GENESIS MICROCHIP INC /DE
Form 10-Q
August 09, 2007

**UNITED STATES**
**SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, DC 20549**

---

**FORM 10-Q**

(mark one)

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

FOR THE QUARTERLY PERIOD ENDED June 30, 2007

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.**
**(Exact name of registrant as specified in its charter)**

| **DELAWARE** | **77-0584301** |
| --- | --- |
| **(State or other jurisdiction of incorporation or organization)** | **(I.R.S. Employer Identification No.)** |
| **2525 AUGUSTINE DRIVE SANTA CLARA, CALIFORNIA** | **95054** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (408) 919-8400**

---

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

Former address: N/A

Former Fiscal Year: N/A

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

Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act):

Yes ¨ No x

There were 37,429,242 shares of the registrant's common shares issued and outstanding as of July 31, 2007.

1

**GENESIS MICROCHIP INC.**
**FORM 10-Q**
**THREE MONTHS ENDED June 30, 2007**

**Index**


| Item Number | | Page |
|---|---|---|
| **Part I: Financial Information** | | |
| Item 1. | Financial Statements | |
| | Condensed Consolidated Balance Sheets at June 30, 2007 and March 31, 2007 | 3 |
| | Condensed Consolidated Statements of Operations for the three months ended June 30, 2007 and June 30, 2006 | 4 |
| | Condensed Consolidated Statements of Cash Flows for the three months ended June 30, 2007 and June 30, 2006 | 5 |
| | Notes To Condensed Consolidated Financial Statements | 6 |
| Item 2. | Management's Discussion and Analysis of Financial Condition and Results of Operations | 14 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 24 |
| Item 4. | Controls and Procedures | 24 |
| **Part II: Other Information** | | |
| Item 1a. | Risk Factors | 25 |
| Item 6. | Exhibits | 35 |
| **Signatures** | | 38 |

**PART I: FINANCIAL INFORMATION**

**ITEM 1: FINANCIAL STATEMENTS**

**GENESIS MICROCHIP INC.**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
**(amounts in thousands, except per share amounts)**

| | June 30, 2007 (unaudited) | March 31, 2007 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 126,371 | $ 123,701 |
| Short-term investments | 60,067 | 64,549 |
| Accounts receivable trade, net of allowance for doubtful accounts of nil at June 30 and March 31 | 22,475 | 19,455 |
| Inventories | 12,430 | 16,424 |
| Prepaids and other | 7,309 | 6,324 |
| Total current assets | 228,652 | 230,453 |
| Property and equipment, net | 15,548 | 16,238 |
| Intangible assets, net | 6,822 | 5,006 |
| Goodwill | 84,405 | 84,405 |
| Deferred income taxes | 299 | 252 |
| Other long-term assets | 15,214 | 15,360 |
| Total assets | $ 350,940 | $ 351,714 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 6,363 | $ 6,759 |
| Accrued liabilities | 20,247 | 14,888 |
| Income taxes payable | 7,601 | 6,698 |
| Total current liabilities | 34,211 | 28,345 |
| Stockholders' equity: | | |
| Capital stock: | | |
| Preferred stock: | | |
| Authorized - 5,000 preferred shares, $0.001 par value | | |
| Issued and outstanding - none at June 30 and at March 31 | - | - |
| Common stock: | | |
| Authorized - 100,000 common shares, $0.001 par value | | |
| Issued and outstanding - 37,181 shares at June 30 and 37,097 shares at March 31 | 37 | 37 |
| Additional paid-in capital | 469,812 | 465,744 |
| Treasury shares | (833) | (833) |
| Cumulative other comprehensive loss | (94) | (94) |
| Deficit | (152,193) | (141,485) |
| Total stockholders' equity | 316,729 | 323,369 |

| | | | | |
|---|---|---|---|---|
| Total liabilities and stockholders’ equity | $ | 350,940 | $ | 351,714 |

See accompanying notes to condensed consolidated financial statements.

3

**GENESIS MICROCHIP INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**
**(amounts in thousands, except per share amounts)**
**(unaudited)**

| | Three Months Ended June 30 | |
|---|---|---|
| | **2007** | **2006** |
| Revenues | $ 43,984 | $ 55,899 |
| Cost of revenues (1) | 27,031 | 33,240 |
| Gross profit | 16,953 | 22,659 |
| | | |
| Operating expenses: | | |
| Research and development (2)(4) | 16,233 | 14,917 |
| Selling, general and administrative (3) | 12,858 | 14,822 |
| Total operating expenses | 29,091 | 29,739 |
| Loss from operations | (12,138) | (7,080) |
| Interest and other income | | |
| Interest income | 2,321 | 2,164 |
| Other income (5) | - | 3,217 |
| Total interest and other income | 2,321 | 5,381 |
| Loss before income taxes | (9,817) | (1,699) |
| Provision for (recovery of) income taxes | 891 | (3,139) |
| Net income (loss) | $ (10,708) | $ 1,440 |
| | | |
| Earnings (loss) per share: | | |
| Basic | $ (0.29) | $ 0.04 |
| Diluted | $ (0.29) | $ 0.04 |
| | | |
| Weighted average number of common shares outstanding: | | |
| | | |
| Basic | 37,142 | 36,001 |
| Diluted | 37,142 | 36,518 |
| | | |
| | | |
| (1) Amount includes stock-based compensation | $ 164 | $ 428 |
| (2) Amount includes stock-based compensation | $ 1,850 | $ 1,891 |
| (3) Amount includes stock-based compensation | $ 1,900 | $ 3,023 |
| (4) Amount includes amortization of intangibles related to acquisitions | $ 50 | $ 482 |
| (5) Gain on sale of investment | $ - | $ 3,217 |

See accompanying notes to condensed consolidated financial statements.

**GENESIS MICROCHIP INC.**
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(amounts in thousands)**
**(unaudited)**

| | Three Months Ended June 30 | |
|---|---|---|
| | **2007** | **2006** |
| Cash flows from (used in) operating activities: | | |
| Net income (loss) | $ (10,708) | $ 1,440 |
| Adjustments to reconcile net income (loss) to net cash from operating activities: | | |
| Depreciation and amortization | 2,830 | 2,098 |
| Amortization of intangible assets | 191 | 568 |
| Stock-based compensation | 3,914 | 5,341 |
| Deferred income taxes | (47) | (4,010) |
| Gain on sale of investment | - | (3,217) |
| Other | - | 250 |
| Change in operating assets and liabilities, net of amounts acquired: | | |
| Accounts receivable trade | (3,020) | 3,868 |
| Inventories | 3,994 | (3,064) |
| Prepaids and other | (985) | (950) |
| Accounts payable | (396) | (5,140) |
| Accrued liabilities | 5,492 | (3,713) |
| Income taxes payable | 903 | 819 |
| Net cash provided by (used in) operating activities | 2,168 | (5,710) |
| Cash flows from (used in) investing activities: | | |
| Purchase of short-term investments | (22,344) | (26,733) |
| Proceeds on maturity of short-term investments | 26,826 | 18,860 |
| Additions to property and equipment | (1,601) | (1,223) |
| Proceeds on sale of investment | - | 3,919 |
| Additions to mask sets | (526) | (435) |
| Additions to intangible assets | (2,007) | (297) |
| Net cash from (used in) investing activities | 348 | (5,909) |
| Cash flows from financing activities: | | |
| Proceeds from issue of common stock | 154 | 926 |
| Net cash provided by financing activities | 154 | 926 |
| | | |
| Increase (decrease) in cash and cash equivalents | 2,670 | (10,693) |
| Cash and cash equivalents, beginning of period | 123,701 | 154,630 |
| Cash and cash equivalents, end of period | $ 126,371 | $ 143,937 |

See accompanying notes to condensed consolidated financial statements.

**GENESIS MICROCHIP INC.**
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**
**(dollars in thousands, except per share amounts)**
**(unaudited)**

## 1. Basis of presentation

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

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles 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 GAAP for a complete set of annual financial statements. The accounting policies we have applied for the quarter ended June 30, 2007 are consistent with those at March 31, 2007, except as outlined in Note 2. These condensed consolidated financial statements should be read in conjunction with our consolidated financial statements and notes thereto for the year ended March 31, 2007, that are included in our most recent Annual Report on Form 10-K filed with the Securities and Exchange Commission. In the opinion of management, 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. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. The results of operations for the three months ended June 30, 2007 are not necessarily indicative of the results to be expected for the full fiscal year or for any other period.

## 2. Significant Accounting Policies

### *Property and equipment*

Property and equipment are stated at cost or fair value at the date of acquisition.

In the first quarter of fiscal year 2008, the Company completed its review of amortization methods applied to property and equipment. As a result of the review, the Company concluded that a straight-line depreciation method better reflects the pattern of consumption for certain assets which have historically been amortized on a declining balance basis. The effect of the change is not material.

Effective April 1, 2007, amortization of property and equipment is recorded using the following estimated useful lives of the assets:

| | |
|---|---|
| Property and equipment | 5 to 10 years |
| Software | 1 to 5 years |
| Leasehold improvements | Over the term of the lease |

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

### *Intangible assets*

Intangible assets are comprised of acquired technology and patents.

In the first quarter of fiscal year 2008, the Company completed its review of amortization methods applied to patents. As a result of the review, no change has been made to the method by which patents are amortized.

The Company continually evaluates the remaining estimated useful life of intangible assets that are being amortized to determine whether events or circumstances warrant a revision to the remaining period of amortization.

***Income taxes***

In the first quarter of fiscal year 2008, the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109 (FIN 48). See Note 11 for further discussion.

**3. Stock-based compensation**

During the three months ended June 30, 2007 and June 30, 2006, the Company recognized stock-based compensation expense of $3,914 and $5,342, respectively, related to stock options, restricted share units and employee share purchase plans granted to employees and directors. The Company has not capitalized any stock-based compensation costs as part of the cost of an asset. There were no tax benefits recognized related to the compensation cost for share-based payments.

The fair value of stock-based compensation was determined using the Black-Scholes option-pricing model using a dividend yield of 0% and the assumptions noted in the following table:

| | **Three Months Ended** June 30 | |
|---|---|---|
| | **2007** | **2006** |
| Stock Option Plans: | | |
| Risk-free interest rates | 4.9% | 5.1% |
| Volatility | 55% | 71% |
| Expected life in years | 4.25 | 4.25 |
| | | |
| Employee Stock Purchase Plans: | | |
| Risk-free interest rates | 4.9% | 5.2% |
| Volatility | 40% | 53% |
| Expected life in years | 0.75 | 1.25 |

The Company uses historical volatility as a basis for projecting the expected volatility of the underlying stock and estimates the expected life of its stock options based upon historical data. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The weighted average grant date fair values of options granted during the three months ended June 30, 2007 and June 30, 2006 were $4.24 and $7.13 respectively.

***Summary of Stock Options***

Details of stock option transactions are as follows:

| | **Number of Options (in thousands)** | **Weighted Average Exercise Price Per Share** | **Weighted Average Remaining Life (Years)** |
|---|---|---|---|
| Outstanding, March 31, 2007 | 6,354 | $ 15.61 | 5.90 |
| Granted | 358 | 8.67 | |
| Exercised | (21) | 7.30 | |
| Forfeited | (133) | 15.12 | |
| Expired | (192) | 15.07 | |

| | | | | |
|---|---|---|---|---|
| Outstanding, June 30, 2007 | 6,366 | $ | 15.27 | 5.67 |
| | | | | |
| Exercisable, March 31, 2007 | 4,239 | $ | 16.52 | 5.72 |
| Exercisable, June 30, 2007 | 4,351 | $ | 16.47 | 5.52 |
| | | | | |

7

***Summary of Restricted Stock Units***

Details of restricted stock unit transactions are as follows:

| | Number of Units (in thousands) | Weighted Average Grant-Date Fair Value |
|---|---|---|
| Nonvested at March 31, 2007 | 689 | $ 13.15 |
| Granted | 258 | 8.59 |
| Vested | (63) | 9.24 |
| Forfeited | (18) | 13.11 |
| | | |
| Nonvested at June 30, 2007 | 866 | $ 11.73 |

The Company's policy is to satisfy stock option exercises and RSUs by issuing new shares of common stock. No cash was used by the Company to settle equity instruments granted under stock-based compensation arrangements.

**4. Earnings per share**

Basic earnings (loss) per share are computed by dividing the net income (loss) in a period by the weighted average number of shares of common stock outstanding during that period. Diluted earnings (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. The weighted average number of diluted shares outstanding is calculated by assuming that any proceeds from the issuance of 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:

| | Three Months Ended June 30 | |
|---|---|---|
| | 2007 | 2006 |
| Numerator for basic and diluted earnings (loss) per share: | | |
| Net income (loss) | $ (10,708) | $ 1,440 |
| Denominator for basic earnings (loss) per share: | | |
| | | |
| Weighted average common shares | 37,142 | 36,001 |
| Basic earnings (loss) per share: | $ (0.29) | $ 0.04 |
| Denominator for diluted earnings (loss) per share: | | |
| Weighted average common shares | 37,142 | 36,001 |
| Stock options (1) | - | 517 |
| Shares used in computing diluted earnings (loss) per share | 37,142 | 36,518 |
| Diluted earnings (loss) per share: | $ (0.29) | $ 0.04 |
| | | |
| Anti-dilutive potential common shares excluded from above calculation | 6,370 | 6,691 |

(1) For the three months ended June 30, 2007, excludes the effect of all stock options as they are anti-dilutive due to the loss reported in the period.

**5. Segmented information**

**Market information**

Genesis operates and monitors its results in one operating segment. Genesis designs, develops and markets integrated circuits that manipulate and process digital video and graphic images. The target market is the advanced display market including LCD monitors and digital televisions.

**Geographic information**

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

Revenues from unaffiliated customers by geographic region were as follows:

| | Three Months Ended June 30 | |
|---|---|---|
| | 2007 | 2006 |
| United States | $ 314 | $ 158 |
| China | 14,074 | 25,553 |
| Europe | 2,431 | 5,578 |
| Japan | 6,484 | 5,481 |
| South Korea | 14,362 | 12,241 |
| Taiwan | 4,528 | 5,841 |
| Rest of world | 1,791 | 1,047 |
| | $ 43,984 | $ 55,899 |

Net long-lived assets by country were as follows:

| | June 30, 2007 | March 31, 2007 |
|---|---|---|
| United States, including goodwill | $ 96,690 | $ 94,716 |
| Rest of world | 15,109 | 16,103 |
| | | |
| | $ 111,799 | $ 110,819 |

**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 June 30 | |
|---|---|---|
| | 2007 | 2006 |
| Customer A | 19% | 16% |

| | | |
|---|---|---|
| Customer B | 12% | - |
| Customer C | 11% | 13% |
| Customer D | - | 12% |

The following table shows customers accounting for more than 10% of accounts receivable trade at June 30, 2007 and March 31, 2007:

| | **June 30, 2007** | **March 31, 2007** |
|---|---|---|
| Customer 1 | 31% | 36% |
| Customer 2 | 12% | 13% |
| Customer 3 | 12% | - |

**Supplier arrangements**

Genesis subcontracts most of its semiconductor manufacturing from a limited number of suppliers. Should our wafer supplier or any of Genesis's packaging or testing subcontractors cease to be available, management believes that this would have a material adverse effect on Genesis's business, financial condition and results of operations. Genesis has no guarantee of minimum capacity from its suppliers, long term pricing agreements, and is not liable for any significant minimum purchase commitments.

**6. Inventories**

Inventories consist of the following:

| | June 30, 2007 | March 31, 2007 |
|---|---|---|
| Finished goods | $ 10,085 | $ 11,596 |
| Work-in-process | 5,952 | 8,757 |
| | 16,037 | 20,353 |
| Less: Inventory reserve | (3,607) | (3,929) |
| | $ 12,430 | $ 16,424 |

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

| | Three Months Ended June 30 | |
|---|---|---|
| | 2007 | 2006 |
| Balance at beginning of period | $ 3,929 | $ 3,665 |
| Increase (decrease) to provision | (321) | 236 |
| Write offs | (1) | (145) |
| Balance at end of period | $ 3,607 | 3,756 |

**7. Product warranty**

Genesis accrues the estimated future cost of replacing faulty products under the provisions of its warranty agreements as an increase to cost of revenues. Product warranties typically cover a one-year period from the date of delivery to the customer. Management estimates the accrual based on known product failures (if any), historical experience, and other currently available evidence and records the accrual within accrued liabilities. The following table presents a roll forward of the product warranty accrual for the indicated periods:

| | Three Months Ended June 30 | |
|---|---|---|
| | 2007 | 2006 |
| Balance at beginning of period | $ 210 | $ 164 |
| Increase to provision | 256 | 260 |
| Processed claims | (87) | (78) |
| Balance at end of period | $ 379 | $ 346 |

**8. Intangible assets**

Intangible assets consist of the following:

| | June 30, 2007 | | | |
|---|---|---|---|---|
| | Cost | Accumulated Amortization | Impairment | Net |
| Acquired technology | $ 50,577 | $ 44,144 | $ 3,425 | $ 3,008 |
| Patents | 5,117 | 1,303 | — | 3,814 |
| Other | 500 | 500 | — | — |
| Total | $ 56,194 | $ 45,947 | $ 3,425 | $ 6,822 |

| | March 31, 2007 | | | |
|---|---|---|---|---|
| | Cost | Accumulated Amortization | Impairment | Net |
| Acquired technology | $ 48,792 | $ 44,009 | $ 3,425 | $ 1,358 |
| Patents | 5,132 | 1,484 | — | 3,648 |
| Other | 500 | 500 | — | — |
| Total | $ 54,424 | $ 45,993 | $ 3,425 | $ 5,006 |

In the quarter ended December 31, 2006, the Company determined a triggering event occurred, due to a decline in projected revenue for products which incorporate technology acquired from VM Labs in fiscal 2002, which required the Company to reassess the underlying value of the acquired technology. The Company engaged an independent valuation professional to assist with its measurement of fair value as part of the intangible asset impairment test. The recoverability of this asset was assessed by comparing its carrying amount with its estimated fair value using a discounted cash flow approach. An impairment was identified for which the Company recorded a non-cash impairment charge of $3,425 in the quarter ended December 31, 2006 prior to performing the goodwill impairment analysis.

Estimated future intangible assets' amortization expense, based on current balances as of June 30, 2007, is as follows:

| **For the year ended March 31:** | |
|---|---|
| 2008 | $ 1,030 |
| 2009 | 1,324 |
| 2010 | 1,106 |
| 2011 | 447 |
| 2012 | 240 |
| Thereafter | 2,675 |
| Total | $ 6,822 |

**9. Goodwill**

The majority of the goodwill carried on the balance sheet arose in February 2002 when the Company acquired Sage Inc. for approximately $297,000.

The Company is required to evaluate goodwill annually or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment is tested at the reporting unit level by comparing the reporting unit's carrying amount to its fair value. Management has determined that the Company has one reporting unit for purposes of goodwill impairment review under SFAS 142. Where the carrying amount of the reporting unit exceeds its fair value, an impairment loss is recognized for the amount by which the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill.

In the quarter ended December 31, 2006, the Company determined a triggering event occurred due to a sustained reduction in the Company's market capitalization plus the decline in current and projected revenue from certain customers, which required management to assess the recoverability of goodwill. Upon performing the impairment test, it was found that the carrying value of goodwill exceeded its implied fair value of $84,405 and therefore an impairment charge of $97,576 was recorded in the quarter ending December 31, 2006. The Company engaged an independent valuation professional to assist with its measurement of fair value as part of the goodwill impairment test. The fair value of the reporting unit was estimated using a combination of the market approach and a discounted cash flows approach.

| | June 30, 2007 | | | March 31, 2007 | | |
|---|---|---|---|---|---|---|
| | Cost | Impairment | Net | Cost | Impairment | Net |
| Goodwill | $ 181,981 | $ (97,576) | $ 84,405 | $ 181,981 | $ (97,576) | $ 84,405 |

**10. Other long-term assets**

Other long-term assets consist of the following:

| | June 30, 2007 | | | March 31, 2007 | | |
|---|---|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net | Cost | Accumulated Amortization | Net |
| Investments, at cost | $ 10,190 | $ — | $ 10,190 | $ 10,190 | $ — | $ 10,190 |
| Production mask sets | 9,456 | 4,432 | 5,024 | 8,930 | 3,760 | 5,170 |
| Total | $ 19,646 | $ 4,432 | $ 15,214 | $ 19,120 | $ 3,760 | $ 15,360 |

**11. Income Taxes**

In June 2006, the Financial Standards Accounting Board ("FASB") issued Financial Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." The interpretation prescribes a recognition threshold and measurement attribute criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

We adopted the provisions FIN 48 on April 1, 2007. No material adjustments in the reserve for unrecognized income tax benefits was recorded as a result of the implementation of FIN 48. At the adoption date of April 1, 2007, we had

$6,340 of unrecognized tax benefits, $1,258 of which would affect our effective tax rate if recognized.

At June 30, 2007, we have $6,340 of unrecognized tax benefits. It is possible that this balance may decrease by approximately $201 in the next 12 months due to the settlement of an ongoing tax audit and the filing of amended tax returns. These balances relate to certain non-deductible expenditures.

We recognize interest and penalties related to uncertain tax positions in income tax expense. As of June 30, 2007, we have approximately $519 of accrued interest and penalties related to uncertain tax positions.

The tax years from 1999 onwards remain open to examination in Canada and the tax years from 1995 onwards remain open to examination in the United States.

**12. Related party transactions**
In March 2006, Genesis made an equity investment in Mobilygen Corp, and Elias Antoun, our president and CEO, joined Mobilygen's Board of Directors.

In March 2006, we entered into a cross-licensing agreement with Mobilygen Corp., a privately held company that is developing H.264 and other video codec solutions for mobile devices. The agreement allows for both companies access to certain technologies for select markets and enables them to jointly define future products to complement existing product portfolios.

The investment in Mobilygen is recorded within other long term assets. No financial transactions were undertaken with Mobilygen during the quarter ended June 30, 2007 and June 30, 2006.

**13. Contingent liabilities**

Genesis is not party to any material legal proceedings.

**14. Recent Accounting Pronouncements**

Statement of Financial Accounting Standards No. 157, "Fair Value Measurement" ("SFAS 157") was issued in September 2006. SFAS 157 provides guidance for using fair value to measure assets and liabilities. SFAS 157 also expands disclosures about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurement on earnings. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements and does not expand the use of fair value measurements in any new circumstances. Under SFAS 157, fair value refers to the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the entity transacts. SFAS 157 is effective for fair value measurements and disclosures made by the Company in its fiscal year beginning on April 1, 2008. The Company is currently reviewing the impact of this statement.

In February 2007, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 permits an entity to choose to measure many financial instruments and certain other items at fair value. Most of the provisions in SFAS 159 are elective; however, the amendment to FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities", applies to all entities with available-for-sale and trading securities. SFAS 159 is effective for the Company beginning April 1, 2008. The Company is currently assessing the potential impact that the adoption of SFAS 159 will have on its financial statements.

In June 2007 the Emerging Issues Task Force ("EITF") reached a consensus on Issue 07-03 *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development.* Under this EITF, an entity would defer and capitalize non-refundable advance payments made for research and development activities until the related goods are delivered or the related services are performed. EITF 07-03 is effective for fiscal years beginning after December 15, 2007 and interim periods within those years. The Company is currently assessing the potential impact of this new EITF.



---

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

*The following discussion 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 and unit shipments, gross margins, operating expenses, inventory levels, tax rates, amortization of intangibles and stock-based compensation, liquidity and cash flow, business strategy, demand for our products, average selling prices, regional market growth, amount of sales to distributors and future competition. 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 month periods ended June 30, 2007 and June 30, 2006 as viewed through the eyes of our 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. Dollars are in thousands unless otherwise noted.

## OVERVIEW

We develop and market image-processing and image enhancing 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 proprietary integrated circuits, or chips. Our products are primarily used in large-area liquid crystal displays ("LCDs"). These displays may be used in desktop monitor applications or other types of display devices, including LCD TVs, Plasma TVs, Rear Projection TVs, Digital CRT TVs, DVD players and AVRs (Audio/Video Receivers).

We generate the majority of our revenue by selling our image-processing solutions to the manufacturers of LCD monitors, flat panel displays 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 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 primary target end-markets are LCD computer monitors and flat panel televisions. We also design products that serve both applications, so-called multi-function monitors, 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 in flat panel televisions. We assist customers in developing their designs. Typically, a TV design will take substantially more time and support from our software application and field application engineers than a monitor design, 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 flat panel TV today, while the cost of the LCD panel within a LCD computer monitor or flat panel TV represents the majority of the cost of the finished product. The increase in production volumes of larger size LCD panels in new fabrication facilities coming on line over the next few years is expected to result in lower-cost panels and hence lower average selling prices of the end product. We believe retail prices for televisions will continue to decline and we expect this trend to lead to an increase in demand for display controllers.



---

The LCD computer monitor and flat panel TV industries are very competitive and growth industries like ours tend to attract new entrants. The average selling prices of monitor display controllers, in spite of increased functionality, have declined by more than 40% over the past two fiscal years. Our strategy is to lead the market by integrating new features and functions and by providing the highest image quality at a cost-effective price. Our goal is to deliver the desired feature-rich image quality through relationships with customers, patented technologies, effective chip design, software capabilities, and customer support. We also strive to generate profitability by reducing product cost through efficient chip design and driving costs down throughout our supply chain.

Sales to distributors comprised approximately 25% of revenue for the quarter ended June 30, 2007. We are also using distributor relationships to enable us to increase our market penetration of smaller customers with minimal incremental direct customer support.

Average selling prices and product margins of our products are typically highest during the initial periods following product introduction and decline over time and as volume increases.

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**

Genesis recognizes revenue primarily from semiconductor product sales to customers when a contract is established, the price is determined, shipment is made and collectibility is reasonably assured. Genesis has also periodically entered into license agreements and recognizes royalty revenue. Product sales to distributors may be subject to agreements having a right of return on termination of the distributor relationship. Revenue, and related cost of revenues from sales to distributors, is deferred until the distributors resell the product, verified by point-of-sale reports. At the time of shipment to distributors, we record a trade receivable for the selling price, relieve inventory of the value of the product shipped and record the gross margin as deferred revenue, a component of accrued liabilities on our consolidated balance sheet. In certain circumstances, where orders are placed with non-cancelable/non-return terms, we recognize revenue 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 and substrates, from which our products are manufactured, can be as long as three to four 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 review and, where feasible, establish alternative sources of supply to reduce our reliance on individual key suppliers and reduce lead times, though dual sourcing for specific products sometimes is more costly due to initial set-up costs and lower initial yields as each new 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, which 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.

**Global Operations**

We operate through subsidiaries and offices in several countries throughout the world. Our head office is located in Santa Clara (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, Germany, Japan, Singapore, South Korea, Taiwan and Turkey. Our third party suppliers are located primarily in Taiwan. Although all of our revenues and virtually all of our costs of revenues are denominated in U.S. dollars, portions of our operating expenses are denominated in foreign currencies. Accordingly, our operating results are affected by changes in the exchange rate between the U.S. dollar and those currencies. Any future strengthening of 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.

**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, royalty obligations to third parties 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 and royalty obligations, 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 or upon termination of a distributor agreement, 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 and other disputes. 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 inventory obsolescence reserves against our inventory for estimated obsolete 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 account for stock-based compensation in accordance with Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment. Under the provisions of SFAS No. 123R, stock based compensation is estimated at the grant date based on the award’s fair-value as calculated by the Black-Scholes option-pricing model and is recognized as expense ratably over the requisite service period. The Black-Scholes model requires various judgmental assumptions including volatility, and expected option life. In addition, share-based compensation expense is adjusted to reflect estimated forfeiture rates. If any of the assumptions change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period.

· 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 or more frequently if events or changes in circumstances indicate that the carrying amount may not be recoverable. 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 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 goodwill. The implied fair value of goodwill would be 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.



---

As a result of an impairment review that was performed in December 2006, the Company recorded a goodwill impairment charge of $97,576 in fiscal 2007. We did not record any goodwill impairment charges in fiscal 2006 or 2005. Goodwill balances may also be affected by changes in other estimates, for example, related to the ability to utilize acquired tax benefits, made at the time of acquisitions.

- We adopted the provisions of the Financial Standards Accounting Board (FASB) Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), as of April 1, 2007. FIN48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. The interpretation prescribes a recognition threshold and measurement attribute criteria for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

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. The Company has, and expects to continue to provide a valuation allowance on future tax benefits in certain jurisdictions until it can demonstrate a sustained level of profitability that establishes its ability to utilize the assets in the jurisdictions that the assets relate.

- 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.

**Recent Accounting Pronouncements**

Please refer to Note 14 of the condensed consolidated financial statements of this report.

**RESULTS OF OPERATIONS**

**REVENUE AND GROSS PROFIT**

The following table shows unaudited statement of operations data for the three months ended June 30, 2007 and June 30, 2006:

| | Three months ended June 30 (dollars in thousands) | |
|---|---|---|
| | **2007** | **2006** |
| Total revenue | $ 43,984 | $ 55,899 |
| Gross profit | 16,953 | 22,659 |
| Gross profit percentage | 38.5% | 40.5% |
| Revenue by geography: | | |
| United States | $ 314 | $ 158 |
| China | 14,074 | 25,553 |
| Europe | 2,431 | 5,578 |
| Japan | 6,484 | 5,481 |
| South Korea | 14,362 | 12,241 |
| Taiwan | 4,528 | 5,841 |
| Rest of world | 1,791 | 1,047 |
| Total revenue | $ 43,984 | $ 55,899 |

**Total Revenues**

Revenues for the three months ended June 30, 2007 decreased by 21% to $43,984 from $55,899 for the three months ended June 30, 2006. The revenue decline year over year is attributable to a 20% decrease in unit shipments to 12.9 million units for the quarter ended June 30, 2007 from 16.0 million units for the same period last year, as well as the declining average selling prices (“ASPs”) of 2%. The LCD computer monitor and flat panel TV industries are very competitive and growth industries like ours tend to attract new entrants. The average selling prices of monitor display controllers, in spite of increased functionality, have declined by more than 40% over the past two fiscal years. Going forward we do not expect the decline in ASPs for these products to continue at the same pace.

Our products are designed for multiple applications. Therefore, we must estimate whether the chips we have sold are used in LCD monitors or flat-panel televisions. Estimated revenue from monitor controllers and licensing decreased to $21,368 for the quarter ended June 30, 2007 from $24,505 for the same period last year, due to lower unit shipments. Our estimate of unit shipments into digital televisions and other related video devices decreased by 22%, compared to the same period last year. Estimated revenue from this market decreased by 28% to $22,538. During the first quarter of fiscal year 2008, we estimate that approximately 51% of total revenue was from TV and video products, compared with 56% for the same period last year. We expect an increase in revenue in the second quarter of fiscal 2008, due to higher unit shipments of flat panel TV controllers. This is typically our strongest quarter due to seasonality of our customer demands.

Revenue in China decreased 45% in the quarter ending June 30, 2007 compared with the same period last year. The revenue decline year over year is mainly attributable to a loss in market share of monitor products. We expect revenue levels in China to remain relatively flat or decrease slightly in future quarters.

We continue to ship the majority of our product to customers located in Asia, and we expect most of our revenue to come from this region in the future.



---

**Gross Profit**

Gross profit for the three months ended June 30, 2007 was $16,953, representing a decrease of approximately 25% compared with the quarter ended June 30, 2006 gross profit of $22,659. Gross profit represented 38.5% of revenues for the three months ended June 30, 2007, compared with 40.5% for the same period last year. The decrease in the gross profit % is primarily due to a lower percentage of the higher margin TV business and increased pricing pressures on our products, partially offset by a decrease in inventory reserves and royalty revenue received during the current quarter. We expect a slight decline in gross profit % during the second quarter of fiscal 2008, as the one time benefit of selling previously reserved inventory is not expected to recur.

**OPERATING EXPENSES**

**Research and Development**

| | Three months ended | | | |
|---|---|---|---|---|
| | June 30, 2007 | | June 30, 2006 | |
| | $000 | % of Revenue | $000 | % of Revenue |
| Research and development | $ 16,233 | 36.9% | $ 14,917 | 26.7% |

Research and development expenses include costs associated with research and development personnel, application engineers, development tools, hardware and software licenses, prototyping and the amortization of acquired intangibles.

Research and development expenses for the three months ended June 30, 2007 were $16,233, compared with $14,917 in the three months ended June 30, 2006. This 9% increase is a reflection of the continued investment in the research and development of technologies addressing the television and video markets, especially the digital TV market and other related technologies, such as DisplayPort, a new digital interconnect standard, MCTi[tm] by Faroudja, our motion compensation technology, and our universal demodulator technology for our DTV products. In addition, the mix of spending has changed, as we devote increasing resources to improving performance and integration of the more complex multimedia and video applications, especially digital TV technologies, while the focus within the monitor applications has moved more towards technologies supporting multi-function monitors. Genesis's move towards lower geometry processes, including 0.13 micron and lower, for its highly integrated SOC digital TV chips has also increased research and development spending.

Research and development expenses for the quarters ended June 30, 2007 and June 30, 2006 include stock based compensation charges of $1,850 and $1,891, respectively, and amortization of acquired intangibles of $50 and $482, respectively.

**Selling, General and Administrative**

| | Three months ended | | | |
|---|---|---|---|---|
| | June 30, 2007 | | June 30, 2006 | |
| | $000 | % of Revenue | $000 | % of Revenue |
| Selling, general and administrative | 12,858 | 29.2% | 14,822 | 26.5% |

Selling, general and administrative expenses consist of personnel and related overhead costs for selling, including field application engineers, product marketing, marketing communications, customer support, finance, human resources, legal costs including settlement fees, IT, public company costs related, but not limited to, our compliance with the Sarbanes Oxley Act of 2002, general management functions and commissions paid to sales representatives.

Selling, general and administrative expenses for the three months ended June 30, 2007, were $12,858, compared with $14,822 million in the three months ended June 30, 2006. The decrease in selling, general and administrative expenses is mostly due to a decrease in stock-based compensation of $1,100. Selling, general and administrative expenses for the quarters ended June 30, 2007 and June 30, 2006 include stock-based compensation charges of $1,900 and $3,023, respectively.

**NON OPERATING INCOME AND EXPENSES**

**Interest and Other Income**

| | Three months ended | |
|---|---|---|
| | June 30, 2007 $000 | June 30, 2006 $000 |
| Interest income | 2,321 | 2,164 |
| Other income | — | 3,217 |
| | | |
| Interest and other income | 2,321 | 5,381 |

20

Interest income includes interest earned on cash, cash equivalents and short-term investments.

Interest income earned for the three months ended June 30, 2007 was $2,321compared with $2,164 for the three months ended June 30, 2006. The slight increase is due to the combined effects of higher average cash, cash equivalents and short-term investments and higher average interest rates during the first quarter of fiscal 2007 compared to the same period last year.

Other income declined for the three months ended June 30, 2007 compared to the three months ended June 30, 2006 due to the fact that the prior period includes a gain of $3,217 on the disposal of our entire investment in the shares of Techwell, Inc. in conjunction with their initial public offering. This gain on sale of investment is a non-recurring item outside the ordinary course of business and no such dispositions occurred in the three months ended June 30, 2007.

**Provision for (Recovery of) Income Taxes**

| | **Three months ended** | |
|---|---|---|
| | **June 30, 2007 $000** | **June 30, 2006 $000** |
| Current income tax expense | 938 | 871 |
| Deferred income tax expense (recovery) | (47) | (4,010) |
| | | |