe various Silicon Image patent claims. Silicon Image seeks an injunction to halt the sale, manufacture and use of Genesis' s DVI receiver products and unspecified monetary damages. In December 2001, Silicon Image formally moved to withdraw its complaint before the ITC and those proceedings have terminated.

In July 2003, the District Court issued a memorandum opinion, followed by a final judgment in August 2003 and an amended final judgment in December 2003. In its opinion, the District 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 District Court' s opinion states that the MOU is a binding settlement agreement and that Genesis will pay Silicon Image a monetary settlement, license fee and running royalties on all DVI and HDMI products. We recorded a provision for costs associated with this patent litigation in the year ended March 31, 2003; a portion of which was paid in escrow to the court in August 2003 and an additional confidential amount was paid to the court as a bond in March 2004. The payments to the court have been accounted for as reductions of the related liability.

In January 2004, Genesis filed a notice of appeal to the United States Court of Appeals for the Federal Circuit. On January 28, 2005, the Court of Appeals found that the district court' s order was not final, and dismissed the appeal for lack of jurisdiction. The case has returned to the District Court for further adjudication.

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.

MRT, Trumpion and Mstar Litigation

In March 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 the defendants' display controllers infringe various claims of a Genesis U.S. patent. Genesis is seeking monetary damages and a permanent injunction that bars the defendants from making, using, importing, offering to sell, or selling the allegedly infringing products in the United States. In January 2003, Genesis announced a settlement of its litigation against SmartASIC Inc.; the litigation with respect to the other defendants has not been settled. MRT has asserted counterclaims against Genesis, alleging trade secret misappropriation, interference with economic advantage, and unfair practices and competition. Genesis intends to vigorously defend against these claims. A summary judgment hearing is currently scheduled for June 2005.

Genesis previously filed a similar patent infringement complaint against MRT, Trumpion and Mstar Semiconductor, Inc. (Mstar) in the U.S. International Trade Commission (ITC). In August 2004, the ITC determined that Mstar, MRT and Trumpion infringe Genesis's patent, and issued an exclusion order preventing the importation of Mstar, MRT and Trumpion's display controllers into the United States, as well as LCD monitors and boards containing these products.

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In December 2004, Mstar filed an appeal of the exclusion order and related ITC rulings to the Federal Circuit Court of Appeals. MRT and Trumpion did not appeal.

In response to a complaint filed by MRT, the Taiwan Fair Trade Commission investigated Genesis's alleged violation of the Taiwan Fair Trade Law; however, in December 2004, the Taiwan Fair Trade Commission found that Genesis did not commit any such violation.

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 or settlements associated with these claims.

Securities Class Action Litigation

In November 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 former Interim Chief Executive Officer Eric Erdman, and amended in July 2003 to include Executive Vice President 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. The parties are currently awaiting a ruling on Genesis's motion to dismiss the case. Genesis believes that it has meritorious defenses to this lawsuit and will continue to 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.

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.

8. Recent Accounting Pronouncement

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). SFAS 123R is a revision to SFAS 123, *Accounting for Stock Based Compensation* and supersedes APB 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. SFAS 123R establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. SFAS 123R focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions.

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SFAS 123R does not change the accounting guidance for share-based payment transactions with parties other than employees provided in SFAS 123 as originally issued and EITF Issue No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services. SFAS 123R does not address the accounting for employee share ownership plans, which are subject to AICPA Statement of Position 93-6, Employers Accounting for Employee Stock Ownership Plans.

A public entity will initially measure the cost of employee services received in exchange for an award of liability instruments based on its current fair value; the fair value of that award will be re-measured subsequently at each reporting date through the settlement date. Changes in fair value during the requisite service period will be recognized as compensation cost over that period.

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The grant-date fair value of employee share options and similar instruments will be estimated using the option-pricing models adjusted for the unique characteristics of those instruments (unless observable market prices for the same or similar instruments are available).

Excess tax benefits, as defined by SFAS 123R, will be recognized as an addition to paid-in-capital. Cash retained as a result of those excess tax benefits will be presented in the statement of cash flows as financing cash inflows. The write-off of deferred tax assets relating to unrealized tax benefits associated with recognized compensation cost will be recognized as income tax expense unless there are excess tax benefits from previous awards remaining in paid-in capital to which it can be offset.

The notes to the financial statements of public entities will disclose information to assist users of financial information to understand the nature of share-based payment transactions and the effects of those transactions on the financial statements.

We have not made a final determination on the valuation model, methodology, or other impacts of implementing FAS 123R on our financial statements. For an illustration of the effect of using a fair-value based method of accounting for share-based payment transactions on our recent results of operations, see Note 2. The effective date will be as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. Management intends to comply with SFAS 123R at the scheduled effective date for the relevant financial statements.

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

The following contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding anticipated revenues, gross margins, operating expenses, amortization of intangibles and stock-based compensation, liquidity, business strategy, demand for our products, average selling prices, regional market growth, future competition and repatriation under the American Jobs Creation Act of 2004. Words such as anticipates, expects, intends, plans, believes, seeks, estimates and similar expressions identify such forward-looking statements. These forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements. Factors which could cause actual results to differ materially include those set forth in the following discussion, and, in particular, the risks discussed below under the subheading Risk Factors and in other documents we file with the Securities and Exchange Commission. Unless required by law, we undertake no obligation to update publicly any forward-looking statements.

We begin Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) with a general discussion of our target markets, the nature of our products, and some of the business issues we are facing as a company. Next, we address the Critical Accounting Policies and Estimates that we believe are important to understanding the assumptions and judgments incorporated in our reported financial results. We then discuss our Results of Operations for the three and nine months ended December 31, 2004 compared to the three and nine months ended December 31, 2003 as viewed through the eyes of Management. Lastly, we provide an analysis of changes in our balance sheet and cash flows, and discuss our financial commitments. This MD&A should be read in conjunction with the other sections of this Quarterly report on Form 10-Q.

OVERVIEW

Our Markets

We develop and market image-processing solutions. 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 software and

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proprietary integrated circuits, or chips. Our products are primarily used in liquid crystal displays (LCDs). These displays are used in desktop monitor applications, and LCD TVs. In addition, our products may be used in other types of display devices, including plasma TVs, projection TVs and CRT TVs.

We generate the majority of our revenue by selling our image-processing solutions to the manufacturers of LCD monitors and television sets. We outsource the manufacturing of our products to large semiconductor manufacturers, thereby eliminating the need for capital-intensive plant and equipment. Our targeted long-term gross profit percentage is approximately 40%. Our most significant cash operating expense is labor, with our workforce employed in research and development of new products and technologies and in marketing, sales, customer support, and distribution of our products.

Our end target markets are LCD computer monitors and flat panel televisions. We also design products that serve both applications, the so-called multimedia display applications, and it is difficult to distinguish between a monitor with television capability and a television with a PC input. Both of these display devices could use the same Genesis chip. Similarly, we supply certain customers with chips originally designed for an LCD computer monitor that the customer may use as entry-level flat panel television controllers. We assist customers in developing their designs. Typically, a TV design will take more time and support than a monitor design from our software and field application engineers, increasing our costs during a customer's pre-production period.

The growth in our target markets is limited by the industry's capacity to supply LCD panels or other digital displays. Furthermore, the availability of LCD panels from time to time has been constrained, causing unexpected increases in the cost of LCD panels to our customers, thus resulting in customers rapidly changing their demand expectations for our products. Our products usually represent less than two percent of the average retail cost of a standard LCD TV today, while the cost of the LCD panel within a flat panel computer monitor or LCD TV represents the majority of the cost of the finished product. Consequently, constraints on availability of LCD panels or increases in panel costs can result in reduced demand for our products, and it is very difficult to accurately predict the availability or cost of LCD panels and well beyond our means to control. Conversely, it is the increase in production volumes of larger size LCD panels in new fabrication facilities coming on line over the next several years that is expected to result in lower-cost panels and hence lower average selling prices of the end product. While panel prices have decreased significantly over the last few months, the impact of this price decline has not yet been fully reflected at the retail level. However, we believe retail prices will continue to decline in the coming months and we expect this to lead to an increase in demand for display controllers.

Our industry is very competitive and growth industries like ours tend to attract new entrants. The LCD computer monitor industry is highly competitive. Our average selling prices of monitor display controllers, in spite of increased functionality have declined significantly over the past two years. We expect the flat panel television industry will be as competitive over time. Our strategy is to maintain market leadership through integration of new features and functions and by providing the highest image quality at a cost-effective price. We believe we are able to deliver the desired feature-rich image quality through relationships with customers, patented technologies, effective chip design, software capabilities, and customer support. While maintaining our leadership in image quality and product feature sets, we strive to maximize profitability by reducing product cost through efficient chip design and driving costs down throughout our supply chain.

While we primarily market and sell our integrated circuits directly to manufacturers, we also sell finished systems, primarily to the high-end home theatre market, under the Faroudja brand. These products are generally sold through specialty retail channels and represent a very small portion of our overall revenue.

Average selling prices to distributors are typically less than average selling prices to direct customers for similar products. Sales to distributors typically comprise less than 15% of revenue. Average selling prices and product margins of our products are typically highest during the initial months following product introduction and decline over time and as volume increases.

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Part of our overall strategy is to develop intellectual property that is used in our integrated circuits. We have and will continue to defend our intellectual property rights against those companies that may use our technology without the proper authorization. At times we may enter into agreements that allow customers or other companies to license our patented technology.

Revenue Recognition

We recognize revenue from product sales to manufacturers upon shipment, except when risks and rewards of ownership are not transferred upon shipment. In these cases, revenue is not recognized until physical delivery to the customers or their agents premises. For shipments to distributors, we recognize revenue upon the distributors shipment to their end customers, except in certain circumstances where orders are placed with non-cancelable/non-return terms. An example of this would be when last time orders are placed for products at the end of their life cycle. In this situation, revenue would be recognized upon shipment. Reserves for sales returns and allowances are recorded at the time of recognizing revenue. To date we have not experienced significant product returns.

Manufacturing and Supply

We generally need to place purchase orders for products before we receive purchase orders from our customers. This is because production lead times for silicon wafers, from which our products are manufactured, can be as long as three months, while many of our customers place orders only one month or less in advance of their requested delivery date. We have agreements with suppliers in Asia such that we are dependent on the suppliers manufacturing yields. We continue to look at alternative sources of supply to reduce our reliance on key suppliers and reduce lead times, though dual sourcing for specific products is more costly in terms of set-up and yields are typically lower as each manufacturing supplier ramps up production. While we have frequent communication with significant customers to review their requirements, we are restricted in our ability to react to fluctuations in demand for our products and this exposes us to the risk of having either too much or not enough of a particular product. We regularly evaluate the carrying value of inventory held. For the three months ended December 31, 2004, we recorded reserves totaling \$153,000, where certain customers plan to transition to next generation products more quickly than previously anticipated. This has led us to conclude that there will be insufficient future demand for certain on-hand inventory to support its carrying value as of December 31, 2004.

Global Operations

We operate through subsidiaries and offices in several countries throughout the world. Our head office is located in Alviso (Silicon Valley), California. Our research and development resources are located in the United States, Canada and India. The majority of our customers are located in Asia, supported by our sales offices in China, Japan, South Korea and Taiwan. Our third party suppliers are located primarily in Taiwan. Although virtually all of our revenues and costs of revenues are denominated in U.S. dollars, portions of our revenue and 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 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. Our operating expenses are also affected by changes in the rate of inflation in the various countries in which we operate.

Mergers and Acquisitions

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Technology companies often use mergers or acquisitions to accelerate development of products, to realize potential synergies or to enter new markets. We have made significant acquisitions in the past, for example Sage Inc. in February 2002, resulting in the recording of significant intangible assets on our balance sheet.

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For further details on earlier acquisitions, please refer to previously filed Annual and Quarterly Reports.

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 obsolescence provision, deferred tax asset valuation, potential settlements and costs associated with patent litigation and the useful lives of intangible assets. We evaluate our estimates on an on-going basis, including those related to product returns, bad debts, inventories, investments, intangible assets, income taxes, warranty obligations and 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 based on historical experience. A customer has a right to return products only if the product is faulty, although in certain circumstances we agree to accept returns if replacement orders are placed for other products or to maintain our business relationship. If actual customer returns increase, we may be required to recognize additional reductions to revenue.

We record the estimated future cost of replacing faulty product as an increase to cost of revenues. To date we have not experienced significant returns related to quality. If returns increase as a result of changes in product quality, we may be required to recognize additional warranty expense.

We maintain allowances 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 have not suffered any significant loss in this area.

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

Goodwill, which represents the excess of cost over the fair value of net assets acquired in business combinations, is tested annually for impairment, and is tested for impairment more frequently if events and circumstances indicate that the goodwill might be impaired. The impairment tests are performed in accordance with FASB Statement of Financial Accounting Standards No. 142,

Goodwill and Other Intangible Assets . Accordingly, an impairment loss is recognized to the extent that the carrying amount of goodwill exceeds its implied fair value. This determination is made at the reporting unit level. We have assigned all goodwill to a single, enterprise-level reporting unit. The impairment test consists of two steps. First, we determine the fair value of the reporting unit. The fair value is then compared to its carrying amount. Second, if the carrying amount of the reporting unit exceeds its fair

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value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that

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goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation in accordance with FASB Statement of Financial Accounting Standards No. 141, Business Combinations. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. We perform our annual impairment test on January 1st of each year. We did not record any goodwill impairment charges in the nine months ended December 31, 2004 nor in the nine months ended December 31, 2003. Goodwill balances may also be affected by changes in other estimates made at the time of acquisitions.

We record a valuation allowance to reduce our deferred tax assets to the amount that we believe is more likely than not to be realized. Should we determine that we will not be able to realize all or part of our gross deferred tax asset, an adjustment to the deferred tax asset would be charged to income in the period such determination was made. In making this determination, we project taxable income by jurisdiction for the next three years based on market assumptions and company plans, and other jurisdictional history.

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**THREE MONTHS ENDED DECEMBER 31, 2004****REVENUE AND GROSS PROFIT**

The following table shows unaudited statement of operations data for the three months ended December 31, 2004 and December 31, 2003 (in thousands):

	Three months ended	
	December 31	
	2004	2003
Total revenue	\$ 48,286	\$ 56,498
Gross profit	21,677	22,352
Gross profit percentage	44.9%	39.6%
Revenue by geography:		
United States	\$ 2,518	\$ 3,731
China	16,089	25,861
Japan	3,744	4,116
South Korea	12,757	11,838
Taiwan	7,141	5,696
Rest of world	6,037	5,256

Total revenue	\$ 48,286	\$ 56,498
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Total Revenues

Revenues for the three months ended December 31, 2004 decreased by 14.5% to \$48.3 million from \$56.5 million for the three months ended December 31, 2003, primarily due to both lower shipments and lower average selling prices (ASP) in the monitor market, offset in part by higher revenue from TV and video products. We believe that part of the reason for the decline in shipments of monitor products resulted from a build up of finished goods monitor inventory in the channel as customers ordered in advance of anticipated large LCD monitor price declines, which did not materialize to the extent projected and therefore did not stimulate end user demand beyond normal market expectations. Unit shipments into advanced flat panel televisions grew by 86% driving revenue from this market to a 43% increase compared to the same period last year. Average ASP s for the company s products as whole increased by 2% from the three months ended September 30, 2004, reflecting the impact of the growing advanced television market, which typically have significantly higher ASP s than monitor products, and the change in product mix within the monitor controller market.

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The majority of our shipments continue to be to customers located in Asia. We expect to continue to see growth in these regions, although revenues from China decreased this quarter reflecting the lower units shipped into the monitor market.

Revenues from shipments into displays with video capability, such as LCD television, continued to increase and have become a larger proportion of total revenue. During the three months ended December 31, 2004, we estimate that approximately 47% of total revenue was from consumer video related products, compared with 35% for the three months ended December 31, 2003. While we expect strong competition in all sectors of the market to continue, we experienced only modest sequential ASP declines of approximately 3% in our monitor products on a part for part basis from the September quarter, and we continue to believe there are fewer new entrants into this marketplace. As for higher-end display controllers with video capability, we still believe there remains considerable opportunity to add features and reduce system cost through further integration.

In addition to revenue from shipments of display controllers, we continue to generate revenues from licensing of our patented technology to third parties in connection with our favorable final determination in the ITC case. We signed new licensing agreements with a number of customers during the three months ended December 31, 2004. By licensing to our customers, we are providing them with the flexibility to maintain multiple sources for supply, while ensuring that we are compensated for the rights to use our intellectual property.

We currently anticipate that revenues in the quarter ended March 31, 2005 will be between \$47 and \$52 million. Revenue is highly dependent on a number of factors including, but not limited to, the growth rate of the LCD monitor, flat-panel TV and Genesis other markets, the degree of acceptance of Genesis products in those markets, customer inventory levels and manufacturing schedules, availability of other components for LCD monitors and flat-panel TVs, changes in product pricing and actions of competitors, the company's ability to maintain design wins with customers and make timely new product introductions, supply of products from Genesis third party suppliers, and general economic conditions.

Gross Profit

Gross profit for the three months ended December 31, 2004 decreased to \$21.7 million from \$22.4 million for the three months ended December 31, 2003. As a percentage of revenues, gross profit represented 44.9% of revenues for the three months ended December 31, 2004, compared with 39.6% for the three months ended December 31, 2003. The improvement in gross margin percentage is primarily attributable to improvements in production yields and lower product costs.

We expect gross profit margins in the quarter ended March 31, 2005 to be in the range of 41% to 43% for the company as a whole. Gross margins could be higher or lower than expected due to many factors including, but not limited to changes in product costs by our third party manufacturers, product pricing and actions of competitors, manufacturing yields, inventory reserves, actual revenue levels and product mix.

OPERATING EXPENSES

Management focuses on particular operating expenses in evaluating our financial condition and operating performance. The following table presents these expenses in the form reviewed by management. Significant trends and fluctuations between periods are addressed in the narrative which follows. In order to evaluate operating performance, management internally reports operating expenses in categories of a cash, non-cash, and non-recurring nature. Non-cash expenses such as the amortization of intangible assets and stock-based compensation are reviewed separately from other operating expenses. Management finds this presentation to be a more effective method of assessing current operating

performance.

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	Three months ended			
	December 31, 2004		December 31, 2003	
		% of		% of
	\$000	Revenue	\$000	Revenue
Research and development	\$ 7,520	15.6%	\$ 6,694	11.8%
Selling, general and administrative	12,568	26.0%	9,308	16.5%
Provision for costs associated with patent litigation	989	2.0%	3,529	6.2%
Amortization of acquired intangibles	2,654	5.5%	2,654	4.7%
Stock-based compensation	2,465	5.1%	930	1.7%
Total operating expenses	\$ 26,196	54.2%	\$ 23,115	40.9%

Research and Development

Research and development expenses include costs associated with research and development personnel, development tools, hardware and software licenses, and prototyping. Research and development expenses for the three months ended December 31, 2004 were \$7.5 million, compared with \$6.7 million in the three months ended December 31, 2003. This 12% increase was primarily due to higher labor-related costs as we continued to invest more heavily in the research and development of technologies addressing the television and video markets. In addition, the mix of spending changed, with less effort directed at lower-end monitor applications, and more focus on multimedia and video applications.

These expenses represented 15.6% of revenues in the three months ended December 31, 2004, and 11.8% in the three months ended December 31, 2003.

Selling, General and Administrative

Selling, general and administrative expenses consist of personnel and related overhead costs for selling, including field application engineers, marketing communications, product marketing, customer support, finance, human resources, legal and general management functions and of commissions paid to regional sales representatives. Selling, general and administrative expenses for the three months ended December 31, 2004 were \$12.6 million, compared with \$9.3 million in the three months ended December 31, 2003. The increase was attributable to \$1.0 million of severance costs and other costs associated with the departure of certain employees, including former executive officers, \$0.3 million of additional marketing expense, \$0.5 million of costs associated with compliance with the Sarbanes-Oxley Act of 2002, and increased contractor headcount, to support the expected growth in the advanced display market.

We market our DCD[®] by Faroudja and other brands directly through trade shows and publications, and indirectly through partnerships with companies that use our products. We believe that in building brand awareness, we will establish a reputation for quality and performance of our products in high-end applications. This may be one of the cornerstones of our success as the consumer electronics market grows and as these displays become more affordable to the end user.

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We also provide technical sales support through field application engineers in China, Japan, India, South Korea, and Taiwan. These engineers assist our customers to integrate our products into their display designs. We believe that this kind of investment at the early stages of a growing market positions us well to capitalize on the future unit growth that is forecasted for the television market. We expect these costs to continue to increase during fiscal 2005 as we assist customers in design activity in anticipation of production volumes in fiscal 2006 and beyond.

These expenses represented 26.0% of revenues in the three months ended December 31, 2004 and 16.5% in the three months ended December 31, 2003.

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Amortization of Acquired Intangibles

Amortization of acquired intangible assets was \$2.7 million for the three months ended December 31, 2004 and 2003. We anticipate the amortization of existing acquired intangibles to remain constant at \$2.7 million for the quarter ending March 31, 2005 and to be fully amortized by the end of fiscal 2006.

Stock-Based Compensation

As part of the accounting for the acquisition of Sage in February 2002, the intrinsic value of unvested options issued in exchange for previously issued Sage 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. This amortization amounted to \$0.5 million for the three months ended December 31, 2004. In addition to this ongoing charge, stock-based compensation of \$1.9 million was recorded during the quarter, primarily resulting from the modification of option grants to certain executives as part of their separation agreements. In assessing operating performance, management excludes these expenses from other research and development and selling, general and administrative costs. We expect the ongoing quarterly amortization of deferred stock-based compensation to decline over the remainder of fiscal 2005, and to be fully amortized by the end of fiscal 2006.

Costs Associated with Patent Litigation

We have incurred significant costs associated with patent litigation over the past three fiscal years. During the three months ended December 31, 2004, we incurred legal costs of \$1.0 million associated with ongoing patent litigation activities. In the three months ended December 31, 2003, we recognized total costs of \$3.5 million, the majority of which was in connection with certain patent litigation brought by us against several companies resulting in a favorable ruling in August 2004. If we decide to take legal action against other companies in the future, or if intellectual property infringement suits are brought against us or our customers, these costs may increase. More details of the various litigation matters are described in Part II: Other Information, Item 1. Legal Proceedings.

Total Operating Expenses

Total operating expenses for the three months ended December 31, 2004 were \$26.2 million, representing an increase of \$3.1 million from \$23.1 million in the three months ended December 31, 2003, for the reasons described above. We expect total combined operating expenses of approximately \$22 million to \$24 million in the quarter ended March 31, 2005, including approximately \$3.2 million of non-cash charges for stock-based compensation and the amortization of acquired intangibles.

NON OPERATING INCOME AND EXPENSES

Provision for Income Taxes

We recorded an income tax benefit of \$3.0 million for the three months ended December 31, 2004 compared to a provision for income taxes of \$0.04 million for the three months ended December 31, 2003. The income tax recovery for the three months ended December 31, 2004 increased as a result of the impact of the strengthening Canadian dollar relative to the U.S. dollar. As all of the subsidiaries of the corporate group use the U.S. dollar as the functional currency this increased the U.S. dollar book value of Canadian dollar tax attributes and other deductions. Our accounting effective tax rate also differs from the expected statutory rates due to several other permanent differences including, but not limited to, federal and state research and experimental development tax credits, stock-based compensation expense, and differences in tax rates in foreign jurisdictions. The net tax benefit of these items is partially offset by changes in the valuation allowance against net operating loss carryforwards. Therefore, the effective tax rate will continue to be, directly impacted by the mix of earnings between the United States and foreign jurisdictions. A valuation allowance is recorded to the extent that it is more likely than not that some portion of the deferred tax assets will not be realized.

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On October 22, 2004, the American Jobs Creation Act of 2004 (AJCA) was signed into law. The AJCA includes a deduction of 85% of certain foreign earnings that are repatriated, as defined in the AJCA. We may elect to apply this provision to qualifying earnings repatriations in fiscal 2005. We have started an evaluation of the effects of the repatriation provision. However, we do not expect to be able to complete this evaluation until after the U.S. government provides clarifications regarding key elements of the provision. We expect to complete our evaluation of the effects of the repatriation provision following the publication of these clarifications. The range of possible amounts that we are considering for repatriation under this provision is zero to \$140 million, of which up to \$70 million would be expected to be treated as a dividend for U.S. tax purposes. If we choose to repatriate funds, this decision may result in an adjustment to the tax provision in the period during which any decision is made, but we cannot reasonably estimate the amount of the adjustment at this time.

NINE MONTHS ENDED DECEMBER 31, 2004**REVENUE AND GROSS PROFIT**

The following table shows unaudited statement of operations data for the nine months ended December 31, 2004 and December 31, 2003 (in thousands):

	Nine months ended	
	December 31	
	2004	2003
Total revenue	\$ 151,210	\$ 158,548
Gross profit	64,094	64,535
Gross profit percentage	42.4%	40.7%
Revenue by geography:		
United States	\$ 6,679	\$ 11,210
China	53,764	59,149
Japan	10,909	11,698
South Korea	36,725	38,751
Taiwan	22,390	20,473
Rest of world	20,743	17,267
Total revenue	\$ 151,210	\$ 158,548

Total Revenues

Revenues of \$151.2 million for the nine months ended December 31, 2004 were lower than the \$158.5 million recorded during the nine months ended December 31, 2003. Unit shipments increased by 17% from the previous year. However, the revenue impact from these unit volumes was more than offset by declining average selling prices (ASP) of 18% during the same period.

During the nine months ended December 31, 2004, we estimate that approximately 46% of total revenue was from consumer video related products, compared with 28.5% for the nine months ended December 31, 2003.

Gross Profit

Gross profit for the nine months ended December 31, 2004 did not change significantly from the previous period. Gross profit decreased by \$0.5 million to \$64.1 million, with the impact of lower revenue being almost offset by a higher gross margin percentage. Gross profit percentage for the nine months ended December 31, 2004 of 42.4% compared with 40.7% for the nine months ended December 31, 2003.

OPERATING EXPENSES

As with the discussion of the three month period earlier in this MD&A, the following table presents operating expenses for the nine months ended December 31, 2004 and December 31, 2003 in the form reviewed by Management.

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	Nine months ended			
	December 31, 2004		December 31, 2003	
		% of		% of
	\$000	Revenue	\$000	Revenue
Research and development	\$ 23,072	15.2%	\$ 20,360	12.8%
Selling, general and administrative	34,114	22.6%	28,218	17.8%
Costs associated with patent litigation	2,356	1.5%	9,583	6.0%
Amortization of acquired intangibles	7,962	5.3%	7,962	5.0%
Stock-based compensation	4,062	2.7%	2,770	1.8%
Total operating expenses	\$ 71,566	47.3%	\$ 68,893	43.4%

Research and Development

Research and development expenses for the nine months ended December 31, 2004 were \$23.1 million, compared with \$20.4 million in the nine months ended December 31, 2003. As for the nine months ended December 31, 2004, this 13% increase was due to higher labor and consulting related costs as we continued to invest more heavily in the research and development of technologies addressing the advanced television and video markets.

These expenses represented 15.2% of revenues in the nine months ended December 31, 2004, and 12.8% in the nine months ended December 31, 2003.

Selling, General and Administrative

Selling, general and administrative expenses for the nine months ended December 31, 2004 were \$34.1 million, compared with \$28.2 million in the nine months ended December 31, 2003. This increase reflects the investment in building both the brand value of our products and the infrastructure, including increased headcount, to support the expected growth in the advanced display market, severance costs, mostly related to the departure of two executive officers, and costs associated with compliance with the Sarbanes-Oxley Act of 2002.

These expenses represented 22.6% of revenues in the nine months ended December 31, 2004 and 17.8% in the nine months ended December 31, 2003.

Amortization of Acquired Intangibles

Amortization of acquired intangible assets was \$8.0 million for both of the nine months ended December 31, 2004 and December 31, 2003.

Stock-Based Compensation

Stock-based compensation increased by \$1.3 million to \$4.1 million for the nine months ended December 31, 2004 from \$2.8 million during the nine months ended December 31, 2003, primarily due to the modification of option grants to certain executives as part of their separation agreements.

Costs Associated with Patent Litigation

These costs decreased significantly for the nine months ended December 31, 2004, declining by \$7.2 million, or 75%, as ITC proceedings came to an end during the period. More details of the various litigation matters are described in Part II: Other Information, Item 1. Legal Proceedings.

Total Operating Expenses

Total operating expenses for the nine months ended December 31, 2004 were \$71.6 million compared to \$68.9 million for the nine months ended December 31, 2003.

Table of Contents**NON OPERATING INCOME AND EXPENSES****Provision for Income Taxes**

We recorded an income tax benefit of \$3.6 million for the nine months ended December 31, 2004 compared to \$0.6 million for the nine months ended December 31, 2003. Our accounting effective tax rate differs from the expected statutory rates due to several permanent differences including, but not limited to, federal and state research and experimental development tax credits, stock-based compensation expense, foreign exchange fluctuations and differences in tax rates in foreign jurisdictions. The net tax benefit of these items is partially offset by changes in the valuation allowance against net operating loss carryforwards. A valuation allowance is recorded to the extent that it is more likely than not that some portion of the deferred tax assets will not be realized. Therefore, the effective tax rate for accounting purposes is, and will continue to be, directly impacted by the mix of earnings between the United States and foreign jurisdictions.

LIQUIDITY AND CAPITAL RESOURCES

Since inception we have satisfied our liquidity needs primarily through cash generated from operations and sales of equity securities, initially by way of a public offering, and subsequently under our stock option and employee stock purchase plans. We believe that our existing cash balances together with any cash generated from our operations will be sufficient to meet our capital and operating requirements for the foreseeable future.

Periodically, we may be required to use a portion of our cash balances to increase investment 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. Furthermore, 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. While 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.

From time to time we evaluate acquisitions of businesses, products or technologies that are complementary or strategic to 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.

	December 31,	March 31,
	2004	2004
	<hr/>	<hr/>
Cash, cash equivalents and short-term investments	\$ 131,319	\$ 118,222
Working capital	\$ 155,565	\$ 147,651
Current ratio	7.34	7.19
Receivables days outstanding	50	46
Inventory turnover days	56	53

We believe that our financial condition remains strong. At December 31, 2004, cash, cash equivalents and short-term investments totaled \$131.3 million compared with \$118.2 million at March 31, 2004. Prior to changes in working capital balances, we generated \$10.6 million of cash provided by operations during the nine months ended December 31, 2004, compared with \$8.3 million for the nine months ended December 31,

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2003. We have no debt and we expect to continue to generate cash from operations during fiscal 2005. After changes in working capital balances, net cash provided by operating activities was \$15.8 million for the nine months ended December 31, 2004 compared with \$6.7 million for the nine months ended December 31, 2003.

Working capital sources of cash related primarily to decreases in accounts receivable and inventory. Accounts receivable decreased by \$1.9 million from March 31, 2004 to December 31, 2004. The days sales outstanding also increased from 46

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days at March 31, 2004 to 50 days at December 31, 2004. This increase is attributable to the timing of shipments to our customers during the period and more favorable credit terms offered to customers in response to competitive pressures. For the three months ended December 31, 2004, our three largest customers accounted for 33% of revenue, compared with 36% for the three months ended December 31, 2003. Additionally, the top three customers accounted for 41% of accounts receivable at December 31, 2004 and 44% at March 31, 2004. Inventory levels decreased by 11.2% from March 31, 2004 to \$ 16.4 million, primarily resulting from lower weighted average product cost. Average days of inventory on hand at December 31, 2004 increased slightly at 56 days, compared to 53 days at March 31, 2004. The average inventory levels and inventory turns is impacted by a number of dynamic activities including the accuracy of customer forecasts, expected panel supplies, and pricing considerations. These activities are not necessarily an indication of what inventory turns might be in the future.

Net cash used in investing activities was \$1.0 million during the nine months ended December 31, 2004, compared with \$72.6 million during the nine months ended December 31, 2003. This decrease was primarily due to the significant purchase of short-term investments during the nine months ended December 31, 2003.

Net cash provided by financing activities was \$5.2 million for the nine months ended December 31, 2004, and \$8.6 million for the nine months ended December 31, 2003. These represent funds received for the purchase of shares under the terms of our stock option plans and employee stock purchase plan.

Contractual Obligations

As of December 31, 2004, our principal commitments consisted of obligations outstanding under operating leases. These commitments include leases for two premises in the United States, located in San Jose and Alviso, California, two in China and one location in each of Canada, India, Japan, South Korea and Taiwan. In addition, we have obligations under operating leases for equipment. The aggregate minimum annual payments required under our lease obligations, excluding expected sub-lease income, by fiscal year are as follows (in thousands):

2005	\$ 3,385
2006	3,195
2007	3,195
2008	1,219
2009	1,219
2010	21
	<hr/>
Total	\$ 12,234
	<hr/>

Our lease agreements expire at various dates through calendar 2009.

Purchase orders or contracts for the purchase of raw material and other goods and services have not been separately disclosed. We are not able to determine the aggregate amount of such purchase orders that represent contractual obligations, as purchase orders may represent authorizations to purchase rather than binding agreements. Our purchase orders for manufacturing are based on our current needs and are fulfilled by our vendors within short time horizons. We do not have significant agreements for the purchase of raw materials or other goods specifying minimum quantities or set prices that exceed our expected requirements for three months. We also enter into contracts for outsourced services; however, the obligations under these contracts are not significant and the contracts generally contain clauses allowing for cancellation without significant penalty.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources.

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Capital commitments

We do not have any capital commitments that will have a material future effect on our financial condition.

RISK FACTORS

Our quarterly revenues and operating results fluctuate due to a variety of factors, which may result in volatility or a decline in our stock price.

Our historical revenues and operating results have varied significantly from quarter to quarter. Moreover, our operating results in some quarters may not meet the expectations of stock market analysts and investors, which may cause our stock price to decline. In addition to the factors discussed elsewhere in this Risk Factors section, a number of factors may cause our revenue to fall short of our expectations or cause fluctuations in our operating results, including:

Our ability to make timely new product introductions and gain design wins with our customers;

Growth rate of the LCD monitor market, flat-panel television market and our other markets;

Changes in the mix of products we sell;

Consumer demand for the displays into which our products are incorporated;

Increased competition and competitive pricing pressures;

Fluctuations in supply or demand for other components included in flat panel displays;

Customer inventory levels and manufacturing schedules;

Supply of products from our third party suppliers;

Changes in product costs or manufacturing yields or available production capacity at our fabrication facilities;

The evolving and unpredictable nature of the markets for the display products that incorporate our products, especially the flat panel television market; and

Costs and outcome of legal proceedings.

As a result of the fluctuation in our revenues and operating results, our stock price can be volatile, especially if our actual financial performance in a quarter deviates from the financial targets we set at the beginning of that quarter, or from market expectations.

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 and small companies, including ATI Technologies, Broadcom Corp., LSI Logic Corp., Micronas Semiconductor Holding AG, Media Reality Technologies, Inc., Mediatek Corp., Mstar Semiconductor, Inc., Novatek Microelectronics, Oplus Technologies, Ltd., Philips Semiconductors, a division of Philips Electronics N.V., Pixelworks, Inc., Realtek Semiconductor Corp., Silicon Image, Inc., ST Microelectronics, Inc., Trident Microsystems, Inc., Truphion Microelectronics, Inc. and Zoran Corporation. In addition, many of our current and potential customers have their own internally developed integrated circuit solutions, and may choose not to purchase solutions from third party suppliers like Genesis.

As the markets for our products continue to develop, our current customers may increase reliance on their own internally developed solutions, and competition from diversified electronic and semiconductor companies will intensify. Some competitors, who may include our own customers, are likely to include companies with greater financial and other resources than us. Our overseas competitors have reduced cost structures that enable them to compete aggressively on price. 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 an amended final judgment which states that we have received a license from Silicon Image, Inc. for certain of their DVI and HDMI

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patents, and must pay Silicon Image royalties on all of our DVI and HDMI products. This amended final judgment, if not overturned on appeal, could hinder our ability to compete with unlicensed competitors that are not required to pay royalties on competing products.

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.

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 50% of our revenues, and for our largest customer 16%, for the three months ended December 31, 2004. We expect that a small number of customers will continue to account for a large amount of our revenues. Most 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.

We have had significant management turnover, and may not be able to retain or attract the key personnel we need to succeed.

We have had significant turnover in our management team, in particular in the positions of Chief Executive Officer and Vice President of Sales. We cannot assure you that we will be able to attract and retain other key employees, including senior management and executive positions. If we cannot attract and retain these 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 material knowledge of our departing employees.

Our success will depend on the growth of the market for flat panel televisions and LCD monitors.

Our ability to generate revenues will depend on the growth of the market for flat panel televisions, LCD computer monitors, and digital televisions. Our continued growth will also depend upon emerging markets for consumer electronics markets such as HDTV and home theater. 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,

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

The emergence of competing technologies and standards.

These and other potential markets may not develop as expected, which would harm our business.

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If we are unable to introduce new products with higher average selling prices, our financial results may suffer.

Average selling prices for our flat panel monitor products have declined. When average selling prices decline, our revenues decline unless we are able to sell more units, and our gross margins decline unless we are able to reduce our manufacturing and/or other supply chain costs by a commensurate amount or introduce new higher-priced products to offset the declining price of existing products. Our operating results suffer when gross margins decline. We must introduce new products with higher average selling prices in order to counteract the decline in prices for our existing product line.

The sales of our products are highly concentrated and our products may not continue to be accepted in the advanced display industry.

Our sales are derived from a limited number of products. Five of our products accounted for 58% of our revenues for the three months ended December 31, 2004. There were no other products accounting for more than ten percent of our revenues. We expect that a small number of products will continue to account for a large amount of our revenues.

Our success in the advanced display market, which includes flat panel computer monitors, as well as LCD and digital televisions, home theater, DVD, 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 this market 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.

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.

Intellectual property infringement suits brought against us or our customers 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 December 19, 2003, the court issued its amended final judgment in the proceeding, which such judgment is being appealed; see Part II Other Information, Item 1. Legal Proceedings. In addition, IP Innovation LLC has sued Dell Computer Corporation, alleging patent infringement by certain of Dell's LCD televisions that contain our display controller products. These lawsuits or any future patent infringement lawsuits could subject us to permanent injunctions preventing us from selling the accused products and/or cause us to incur significant costs, including defense costs, settlements and judgments. In addition, as a result of these lawsuits or any future patent infringement lawsuits, our existing customers may decide to stop buying our products, and prospective customers may be unwilling to buy our products.

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Intellectual property lawsuits, regardless of their success, would likely be time-consuming and expensive to resolve and would divert management time and attention. In addition, if we are unsuccessful and our products (or our customers' monitors or televisions that contain our products) are found to infringe the intellectual property rights of others, we could be forced to do one or more of the following:

Stop selling the products or using the 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 costs including defense costs, settlements and/or judgments; and

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

As a result, intellectual property litigation could have a material adverse effect on our revenues, financial results and market share.

We may be required to indemnify our customers against claims of intellectual property infringement

From time to time, we enter into agreements with our customers that contain indemnification provisions for claims based on infringement of third party intellectual property rights. As a result, if such a claim based on our products is made against an indemnified customer, we may be required under our indemnification obligations to defend or settle the litigation, and/or to reimburse that customer for its costs, including defense costs, settlements and judgments. We may also be subject to claims for indemnification under statutory or common law. For example, some of our customers have requested assistance and indemnification in connection with a lawsuit brought against Dell Computer Corporation by IP Innovation LLC alleging patent infringement by certain LCD televisions that may contain our products. This or other patent litigation and any indemnification obligations we may have could have a material adverse effect on our revenues, financial results and market share, and could result in significant payments by us that could have a material adverse effect on our financial position.

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.

We may become subject to judgments for securities class action suits.

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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.

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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, cause customer claims, 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, 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 and reliability;

Increased manufacturing cost to us in the event that manufacturing capacity becomes constrained;

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

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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 or cause us to incur costs to obtain adequate and timely supply of products.

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

Most of our outside foundries, third-party assembly and test subcontractors are located in Taiwan, which is an area susceptible to natural disasters. In addition, some of our significant customers are located in Taiwan. Damage caused by natural disasters in Taiwan may result in shortages of water or electricity or cause transportation difficulties that could limit the production capacity of our outside foundries or the ability of our subcontractors to provide assembly and test services. Any reduction in production capacity or the ability to provide assembly and test services could cause delays or shortages in our product supply, which would harm our business. Foundries located in Taiwan were responsible for most of our semiconductor product revenue for the three months ended December 31, 2004. Sales to customers located in Taiwan were 15% of our revenue for the three months ended December 31, 2004. If future natural disasters 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 natural disasters, 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.

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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.

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

A large portion of our revenues will come from sales to customers outside of the United States, particularly to equipment manufacturers located in South Korea, China, Japan and Taiwan. For the three months ended December 31, 2004, sales to regions outside of the United States represented 95% of revenues. For that same period, sales to China and South Korea alone constituted 33% and 26%, respectively, of revenues. These sales are subject to numerous risks, including:

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

Unexpected changes in regulatory requirements;

Political and economic instability;

Exposure to litigation or government investigations 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.

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Our customers experience fluctuating product cycles and seasonality, which causes their sales to fluctuate.

Our products are incorporated into flat panel displays. Because the market for flat panel displays is characterized by numerous new product introductions, our operating results may vary significantly from quarter to quarter. Our customers also experience seasonality in the sales of their products, which affects their orders of our products. Typically, the second half of the calendar year represents a disproportionate percentage of sales for our customers due to the holiday shopping period for these products, and therefore, a disproportionate percentage of our sales. Also, our sales in the first quarter of the calendar year may be lower as a result of the Chinese New Year holiday in Asia. We expect these sales fluctuations to continue for the foreseeable future.

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.

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. The recent acquisitions and potential future acquisitions involve numerous risks, including the following:

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

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

The acquisitions may disrupt our ongoing business,

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

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

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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.

New laws require that we undertake an evaluation of our internal controls that may identify internal control weaknesses and cause our operating expenses to increase.

The Sarbanes-Oxley Act of 2002, the California Disclosure Act and newly proposed or enacted rules and regulations of the Securities and Exchange Commission and the National Association of Securities Dealers impose new duties on us and our executives, directors, attorneys and independent registered public accountants. In order to comply with the Sarbanes-Oxley Act and such new rules and regulations, we are evaluating our internal controls systems to allow management to report on, and

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our independent auditors to attest to, our internal controls. We are currently performing the process of evaluation and testing, and any necessary remediation required, in an effort to comply with the management certification and auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act. These rules are effective for Genesis as of the March 31, 2005 year end. As a result, we expect to incur additional expenses for internal and outside legal, accounting and advisory services, any of which could materially increase our operating expenses and accordingly reduce our net income or increase our net losses. While we aim to fully implement the requirements relating to internal controls and all other aspects of Section 404 in a timely fashion, we cannot be certain as to the outcome of our testing and resulting remediation actions or the impact of the same on our operations, since there is no precedent available by which to measure compliance adequacy. If we are not able to implement the requirements of Section 404 in a timely manner or with adequate compliance or with the discovery of one of more material weaknesses in internal controls, our independent auditors will not issue an unqualified opinion, or we may be subject to investigation and/or sanctions by regulatory authorities, such as the Securities Exchange Commission or The NASDAQ Stock Market and our reputation may be harmed, even though non-compliance may not result in an error in financial reporting. Any such action by regulatory authorities could adversely affect our financial results and the market price of our common stock.

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, many industries are delaying or reducing technology purchases. As a result, if economic conditions in the United States, Asia or 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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

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

We carry out a significant portion of our operations outside of the United States, primarily in Canada and in India and to a lesser extent China, Japan, South Korea and Taiwan. Although virtually all of our revenues and costs of revenues are denominated in U.S. dollars, portions of our operating revenue and expenses are denominated in foreign currencies. Accordingly, our operating results are affected by changes in the exchange rate between the U.S. dollar and those currencies. Any future strengthening of those currencies against the U.S. dollar could negatively impact our operating results by increasing our operating expenses as measured in U.S. dollars. We do not currently engage in any hedging or other transactions intended to manage the risks relating to foreign currency exchange rate fluctuations, other than natural hedges that occur as a result of holding both assets and liabilities denominated in foreign currencies. We may in the future undertake hedging or other such transaction if we determine it is necessary to offset exchange rate risks. Based on our overall currency rate exposure at December 31, 2004, a near-term 10% appreciation or depreciation in the U.S. dollar relative to a pool of our foreign currencies would not have a material effect on our operating results or financial condition.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures

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

Our disclosure controls and procedures provide our Chief Executive Officer and Chief Financial Officer reasonable assurances that our disclosures are appropriate. 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 the objectives of the control system are met. Furthermore, the design of a control system must reflect the fact 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 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 any design will succeed in achieving its stated objectives under all potential future conditions.

Changes in internal control over financial reporting

We are completing our detailed assessment of our internal controls over financial reporting to comply with Section 404 of the Sarbanes-Oxley Act of 2002. We have identified changes that need to be made to our internal controls, primarily related to better documentation and enhanced controls. We believe the changes made during the three months ended December 31, 2004 did not, individually or in the aggregate, have a material effect on, and are not reasonably likely to materially affect, our internal controls over financial reporting.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Silicon Image Litigation

In April 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 (District Court) and simultaneously filed a complaint before the United States International Trade Commission

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(ITC). The complaint and suit alleged that certain Genesis products that contain digital receivers infringe various Silicon Image patent claims. Silicon Image seeks an injunction to halt the sale, manufacture and use of Genesis 's DVI receiver products and unspecified monetary damages. In December 2001, Silicon Image formally moved to withdraw its complaint before the ITC and those proceedings have terminated.

In July 2003, the District Court issued a memorandum opinion, followed by a final judgment in August 2003 and an amended final judgment in December 2003. In its opinion, the District 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 District Court 's opinion states that the MOU is a binding settlement agreement and that Genesis will pay Silicon Image a monetary settlement, license fee and running royalties on all DVI and HDMI products.

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In January 2004, Genesis filed a notice of appeal to the United States Court of Appeals for the Federal Circuit. On January 28, 2005, the Court of Appeals found that the district court's order was not final, and dismissed the appeal for lack of jurisdiction. The case has returned to the District Court for further adjudication.

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.

MRT, Trumpion and Mstar Litigation

In March 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 the defendants' display controllers infringe various claims of a Genesis U.S. patent. Genesis is seeking monetary damages and a permanent injunction that bars the defendants from making, using, importing, offering to sell, or selling the allegedly infringing products in the United States. In January 2003, Genesis announced a settlement of its litigation against SmartASIC Inc.; the litigation with respect to the other defendants has not been settled. MRT has asserted counterclaims against Genesis, alleging trade secret misappropriation, interference with economic advantage, and unfair practices and competition. Genesis intends to vigorously defend against these claims. A summary judgment hearing is currently scheduled for June 2005.

Genesis previously filed a similar patent infringement complaint against MRT, Trumpion and Mstar Semiconductor, Inc. (Mstar) in the U.S. International Trade Commission (ITC). In August 2004, the ITC determined that Mstar, MRT and Trumpion infringe Genesis's patent, and issued an exclusion order preventing the importation of Mstar, MRT and Trumpion's display controllers into the United States, as well as LCD monitors and boards containing these products.

In December 2004, Mstar filed an appeal of the exclusion order and related ITC rulings to the Federal Circuit Court of Appeals. MRT and Trumpion did not appeal.

In response to a complaint filed by MRT, the Taiwan Fair Trade Commission investigated Genesis's alleged violation of the Taiwan Fair Trade Law; however, in December 2004, the Taiwan Fair Trade Commission found that Genesis did not commit any such violation.

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 or settlements associated with these claims.

Securities Class Action Litigation

In November 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 former Interim Chief Executive Officer Eric Erdman, and amended in July 2003 to include Executive Vice President Anders Frisk (collectively the Individual Defendants) in the United States District Court for the

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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. The parties are currently awaiting a ruling on Genesis s motion to dismiss the case. Genesis believes that it has meritorious defenses to this lawsuit and will continue to 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.

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.

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At our annual meeting of stockholders (Annual Meeting) held on November 3, 2004, the following individuals were elected to the Board of Directors as Class III directors for a term of three years:

<u>NOMINEES</u>	<u>Votes For</u>	<u>Votes Withheld</u>
Jon Castor	29,824,502	292,737
Chieh Chang	29,767,794	349,445
Jeffrey Diamond	21,747,040	8,370,199

Tim Christoffersen and Robert Kidd continue as Class I directors of the Company. Eric Erdman and Chandrashekar Reddy continue as Class II directors of the Company. George Duguay and Alexander Lushtak were Class III directors whose terms expired at the Annual Meeting and who elected not to stand for re-election.

In addition, at the Annual Meeting, the following proposal was adopted by the margin indicated: To ratify the appointment of KPMG LLP in Canada as our independent accountants for the fiscal year ending March 31, 2005. The votes cast for this action were 29,703,905 and against were 395,653, with 17,681 abstaining.

ITEM 6. EXHIBITS**(a) Exhibits****Exhibit**

<u>Number</u>	<u>Exhibit Description</u>
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)	

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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 [Intentionally omitted]
- 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, Raphael Mehrbians, Tzayao Chan, 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.

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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(12)*	Settlement Agreement and Release with James E. Donegan.
10.22(10)	Termination and Release Agreement, dated as of August 5, 2003, among Genesis Microchip Inc., Display Acquisition Corporation and Pixelworks, Inc.
10.23(11)*	Offer Letter with Michael Healy.
10.24(11)*	Change of Control Severance Agreement with Michael Healy.
10.25(11)	Option Exchange Agreement with Raphael Mehrbians.
10.26(14)*	Interim CEO Employment Agreement with Eric Erdman.
10.27(14)	Form of director and officer indemnification agreement.
10.28(13)*	2003 Stock Plan.
10.29(15)*	Form of 2000 Nonstatutory Stock Option Plan Stock Option Agreement with Nonemployee Directors
10.30(15)*	Form of 2000 Nonstatutory Stock Option Plan International Stock Option Agreement
10.31(15)*	Form of 2000 Nonstatutory Stock Option Plan Stock Option Agreement for China
10.32(16)*	Amendment No.1 to Separation Agreement and Release with Chandrashekar Reddy, dated November 10, 2004.
10.33(17)*	Offer Letter of Employment with Elias Antoun, dated November 10, 2004.
10.34(18)*	Change in Control Severance Agreement with Elias Antoun, dated November 29, 2004.
10.35(19)*	Separation Agreement and Release with Eric Erdman, dated December 3, 2004.
10.36(19)*	Consulting Agreement with Eric Erdman, dated December 3, 2004.
10.37(20)*	Separation Agreement and Release with Young Ahn, dated December 28, 2004.
21(9)	Subsidiaries.
31.1	Certification of Chief Executive Officer, as required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer, as required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer and Chief Financial Officer, as required by Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).

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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.

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- (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 Exchange Commission on February 21, 2002.
- (9) Incorporated by reference to the Registrant's Annual Report on Form 10-K filed with the Securities Exchange Commission on June 20, 2003.
- (10) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities Exchange Commission on August 6, 2003.
- (11) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q filed with the Securities Exchange Commission on February 13, 2004.
- (12) Incorporated by reference to the Registrant's Annual Report on Form 10-K/A filed with the Securities Exchange Commission on July 29, 2003.
- (13) Incorporated by reference to the Registrant's Registration Statement on Form S-8 filed with the Securities Exchange Commission on October 15, 2003.
- (14) Incorporated by reference to the Registrant's Annual Report on Form 10-K filed with the Securities Exchange Commission on June 10, 2004.
- (15) Incorporated by reference to the Registrant's Quarterly Report on Form 10-Q filed with the Securities Exchange Commission on November 9, 2004.
- (16) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities Exchange Commission on November 15, 2004.
- (17) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities Exchange Commission on November 19, 2004.
- (18) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities Exchange Commission on December 3, 2004.
- (19) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities Exchange Commission on December 8, 2004.
- (20) Incorporated by reference to the Registrant's Current Report on Form 8-K filed with the Securities Exchange Commission on January 3, 2005.
- * 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.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

GENESIS MICROCHIP INC.

By: /s/ MICHAEL E. HEALY

Michael E. Healy
Chief Financial Officer
(Authorized Officer to sign on behalf of

Registrant & Principal Financial Officer)

Date: February 8, 2005

