TORTOISE ENERGY INFRASTRUCTURE CORP
Form 497
December 20, 2004

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under the Securities Act of 1933, as
amended.
File No. 333-119784

[TORTOISE LOGO]

1,755,027 COMMON SHARES
TORTOISE ENERGY INFRASTRUCTURE CORPORATION
$27.35 PER SHARE

Tortoise Energy Infrastructure Corporation (the "Company") is a nondiversified, closed-end management investment company which commenced operations in February 2004. The Company's investment objective is to seek a high level of total return with an emphasis on current distributions paid to stockholders. The Company seeks to provide its stockholders with an efficient vehicle to invest in a portfolio of publicly traded master limited partnerships in the energy infrastructure sector ("MLPs"). Under normal circumstances, the Company invests at least 90% of its total assets (including assets obtained through leverage) in securities of energy infrastructure companies and invests at least 70% of its total assets in equity securities of MLPs. Similar to the tax characterization of distributions made by MLPs to their unit holders, the Company believes that it will have relatively high levels of deferred taxable income (i.e., return of capital) associated with distributions to its stockholders. There is no assurance that the Company will achieve its objective.

The Company's currently outstanding shares of common stock are, and the shares offered in this prospectus will be, listed on the New York Stock Exchange under the trading or "ticker" symbol "TYG." The net asset value of the Company's common stock at the close of business on December 14, 2004 was $26.34 per share, and the last sale price of the common stock on the New York Stock Exchange on such date was $27.53. See "Market and Net Asset Value Information."

INVESTING IN THE COMPANY'S COMMON STOCK INVOLVES A HIGH DEGREE OF RISK. INVESTORS COULD LOSE SOME OR ALL OF THEIR INVESTMENT IN THE COMPANY. SEE "RISKS" BEGINNING ON PAGE 29 OF THIS PROSPECTUS.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	PER SHARE	TOTAL(1)
Public offering price	$27.35	$47,999,988
Underwriting discounts and commissions	$ 1.00	$ 1,755,027
Proceeds, before expenses, to the Company(2)	$26.35	$46,244,961

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(1) The underwriters named in this prospectus have the option to purchase up to 263,254 additional shares at the public offering price, less the

underwriting discounts and commissions, within 45 days from the date of this prospectus to cover over-allotments.

(2) The aggregate expenses of the offering are estimated to be $600,000, of which $100,000 will be borne by the Company, which represents $0.06 per share, and the remainder will be borne by the Adviser.

The underwriters expect to deliver the shares on or about December 22, 2004.

STIFEL, NICOLAUS & COMPANY INCORPORATED   OPPENHEIMER & CO.   RBC CAPITAL MARKETS

ADVEST, INC.   BB&T CAPITAL MARKETS   MORGAN KEEGAN & COMPANY, INC.
MCGINN SMITH & COMPANY, INC.   PARKER/HUNTER INCORPORATED   WUNDERLICH SECURITIES, INC.

Prospectus dated December 16, 2004

Unlike most investment companies, the Company is taxed like a corporation and has not elected to be treated as a regulated investment company under the Internal Revenue Code.

On July 15, 2004, the Company issued two series of auction rate senior notes due July 15, 2044, in an aggregate principal amount of $110,000,000 ("Tortoise Notes"). On September 16, 2004, the Company issued 1,400 auction rate preferred shares (denominated as Money Market Cumulative Preferred Shares or "MMP Shares"), liquidation preference $25,000 per share ($35,000,000 in the aggregate). The Tortoise Notes are rated "Aaa" and "AAA" by Moody's Investors Service Inc. ("Moody's") and Fitch Ratings ("Fitch"), respectively. The MMP Shares are rated "Aa2" and "AA" by Moody's and Fitch, respectively. As of October 31, 2004, the aggregate principal amount of the Tortoise Notes and aggregate liquidation preference of MMP Shares represented 22.4% and 7.1% of the Company's total assets, respectively. The Company may, in the future, issue additional series of Tortoise Notes or MMP Shares or other senior securities to the extent permitted by the Investment Company Act of 1940, as amended (the "1940 Act").

The Company's common stock is junior in liquidation and distribution rights to Tortoise Notes and MMP Shares. The issuance of debt and preferred stock, including Tortoise Notes and MMP Shares, represent the leveraging of the Company's common stock. The issuance of additional common stock offered by this prospectus will enable the Company to increase the aggregate amount of its leverage. The use of leverage creates an opportunity for increased income and capital appreciation for common stockholders, but at the same time, it creates special risks that may adversely affect common stockholders. Because the Adviser's fee is based on total assets (including assets obtained through leverage), the Adviser's fee is higher when the Company is leveraged. There can be no assurance that a leveraged strategy will be successful during any period in which it is used. See "Leverage" and "Risks--Leverage Risk."

The prospectus sets forth concisely the information about the Company that a prospective investor should know before investing. You should read this prospectus, which contains important information about the Company, before deciding whether to invest in the Company's common stock and retain it for future reference. A statement of additional information, dated December 16, 2004, containing additional information about the Company, has been filed with the Securities and Exchange Commission and is incorporated by reference in its entirety into this prospectus. You may request a free copy of the statement of additional information, the table of contents of which is on page 54 of this prospectus, by calling 1-888-728-8784 or by writing to the Company at 10801 Mastin Boulevard, Suite 222, Overland Park, Kansas 66210. You can review and copy documents the Company has filed at the Securities and Exchange Commission's Public Reference Room in Washington, D.C. Call 1-202-942-8090 for information. The Securities and Exchange Commission charges a fee for copies. You can get the same information free from the Securities and Exchange Commission's website (http://www.sec.gov). You may also e-mail requests for these documents to publicinfo@sec.gov or make a request in writing to the Securities and Exchange Commission's Public Reference Section, Washington, D.C. 20549-0102.

The Company's common stock does not represent a deposit or obligation of, and is not guaranteed or endorsed by, any bank or other insured depository institution and is not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

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YOU SHOULD RELY ONLY ON THE INFORMATION CONTAINED OR INCORPORATED BY REFERENCE IN THIS PROSPECTUS. THE COMPANY HAS NOT, AND THE UNDERWRITERS HAVE NOT, AUTHORIZED ANY OTHER PERSON TO PROVIDE YOU WITH DIFFERENT INFORMATION. IF ANYONE PROVIDES YOU WITH DIFFERENT OR INCONSISTENT INFORMATION, YOU SHOULD NOT RELY ON IT. THE COMPANY IS NOT, AND THE UNDERWRITERS ARE NOT, MAKING AN OFFER TO SELL THESE SECURITIES IN ANY JURISDICTION WHERE THE OFFER OR SALE IS NOT PERMITTED. YOU SHOULD ASSUME THAT THE INFORMATION APPEARING IN THIS PROSPECTUS IS ACCURATE ONLY AS OF THE DATE OF THIS PROSPECTUS. THE COMPANY'S BUSINESS, FINANCIAL CONDITION AND PROSPECTS MAY HAVE CHANGED SINCE THAT DATE. THE COMPANY WILL AMEND OR SUPPLEMENT THIS PROSPECTUS TO REFLECT MATERIAL CHANGES TO THE INFORMATION CONTAINED IN THIS PROSPECTUS TO THE EXTENT REQUIRED BY APPLICABLE

LAW.

PROSPECTUS SUMMARY

This is only a summary. This summary may not contain all of the information that you should consider before investing in the Company's shares of common stock offered by this prospectus (the "Common Shares"). You should review the more detailed information contained in this prospectus and in the statement of additional information, especially the information set forth under the heading "Risks" beginning on page 29 of this prospectus. Unless otherwise indicated, the information presented in this prospectus assumes that the underwriters do not exercise their over-allotment option.

THE COMPANY

Tortoise Energy Infrastructure Corporation (the "Company") is a nondiversified, closed-end management investment company which commenced operations in February 2004. The Company's investment objective is to seek a high level of total return with an emphasis on current distributions paid to stockholders. For purposes of the Company's investment objective, total return includes capital appreciation of, and all distributions received from, securities in which the Company will invest regardless of the tax character of the distributions. The Company seeks to provide its stockholders with an efficient vehicle to invest in a portfolio of publicly traded master limited partnerships in the energy infrastructure sector ("MLPs"). Similar to the tax characterization of distributions made by MLPs to its unit holders, the Company believes that it will have relatively high levels of deferred taxable income associated with distributions made to its stockholders. Tortoise Capital Advisors, LLC (the "Adviser") serves as the Company's investment adviser.

The Company completed its initial public offering of common stock in February 2004, raising approximately $300 million in equity after the payment of offering expenses. The Company raised an additional $110 million through the issuance of Tortoise Notes in July 2004 and an additional $35 million through the issuance of MMP Shares in September 2004, before underwriting commissions in both cases. The Company declared distributions to holders of common stock in May, August and November 2004 in the amounts of $0.20, $0.34 and $0.43 per share, respectively. The Company expects that a significant portion of these distributions will be treated as a return of capital to stockholders for tax purposes.

THE OFFERING

The Company is offering 1,755,027 Common Shares at an offering price of $27.35 per share through a group of underwriters (the "Underwriters") led by Stifel, Nicolaus & Company, Incorporated, Oppenheimer & Co. Inc and RBC Capital Markets Corporation. An investor must purchase at least 100 Common Shares ($2,735) in order to participate in this offering. The Company has given the Underwriters an option to purchase up to 263,254 additional Common Shares at the public offering price, less the underwriting discounts and commissions, within 45 days from the date of this prospectus to cover over-allotments. The provisions of the 1940 Act require that the public offering price of the Common Shares, less underwriting commissions and discounts, must equal or exceed the net asset value per share of the Company's common stock (calculated within 48 hours of pricing). See "Underwriting."

LISTING

Like the Company's outstanding shares of common stock, the Common Shares will be listed on the New York Stock Exchange ("NYSE") under the trading or "ticker" symbol "TYG."

TAX STATUS OF COMPANY

Unlike most investment companies, the Company is not treated as a regulated investment company under the U.S. Internal Revenue Code of 1986, as amended (the "Internal Revenue Code"). Therefore, the Company is obligated to pay federal and applicable state corporate taxes on its taxable income. On the other hand, the Company is not subject to the "qualifying income" rules applicable to regulated investment companies. Under current tax law, the qualifying income rules limit the ability of regulated investment companies to invest directly in MLPs. Unlike regulated investment companies, the Company is not required to distribute substantially all of its income and capital gains. The Company invests a substantial portion of its

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assets in MLPs. Although the MLPs generate taxable income to the Company, the Company expects the MLPs to pay cash distributions in excess of the taxable income reportable by the Company. Similarly, the Company expects to distribute cash in excess of its taxable income to its stockholders and intends to distribute substantially all of its distributable cash flow (generally, cash from operations less certain operating expenses and reserves). The taxation of Company distributions is discussed below under "Prospectus Summary -- Stockholder Tax Features." See also "Tax Matters."

TAXATION OF MLPS AND MLP INVESTORS

The Company invests primarily in MLPs, which are treated as partnerships for federal income tax purposes. Limited partners, such as the Company, are required to pay tax on their allocable share of the MLPs' income, gains, losses and deductions, including accelerated depreciation and amortization deductions. Such items generally are allocated among the general partner and limited partners in accordance with their percentage interests in the MLP. Partners recognize and must report their allocable share of income regardless of whether any cash distributions are paid out. MLPs typically are required by their charter documents to distribute substantially all of their distributable cash flow. The types of MLPs in which the Company invests have historically made cash distributions to limited partners that exceed the amount of taxable income allocable to limited partners. This may be due to a variety of factors, including that the MLP may have significant non-cash deductions, such as accelerated depreciation. If the cash distributions exceed the taxable income reported, the MLP investor's basis in MLP units will decrease. This feature will reduce current income tax liability, but potentially will increase the investor's gain upon the sale of its MLP interest.

STOCKHOLDER TAX FEATURES

Stockholders of the Company hold common stock of a corporation. Shares of common stock differ substantially from partnership interests for federal income tax purposes. Unlike holders of MLP common units, stockholders of the Company will not recognize an allocable share of the Company's income, gains, losses and deductions. Stockholders recognize income only if the Company pays out distributions. The tax character of the distributions can vary. If the Company makes distributions from current or accumulated earnings and profits allocable to the particular shares held by a stockholder, such distributions will be taxable to a stockholder in the current period as dividend income. Dividend income will be treated as "qualified dividends" for federal income tax purposes, subject to favorable capital gains rates. If distributions exceed the Company's allocated current or accumulated earnings and profits, such excess distributions will constitute a tax-free return of capital to the extent of a stockholder's basis in its common stock. To the extent excess distributions exceed a stockholder's basis, the amount in excess of basis will be taxed as capital gain. Based on the historical performance of MLPs, the Company expects that a significant portion of distributions to holders of common stock will constitute a tax-free return of capital. In addition, earnings and profits are treated generally, for federal income tax purposes, as first being used to pay distributions on the MMP Shares, and then to the extent remaining, if any, to pay distributions on common stock. There is no assurance that the Company will make regular distributions or that the Company's expectation regarding the tax character of its distributions will be realized. The special tax treatment for qualified dividends is scheduled to expire as of December 31, 2008.

Upon the sale of common stock, a stockholder generally will recognize capital gain or loss measured by the difference between the sale proceeds received by the stockholder and the stockholder's federal income tax basis in its common stock sold, as adjusted to reflect return(s) of capital. Generally, such capital gain or loss will be long-term capital gain or loss if common stock were held as a capital asset for more than one year. The tax basis for common stock owned by an individual stockholder will be adjusted to equal their full market value upon such stockholder's death. See "Tax Matters."

COMPARISON WITH DIRECT INVESTMENTS IN MLPS

The Company is designed to provide an efficient vehicle for investing in a portfolio of MLPs. The Company was the first publicly traded investment company offering access to a portfolio of energy infrastructure MLPs. The Company believes that an investor who invests in the Company will benefit from a

number of portfolio and tax features that would not be available from a direct investment in MLPs, including the following:

- An investment in the Company offers exposure to a number of MLPs within the energy infrastructure sector through a single investment vehicle;

- An investment in the Company offers access to direct placements. Direct placements offer the potential for increased return, but are typically only available to a limited number of institutional investors such as the Company;

- Each stockholder of the Company will receive a single Form 1099, rather than a Form K-1 from each MLP if an investor invested directly in the MLP;

- Stockholders of the Company will not be required to file state income tax returns in each state in which MLPs owned by the Company operate, whereas limited partners of MLPs may be required to make state filings in states in which the MLP operates;

- The passive activity income and loss rules apply to a direct investment in MLPs, but not to an investment in the Company (these rules limit the ability of an investor to use losses to offset other gains);

- The Internal Revenue Code generally excludes corporate dividends from treatment as unrelated business taxable income ("UBTI") (unless the stock is debt-financed). Tax-exempt investors, including employee benefit plans and IRAs, will not have UBTI upon receipt of distributions from the Company, whereas a tax-exempt limited partner's allocable share of income of an MLP is treated as UBTI; and

- There is a limit on the extent to which regulated investment companies can invest in MLP units, but such limit does not apply to the Company.

Unlike MLPs, the Company is obligated to pay current and deferred tax with respect to its income, thereby subjecting the Company's income to a double layer of tax upon distribution to the Company's stockholders. Like other investment companies, stockholders of the Company bear the operating costs of the Company, including management fees, custody and administration, and the costs of operating as a public company.

INVESTMENT POLICIES

Under normal circumstances, the Company invests at least 90% of its total assets (including assets obtained through leverage) in securities of energy infrastructure companies and invests at least 70% of its total assets in equity securities of MLPs. Energy infrastructure companies engage in the business of transporting, processing, storing, distributing or marketing natural gas, natural gas liquids (primarily propane), coal, crude oil or refined petroleum products, or exploring, developing, managing or producing such commodities. The Company invests solely in energy infrastructure companies organized in the United States. All publicly traded companies in which the Company invests have an equity market capitalization greater than $100 million.

The Company invests primarily in equity securities of MLPs, which currently consist of the following instruments: common units, convertible subordinated units and I-Shares. As of the date of this prospectus, almost all MLP common units and I-Shares in which the Company invests are listed and traded on the NYSE, American Stock Exchange ("AMEX") or NASDAQ National Market. The Company also may purchase MLP common units through direct placements. MLP convertible subordinated units are not listed or publicly traded and are typically purchased in directly negotiated transactions with MLP affiliates or institutional holders of such shares.

MLP common unit holders have typical limited partner rights, including limited management and voting rights. MLP common units have priority over convertible subordinated units upon liquidation. Common unit holders are entitled to minimum quarterly distributions ("MQD"), including arrearage rights, prior to any distribution payments to convertible subordinated unit holders or incentive distribution payments to the

general partner. MLP convertible subordinated units are convertible into common units on a one-to-one basis after the passage of time and/or achievement of specified financial goals. MLP convertible subordinated units are entitled to MQD after the payments to holders of common units and before incentive distributions to the general partner. MLP convertible subordinated units do not have arrearage rights. I-Shares have similar features to common units except that distributions are payable in additional I-Shares rather than cash. The Company invests in I-Shares only if it has adequate cash to satisfy its distribution targets.

Although the Company also may invest in equity and debt securities of energy infrastructure companies that are organized and/or taxed as corporations, it is likely that any such investments will be in debt securities because the dividends from equity securities of such corporations typically do not meet the Company's investment objective. The Company also may invest in securities of general partners or other affiliates of MLPs and private companies operating energy infrastructure assets.

The Company has adopted the following additional nonfundamental investment policies:

- The Company may invest up to 30% of its total assets in restricted securities, primarily through direct placements. Subject to this policy, the Company may invest without limitation in illiquid securities. The types of restricted securities that the Company may purchase consist of MLP convertible subordinated units, MLP common units and securities of private energy infrastructure companies (i.e., non-MLPs). Investments in private companies that do not have any publicly traded shares or units are limited to 5% of total assets.

- The Company may invest up to 25% of total assets in debt securities of energy infrastructure companies, including securities rated below investment grade (commonly referred to as "junk bonds"). Below investment grade debt securities will be rated at least B3 by Moody's Investors Service, Inc. ("Moody's") and at least B- by Standard & Poor's Ratings Group ("S&P") at the time of purchase, or comparably rated by another statistical rating organization or if unrated, determined to be of comparable quality by the Adviser.

- The Company will not invest more than 10% of total assets in any single issuer.

- The Company will not engage in short sales.

The Company may change its nonfundamental investment policies without stockholder approval and will provide notice to stockholders of material changes (including notice through stockholder reports); provided, however, that a change in the policy of investing at least 90% of its total assets in energy infrastructure companies requires at least 60 days prior written notice to stockholders. Unless otherwise stated, all investment restrictions apply at the time of purchase and the Company will not be required to reduce a position due solely to market value fluctuations. The term total assets includes assets obtained through leverage for the purpose of each investment restriction.

CONFLICTS OF INTEREST

Conflicts of interest may arise from the fact that the Adviser and its affiliates carry on substantial investment activities for other clients, in which the Company has no interest. The Adviser or its affiliates may have financial incentives to favor certain of such accounts over the Company. Any of their proprietary accounts and other customer accounts may compete with the Company for specific trades. The Adviser or its affiliates may give advice and recommend securities to, or buy or sell securities for, the Company, which advice or securities recommended may differ from advice given to, or securities recommended or bought or sold for, other accounts and customers, even though their investment objectives may be the same as, or similar to, those of the Company.

Situations may occur when the Company could be disadvantaged because of the investment activities conducted by the Adviser and its affiliates for its other accounts. Such situations may be based on, among other things, the following: (i) legal or internal restrictions on the combined size of positions that may be taken for the Company or the other accounts, thereby limiting the size of the Company's position; (ii) the difficulty of liquidating an investment for the Company or the other accounts where the market cannot absorb the sale of the combined position; or (iii) limits on co-investing in private placement securities under the 1940 Act. The Company's investment opportunities may be limited by affiliations of the Adviser or its affiliates with energy infrastructure companies. See "The Company -- Conflicts of Interest."

USE OF LEVERAGE BY THE COMPANY

The Company currently is engaged in, and may in the future engage in, the use of financial leverage. On July 15, 2004, the Company issued $110,000,000 in aggregate principal amount of Tortoise Notes. On September 16, 2004, the Company issued 1,400 MMP Shares with an aggregate liquidation preference of $35,000,000. Together, the aggregate principal amount of outstanding Tortoise Notes and the aggregate liquidation preference of outstanding MMP Shares represent approximately 29.5% of its total assets, as of October 31, 2004. The aggregate liquidation preference of MMP Shares represents approximately 7.1% of the Company's total assets and the aggregate principal amount of the Tortoise Notes represents approximately 22.4% of the Company's total assets, as of October 31, 2004. The Company may make further use of financial leverage through the issuance of additional Tortoise Notes or MMP Shares or other senior securities to the extent permitted by the 1940 Act. Currently under the 1940 Act, the Company may not borrow for investment purposes more than 33 1/3% of its total assets, including the amount borrowed, and may not issue preferred stock with an aggregate liquidation preference of more than 50% of its total assets.

Because the Adviser's fee is based upon a percentage of the Company's Managed Assets (as defined below), the Adviser's fee is higher when the Company is leveraged. Therefore, the Adviser has a financial incentive to leverage the Company, which may create a conflict of interest between the Adviser and the holders of the Common Shares. There can be no assurance that a leveraging strategy will be successful during any period in which it is used. The use of leverage involves risks, which can be significant. See "Leverage" and "Risks -- Leverage Risk."

The Company may, but is not required to, hedge general interest rate exposure arising from its leverage transactions. Under current market conditions, hedging would be accomplished principally by entering into interest rate transactions such as swaps, caps and floors. The Company has entered into interest rate swap transactions that are intended to hedge the Company's interest payment obligations under the Tortoise Notes against material increases in interest rates through mid-July 2007. The Company's dividend payment obligations under the MMP Shares remain unhedged as of the date of this prospectus. The use of interest rate transactions is a highly specialized activity that involves investment techniques and risks different from those associated with ordinary portfolio security transactions. See "Risks -- Hedging Strategy Risk."

INVESTMENT ADVISER

Tortoise Capital Advisors, LLC was formed in October 2002 to provide portfolio management services to institutional and high-net-worth investors seeking professional management of their MLP investments. The Adviser is controlled equally by Fountain Capital Management, L.L.C. ("Fountain Capital") and Kansas City Equity Partners LC ("KCEP"). As of October 31, 2004, the Adviser had approximately $591 million of client assets under management. Affiliates of the Adviser had an additional $325 million of energy infrastructure investment assets under management. The Adviser's investment committee is comprised of five portfolio managers led by David J. Schulte, CFA.

The principal business address of the Adviser is 10801 Mastin Boulevard, Suite 222, Overland Park, Kansas 66210.

The Adviser is responsible for the investment of the Company's portfolio in accordance with the Company's investment objective and policies. The Adviser makes all investment decisions for the Company, subject to oversight by the Company's Board of Directors. Day-to-day management of the Company's portfolio is the responsibility of a team of investment analysts and portfolio managers led by Mr. Schulte. Three of the four other members of the Adviser's investment committee are affiliates of, but not employees of, the Adviser, and have significant responsibilities with KCEP, Fountain Capital and their affiliates. All members of the investment committee have undertaken to provide such services as are necessary to fulfill the obligations of the Adviser to the Company. The Company pays the Adviser a fee for its investment management services equal to an annual rate of 0.95% of the Company's average monthly total assets (including any assets attributable to any leverage) minus accrued liabilities other than (i) deferred taxes, (ii) debt entered into for purposes of leverage and (iii) the aggregate liquidation preference of any outstanding preferred shares ("Managed Assets"). This fee is calculated monthly and paid quarterly.

DISTRIBUTIONS

The Company intends to pay out substantially all of its Distributable Cash Flow ("DCF") to holders of common stock through quarterly distributions. DCF is the amount received by the Company as cash or paid-in-kind distributions from MLPs or their affiliates, and interest payments received on debt securities owned by the Company, less current or anticipated operating expenses, taxes on Company taxable income, and leverage costs paid by the Company. The Company's board of directors (the "Board of Directors" or the "Board") adopted a policy to target distributions to common stockholders in an amount of at least 95% of DCF on an annual basis. Distributions will be paid each fiscal quarter out of DCF, if any. There is no assurance that the Company will continue to make regular distributions. The Company has a fiscal year ending November 30.

If a stockholder's shares are registered directly with the Company or with a brokerage firm that participates in the Company's Automatic Dividend Reinvestment Plan, distributions will be automatically reinvested in additional common stock under the Automatic Dividend Reinvestment Plan unless a stockholder elects to receive distributions in cash. If a stockholder elects to receive distributions in cash, payment will be made by check. See "Distributions -- Automatic Dividend Reinvestment Plan."

RISKS

Limited Operating History. The Company is a nondiversified, closed-end management investment company which commenced operations in February 2004.

Delay in Use of Proceeds. Although the Company currently intends to invest the proceeds of any sales of Common Shares as soon as practicable following the closing, such investments may be delayed if suitable investments are unavailable at the time or for other reasons or if the Company is unable to secure firm commitments for direct placements. Due to the trading market and volumes for MLPs, it may take the Company a period of time to accumulate positions in certain securities. Because the market for MLP securities may at times be less liquid than the market for many other securities, the Company may be unable to obtain such securities within the time, and in the amount, currently anticipated by the Company. As a result, the proceeds may be invested in cash, cash equivalents, high-quality debt instruments, or other securities pending investment in MLPs or securities of energy infrastructure companies. A delay in the anticipated use of proceeds could lower returns and lower the Company's distribution for the outstanding shares of common stock and the Common Shares offered in this prospectus. See "Use of Proceeds."

Energy Infrastructure Sector. Under normal circumstances, the Company concentrates its investments in the energy infrastructure sector, with an emphasis on securities issued by MLPs. Certain risks inherent in the energy infrastructure business of these types of MLPs include the following:

- Processing and coal MLPs may be directly affected by energy commodity prices. The volatility of commodity prices can indirectly affect certain other MLPs due to the impact of prices on the volume of commodities transported, processed, stored or distributed. Pipeline MLPs are not subject to direct commodity price exposure because they do not own the underlying energy commodity. While propane MLPs do own the underlying energy commodity, the Adviser intends to seek high quality MLPs that are able to mitigate or manage direct margin exposure to commodity price levels. The MLP sector can be hurt by market perception that MLPs' performance and distributions are directly tied to commodity prices.

- The profitability of MLPs, particularly processing and pipeline MLPs, may be materially impacted by the volume of natural gas or other energy commodities available for transporting, processing, storing or distributing. A significant decrease in the production of natural gas, oil, coal or other energy commodities, due to the decline of production from existing facilities, import supply disruption, depressed commodity prices or otherwise, would reduce revenue and operating income of MLPs and, therefore, the ability of MLPs to make distributions to partners.

- A sustained decline in demand for crude oil, natural gas and refined petroleum products could adversely affect MLP revenues and cash flows. Factors that could lead to a decrease in market demand include a recession or other adverse economic conditions, an increase in the market price of the underlying commodity, higher taxes or other regulatory actions that increase costs, or a shift in consumer demand for such products.

- A portion of any one MLP's assets may be dedicated to natural gas reserves and other commodities that naturally deplete over time, which could have a material adverse impact on an MLP's ability to make distributions. MLPs are often dependent upon exploration and development activities by third parties. MLPs employ a variety of means of increasing cash flow, including increasing utilization of existing facilities, expanding operations through new construction, expanding operations through acquisitions, or securing additional long-term contracts. Thus, some MLPs may be subject to construction risk, acquisition risk or other risk factors arising from their specific business strategies. A significant slowdown in large energy companies' disposition of energy infrastructure assets and other merger and acquisition activity in the energy MLP industry could reduce the growth rate of cash flows received by the Company from MLPs that grow through acquisitions.

- The profitability of MLPs could be adversely affected by changes in the regulatory environment. The business of MLPs is heavily regulated by federal and state governments in diverse matters, such as the way in which certain MLP assets are constructed, maintained and operated and the prices MLPs may charge for their services. Such regulation can change over time in scope and intensity. For example, a particular byproduct of an MLP process may be declared hazardous by a regulatory agency and unexpectedly increase production costs. Moreover, many state and federal environmental laws provide for civil as well as regulatory remediation, thus adding to the potential exposure an MLP may face.

- A rising interest rate environment could adversely impact the performance of MLPs. Rising interest rates could limit the capital appreciation of equity units of MLPs because of the increased availability of alternative investments at competitive yields with MLPs. Rising interest rates may also increase an MLP's cost of capital. A higher cost of capital could limit growth from acquisition/expansion projects and limit MLP distribution growth rates.

- Since the September 11th attacks, the U.S. government has issued public warnings indicating that energy assets, specifically those related to pipeline infrastructure, production facilities and transmission and distribution facilities, might be specific targets of terrorist activity. The continued threat of terrorism and related military activity will likely increase volatility for prices in natural gas and oil and could affect the market for products of MLPs.

- Holders of MLP units are subject to certain risks inherent in the partnership structure of MLPs including (i) tax risks (described in detail below), (ii) limited ability to elect or remove management, (iii) limited voting rights, except with respect to extraordinary transactions, and (iv) conflicts of interest of the general partner, including those arising from incentive distribution payments.

Cash Flow Risk. The Company derives substantially all of its cash flow from investments in equity securities of MLPs. The amount of cash that the Company has available to distribute to stockholders is completely dependent on the ability of MLPs held by the Company to make distributions to its partners. The Company has no control over the actions of underlying MLPs. The amount of cash that each individual MLP can distribute to its partners depends on the amount of cash it generates from operations, which will vary from quarter to quarter depending on factors affecting the energy infrastructure market generally and on factors affecting the particular business lines of the MLP. Available cash will also depend on the MLPs' level of

operating costs (including incentive distributions to the general partner), level of capital expenditures, debt service requirements, acquisition costs (if any), fluctuations in working capital needs and other factors.

Tax Risk of MLPs. The value of the Company's investment in MLPs depends largely on the MLPs being treated as partnerships for federal income tax purposes. If an MLP does not meet current law requirements to maintain partnership status, or if it is unable to do so because of tax law changes, it would be taxed as a corporation. In that case, the MLP would be obligated to pay income tax at the entity level and distributions received by the Company would be taxed entirely as dividend income. As a result, there would be a material reduction in the Company's cash flow and there would likely be a material decrease in the value of the Common Shares.

Items of income, gains, losses and deductions of each MLP flow through to the Company in its capacity as a partner of the MLP. Historically, a substantial portion of MLP income has been offset by tax deductions. If the amount of MLP income tax deductions that may be claimed by the Company is less than anticipated or the Company turns over its portfolio more rapidly than anticipated, the Company will incur greater current income taxes. A significant slowdown in acquisition activity by the MLPs in the Company's portfolio also could accelerate the Company's obligations to pay income taxes due in part to less accelerated depreciation generated by new acquisitions. In such a case, the portion of the Company's distributions that is treated as a return of capital will be reduced and the portion treated as dividend income would increase, resulting in lower after tax distributions for the Company's stockholders. See "Risks -- Deferred Tax Risk."

Equity Securities Risk. MLP common units and other equity securities can be affected by macro economic and other factors affecting the stock market in general, expectations of interest rates, investor sentiment towards MLPs or the energy sector, changes in a particular issuer's financial condition, or unfavorable or unanticipated poor performance of a particular issuer (in the case of MLPs, generally measured in terms of distributable cash flow). Prices of common units of individual MLPs and other equity securities can also be affected by fundamentals unique to the partnership or company, including earnings power and coverage ratios.

Investing in securities of smaller companies may involve greater risk than is associated with investing in more established companies. Smaller capitalization companies may have limited product lines, markets or financial resources; may lack management depth or experience; and may be more vulnerable to adverse general market or economic developments than larger more established companies.

Because MLP convertible subordinated units generally convert into common units at a one-to-one ratio, the price that the Company can be expected to pay upon purchase or to realize upon resale is generally tied to the common unit price less a discount. The size of the discount varies depending on a variety of factors including the likelihood of conversion, the length of time remaining to conversion, and the size of the block purchased.

The price of I-Shares and their volatility tend to be correlated to the price of common units, although the price correlation is not precise.

Leverage Risk. The issuance of senior debt securities and preferred stock, including Tortoise Notes and MMP Shares, represents the leveraging of the Company's common stock. Leverage creates an opportunity for an increased return to common stockholders, but it is a speculative technique that could adversely affect common stockholders. Unless the income and capital appreciation, if any, on securities acquired with leverage proceeds or other borrowed funds exceed the costs of the leverage, the use of leverage could cause the Company to lose money. When leverage is used, the net asset value and market value of the Company's common stock will be more volatile. There is no assurance that the use of leverage will be successful during any period in which it is used.

Common stockholders bear the costs of leverage, including outstanding Tortoise Notes and MMP Shares, through higher operating expenses. Common stockholders also bear management fees, whereas, holders of Tortoise Notes and MMP Shares do not bear management fees. Because management fees are based on Managed Assets, the use of leverage increases the effective management fee borne by holders of common stock. In addition, the issuance of additional senior debt securities or preferred stock by the Company

would result in offering expenses and other costs, which would ultimately be borne by the holders of the Company's common stock. Fluctuations in interest rates could increase the Company's interest or dividend payments on Tortoise Notes, MMP Shares or other senior securities and could reduce cash available for distributions on common stock. The Tortoise Notes and MMP Shares are each subject to covenants regarding asset coverage, portfolio composition and other matters, which may affect the Company's ability to pay distributions on common stock in certain instances. The Company may also be required to pledge its assets to the lenders in connection with certain other types of borrowing. See "Risks -- Leverage Risk."

Hedging Strategy Risk. The Company currently uses, and may in the future use, interest rate transactions for hedging purposes only, in an attempt to reduce the interest rate risk arising from the Company's leveraged capital structure. The Company does not intend to hedge interest rate risk of portfolio holdings. Interest rate transactions that the Company may use for hedging purposes will expose the Company to certain risks that differ from the risks associated with its portfolio holdings. There are economic costs of hedging reflected in the price of interest rate swaps, caps and similar techniques, the costs of which can be significant. In addition, the Company's success in using hedging instruments is subject to the Adviser's ability to predict correctly changes in the relationships of such hedging instruments to the Company's leverage risk, and there can be no assurance that the Adviser's judgment in this respect will be accurate.

Depending on the state of interest rates in general, the Company's use of interest rate transactions such as swaps, caps or floors could enhance or decrease distributions on the Company's common stock. To the extent there is a decline in interest rates, the value of interest rate transactions could decline, and result in a decline in the net asset value of the Company's common stock. In addition, if the counterparty to an interest rate transaction defaults, the Company would not be able to use the anticipated net receipts under the interest rate transaction to offset the Company's cost of financial leverage. Consequently, the use of hedging transactions might result in a poorer overall performance for the Company, whether or not adjusted for risk, than if the Company had not engaged in such transactions. See "Risks -- Hedging Strategy Risk."

Competition Risk. At the time the Company completed its initial public offering in February 2004, it was the only publicly traded investment company offering access to a portfolio of energy infrastructure MLPs. Since that time a limited number of other alternatives to the Company as a vehicle for investment in a portfolio of energy infrastructure MLPs, including other publicly traded investment companies and private funds, have been developed. In addition, recent tax law changes or future tax law changes may increase the ability of regulated investment companies or other institutions to invest in MLPs. These competitive conditions may adversely impact the Company's ability to make investments in the MLP market and could adversely impact the Company's distributions to common stockholders. See "Risks -- Competition Risk."

Portfolio Turnover Risk. The Company's annual portfolio turnover rate may vary greatly from year to year. Although the Company cannot accurately predict its annual portfolio turnover rate, it is not expected to exceed 30% under normal circumstances. From the commencement of operations through October 31, 2004, the Company's actual portfolio turnover rate was less than 1%. However, portfolio turnover rate is not considered a limiting factor in the execution of investment decisions for the Company. High portfolio turnover may result in the Company's realization of gains that will be taxable as ordinary income to the Company. In addition, high portfolio turnover may increase the Company's current and accumulated earnings and profits, resulting in a greater portion of the Company's distributions being treated as dividend income to the Company's stockholders. See "The Company -- Portfolio Turnover" and "Tax Matters."

Restricted Securities Risk. The Company may invest up to 30% of total assets in restricted securities, primarily through direct placements. Restricted securities are subject to statutory and contractual restrictions on their public resale, which may make it more difficult to value them, may limit the Company's ability to dispose of them and may lower the amount the Company could realize upon their sale. To enable the Company to sell its holdings of a restricted security not registered under the Securities Act of 1933, as amended (the "1933 Act"), the Company may have to cause those securities to be registered. If the Company decides to pursue a public sale of restricted securities, a considerable period may elapse between the time the decision is made to sell the security and the time the security is registered so that the Company could sell it. The Company would bear the risks of any downward price fluctuation during that period.

Liquidity Risk. Although common units of MLPs trade on the NYSE, AMEX, and the NASDAQ National Market, certain MLP securities may trade less frequently than those of larger companies due to their smaller capitalizations. In the event certain MLP securities experience limited trading volumes, the prices of such MLPs may display abrupt or erratic movements at times. Additionally, it may be more difficult for the Company to buy and sell significant amounts of such securities without an unfavorable impact on prevailing market prices. As a result, these securities may be difficult to dispose of at a fair price at the times when the Company believes it is desirable to do so. These securities are also more difficult to value, and the Adviser's judgment as to value will often be given greater weight than market quotations, if any exist. Investment of the Company's capital in securities that are less actively traded or over time experience decreased trading volume may restrict the Company's ability to take advantage of other market opportunities. See "The Company -- Investment Policies."

Valuation Risk. Market prices generally will not be available for convertible subordinated units or securities of private companies, and the value of such investments will ordinarily be determined based on fair valuations determined by the Adviser pursuant to procedures adopted by the Board of Directors. Similarly, common units acquired through direct placements will be based on fair value determinations if they are subject to legal and contractual restrictions on resale; however, the Adviser expects that such values will be based on a discount from publicly available market prices. Restrictions on resale or the absence of a liquid secondary market may adversely affect the ability of the Company to determine its net asset value. The sale price of securities that are restricted or otherwise not readily marketable may be lower or higher than the Company's most recent fair valuation. In addition, the Company relies on information provided by MLPs to estimate taxable income allocable to MLP units held by the Company and to calculate associated deferred tax liability. See "Net Asset Value."

Interest Rate Risk. Interest rate risk is the risk that debt securities will decline in value because of changes in market interest rates. Generally, when market interest rates rise, the values of debt securities decline, and vice versa. The Company's investment in such securities means that the net asset value and market price of the Common Shares will tend to decline if market interest rates rise. During periods of declining interest rates, the issuer of a security may exercise its option to prepay principal earlier than scheduled, forcing the Company to reinvest in lower yielding securities. This is known as call or prepayment risk. Lower grade securities frequently have call features that allow the issuer to repurchase the security prior to its stated maturity. An issuer may redeem a lower grade obligation if the issuer can refinance the debt at a lower cost due to declining interest rates or an improvement in the credit standing of the issuer.

Below Investment Grade Securities Risk. Below investment grade debt securities are commonly referred to as "junk bonds." Below investment grade quality securities are considered speculative with respect to an issuer's capacity to pay interest and repay principal while they are outstanding. Below investment grade debt securities are susceptible to default or decline in market value due to adverse economic and business developments. The Company does not intend to invest in distressed securities (securities issued by a company in a bankruptcy reorganization, subject to a public or private debt restructuring or otherwise in default or in significant risk of default in the payment of interest and principal). However, in the event any below investment grade debt security becomes distressed while held by the Company, the Company may be required to incur extraordinary expenses in order to protect and recover its investment, and there will be significant uncertainty as to when, in what manner and for what value, if any, the distressed obligations will be satisfied. See "Risks -- Below Investment Grade Securities."

Management Risk. The Adviser was formed in October 2002 to provide portfolio management services to institutional and high-net worth investors seeking professional management of their MLP investments. The Adviser has been managing the Company since the Company began operations in February 2004. The Adviser relies on the officers, employees, and resources of Fountain Capital, KCEP and their affiliates for certain functions. Three of the five members of the investment committee are affiliates of, but not employees of, the Adviser, and each have other significant responsibilities with such affiliated entities. Fountain Capital, KCEP and their affiliates conduct businesses and activities of their own in which the Adviser has no economic interest. If these separate activities become significantly greater than the Adviser's activities, there could be material competition for the efforts of key personnel.

Nondiversification. The Company is a nondiversified, closed-end management investment company under the 1940 Act and is not treated as a regulated investment company under the Internal Revenue Code. Accordingly, there are no regulatory limits under the 1940 Act or the Internal Revenue Code on the number or size of securities held by the Company. There currently are approximately fifty-five (55) companies presently organized as MLPs and only a limited amount of those companies operate energy infrastructure assets. The Company selects MLP investments from this small pool of issuers. The Company may invest in non-MLP securities to a lesser degree, consistent with its investment objective and policies.

Market Discount Risk. The Company's common stock has a limited trading history and has traded both at a premium and at a discount relative to net asset value. The public offering price for the Common Shares represents a 3.83% premium over the per share net asset value on December 14, 2004; however there can be no assurance that this premium will continue after this offering or that the shares will not again trade at a discount. Shares of closed-end investment companies frequently trade at a discount from net asset value, but in some cases have traded above net asset value. Continued development of alternatives to the Company as a vehicle for investment in MLP securities may contribute to reducing or eliminating any premium or may result in the shares trading at a discount. The risk of the shares of common stock trading at a discount is a risk separate from the risk of a decline in the Company's net asset value as a result of investment activities. Depending on the premium of the Company's common stock, the Company's net asset value may be reduced immediately following this offering by the costs of the offering, which will be borne entirely by the Company. See "Risks -- Market Discount Risk" and "Risks -- Competition Risk."

Effects of Terrorism. The U.S. securities markets are subject to disruption as a result of terrorist activities, such as the terrorist attacks on the World Trade Center on September 11, 2001; war, such as the war in Iraq and its aftermath; and other geopolitical events. Such events have led, and in the future may lead, to short-term market volatility and may have long-term effects on the U.S. economy and markets.

Anti-Takeover Provisions. The Company's Charter and Bylaws include provisions that could delay, defer or prevent other entities or persons from acquiring control of the Company, causing it to engage in certain transactions or modifying its structure. These provisions may be regarded as "anti-takeover" provisions. Such provisions could limit the ability of stockholders to sell their shares at a premium over the then-current market prices by discouraging a third party from seeking to obtain control of the Company. See "Certain Provisions in the Company's Charter and Bylaws."

For more information on the risks of investing in the Company, see "Risks." For information on the risks associated with potential stabilization practices of the underwriters, see "Underwriting."

ADMINISTRATOR, CUSTODIAN, TRANSFER AGENT AND DIVIDEND PAYING AGENT

U.S. Bancorp Fund Services, LLC serves as the Company's administrator. Computershare Investor Services, LLC serves as the Company's transfer agent, dividend paying agent, and agent for the dividend reinvestment plan. U.S. Bank N.A. serves as the Company's custodian. See "Administrator, Custodian, Transfer Agent and Dividend Paying Agent."

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SUMMARY OF COMPANY EXPENSES

The following table contains information about the costs and expenses that common stockholders will bear directly or indirectly, after giving effect to issuance of Common Shares pursuant to this prospectus. Both the table and footnote (6) assume that existing leverage (Tortoise Notes in an aggregate principal amount of $110 million and MMP Shares with an aggregate liquidation preference of $35 million) remain outstanding. The table also assumes that the Company issues additional Tortoise Notes following this offering in an aggregate principal amount of approximately $51 million, which would increase outstanding leverage to approximately 33 1/3% of total assets (including the proceeds of leverage). Footnote (6) assumes that no additional leverage is used. In this case, existing leverage would represent 27.0% of total assets.

STOCKHOLDER TRANSACTION EXPENSE

Underwriting Discounts and Commissions (as a percentage of offering price)	3.66%
Offering Expenses Borne by the Company (as a percentage of offering price)(1)	0.21%
Offering Expenses of additional Tortoise Notes expected to be borne by the Company (as a percentage of offering price)*	0.42%
Dividend Reinvestment Plan Fees(2)	None

ANNUAL EXPENSES	PERCENTAGE OF NET ASSETS ATTRIBUTABLE TO COMMON STOCK, AFTER GIVING EFFECT TO THE SALE OF COMMON SHARES OFFERED IN THIS PROSPECTUS (ASSUMES 33 1/3% LEVERAGE IS OUTSTANDING)
Management Fee	1.50%
Leverage Costs(3)(6)	1.91%
Other Expenses(5)	.27%
Total Annual Expenses	3.68%
Less Fee and Expense Reimbursement (through 2/28/06)(4)	(.36)%

Net Annual Expenses..	3.32%

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* Assuming the Company expenses the entire amount of the offering expenses upon issuance of additional Tortoise Notes. Offering expenses of additional Tortoise Notes are estimated to be $200,000.

(1) Total offering expenses are estimated to be $600,000, of which $100,000 will be borne by the Company, and the remainder will be borne by the Adviser.

(2) Stockholders will pay brokerage charges if they direct the Plan Agent to sell their Common Shares held in a dividend reinvestment account. See "Distributions -- Automatic Dividend Reinvestment Plan."

(3) Leverage Costs in the table reflect the weighted average cost to the Company of Tortoise Notes and MMP Shares, expressed as a percentage of the Company's net assets, based on interest rates and dividend rates in effect as of October 31, 2004. The table assumes outstanding Tortoise Notes of $161 million, which reflects leverage in an amount representing 33 1/3% of total assets, and footnote (6) assumes outstanding Tortoise Notes of $110 million, which reflects existing leverage. Because interest payment obligations on Tortoise Notes are fully hedged by swap agreements and the interest payable under the swap agreements currently exceeds the interest payable on Tortoise Notes, the cost of Tortoise Notes is based on the rates payable under the swap agreements. MMP Shares are unhedged and their cost reflects current dividend rates on MMP Shares.

(4) Through February 28, 2006, the Adviser has agreed to waive or reimburse the Company for fees and expenses in an amount equal to 0.23% of the average monthly Managed Assets (as defined on page 38) of the Company, which represents 0.36% of the Company's net assets. Through February 28, 2009, the Adviser has agreed to waive or reimburse the Company for fees and expenses in an amount equal to 0.10% of the average monthly Managed Assets of the Company. Management fees and waivers are expressed as a percentage of net assets in the table. Because holders of Tortoise Notes and MMP Shares do not bear management fees and other expenses, the cost to common stockholders increases as leverage increases.

(5) The Company does not expect to recognize net investment income for its initial fiscal year. Accordingly, the table does not include current or deferred income tax expense (benefit) related to items of net investment income (loss). Such taxes are estimated to be insignificant and will be reflected in the Company's financial statements. Also, other expenses do not include income tax expense (benefit) related to realized or unrealized investment and interest rate swap gains or losses.

(6) The table presented in this footnote estimates what the Company's annual expenses would be, stated as percentages of the Company's net assets attributable to the Company's common stock but, unlike the table above, assumes that the Company does not add any additional leverage to the amount currently outstanding. In accordance with these assumptions, the Company's expenses would be estimated as follows:

PERCENTAGE OF NET ASSETS
ATTRIBUTABLE TO COMMON

	STOCK, AFTER GIVING EFFECT TO THE SALE OF COMMON SHARES OFFERED IN THIS PROSPECTUS (ASSUMES NO ADDITIONAL LEVERAGE)
Management Fee	1.37%
Leverage Costs(a)	1.37%
Other Expenses(b)	.26%
Total Annual Expenses	3.00%
Less Fee Expense and Reimbursement (through 2/28/06)(c)	(.33)%
Net Annual Expenses	2.67%

(a) Leverage Costs in the table reflect the weighted average cost to the Company of Tortoise Notes and MMP shares, expressed as a percentage of the Company's net assets, based on interest rates and dividend rates in effect as of October 31, 2004. This table assumes outstanding Tortoise Notes of $110 million, which reflects existing leverage. Because interest payment obligations on Tortoise Notes are fully hedged by swap agreements and the interest payable under the swap agreements currently exceeds the interest payable on Tortoise Notes, the cost of Tortoise Notes is based on the rates payable under the swap agreements. MMP Shares are unhedged and their cost reflects current dividend rates on MMP Shares.

(b) The Company does not expect to recognize net investment income for its initial fiscal year. Accordingly, the table does not include current or deferred income tax expense (benefit) related to items of net investment income (loss). Such taxes are estimated to be insignificant and will be reflected in the Company's financial statements. Also, other expenses do not include income tax expense (benefit) related to realized or unrealized investment and interest rate swap gains or losses.

(c) Through February 28, 2006, the Adviser has agreed to waive or reimburse the Company for fees and expenses in an amount equal to 0.23% of the average monthly Managed Assets (as defined on page 38) of the Company, which represents 0.33% of the Company's net assets. Through February 28, 2009, the Adviser has agreed to waive or reimburse the Company for fees and expenses in an amount equal to 0.10% of the average monthly Managed Assets of the Company. Management fees and waivers are expressed as a percentage of net assets in the table. Because holders of Tortoise Notes and MMP Shares do not bear management fees and other expenses, the cost to common stockholders increases as leverage increases.

The purpose of the table above and the example below is to help investors understand the fees and expenses that they, as common stockholders, would bear directly or indirectly. The Other Expenses shown in the table and related footnotes are based on estimated amounts for the Company's first year of operations unless otherwise indicated and assume that the Company has issued Common Shares in aggregate amount of $48 million in this offering. If the Company issues fewer Common Shares, all other things being equal, these expenses would increase. For additional information with respect to the Company's expenses, see "Management of the Company."

EXAMPLE:

The following example illustrates the expenses (including the underwriting discounts and commissions of $1.00 and estimated offering costs of this offering borne by the Company of $0.06 per Common Share) that stockholders would pay on a $1,000 investment in Common Shares, assuming (1) total annual expenses of 3.32% of net assets attributable to Common Shares in year 1, increasing to 3.52% in years 2 through 4 and increasing further to 3.68% in years 5 through 10 and (2) a 5% annual return:(1)

	1 YEAR	3 YEARS	5 YEARS	10 YEA
Total Expenses Paid(2)....................................	$71	$141	$215	$413

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(1) The example assumes that the estimated Other Expenses set forth in the fee table are accurate, that all distributions are reinvested at net asset value and that the Company is engaged in leverage of 33 1/3% of total assets, assuming a 3.51% cost of leverage. The cost of leverage is expressed as an interest rate and represents the weighted average of interest payable on Tortoise Notes and dividends payable on MMP Shares. THE EXAMPLE SHOULD NOT BE CONSIDERED A REPRESENTATION OF FUTURE EXPENSES. ACTUAL EXPENSES MAY BE GREATER OR LESS THAN THOSE ASSUMED. MOREOVER, THE COMPANY'S ACTUAL RATE OF RETURN MAY BE GREATER OR LESS THAN THE HYPOTHETICAL 5% RETURN SHOWN IN THE EXAMPLE.

(2) Assumes waiver or reimbursement of fees and expenses of 0.36% of net assets in year one, and 0.16% of net assets in years two through four. The Adviser has not agreed to reimburse the Company for any year beyond 2009.

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FINANCIAL HIGHLIGHTS

Information contained in the table below under the headings "Common Stock Per Share Data" and "Supplemental Data and Ratios" shows the unaudited operating performance of the Company from the commencement of the Company's investment operations on February 27, 2004 through October 31, 2004. The table covers approximately eight months of operations. Accordingly, the information presented may not provide a meaningful picture of the Company's operating performance.

	(UNAUDITED) PERIOD FROM FEBRUARY 27, 2004(1) THROUGH OCTOBER 31, 2004
COMMON STOCK PER SHARE DATA(2):	
Net Asset Value, beginning of period	
Public offering price..................................	$ 25.00
Underwriting discounts and offering costs.............	(1.18)
Income from Investment Operations:	
Net investment loss(3)................................	--

Net realized and unrealized gain on investments	2.27
Total increase from investment operations	2.27
Less Dividends to Preferred Stockholders:	(0.01)
Less Distributions to Common Stockholders:	
Net investment income	--
Return of capital	(0.54)
Total distributions to Common Stockholders	(0.54)
Net Asset Value, end of period	$ 25.54
Per common share market value, end of period	$ 25.35
Total Investment Return Based on Market Value(4)	3.72%

	(UNAUDITED) PERIOD FROM FEBRUARY 27, 2004(1) THROUGH OCTOBER 31, 2004
SUPPLEMENTAL DATA AND RATIOS	
Net assets applicable to common shareholders, end of period (000's)	$323,966
Ratio of expenses to average net assets before waiver(5)	1.86%
Ratio of expenses to average net assets after waiver(5)	1.59%
Ratio of expenses, without regard to non-recurring organizational expenses, to average net assets before waiver(5)	1.74%
Ratio of expenses, without regard to non-recurring organizational expenses, to average net assets after waiver(5)	1.47%
Ratio of net investment loss to average net assets before waiver:(5)	(0.32%)
Ratio of net investment loss to average net assets after waiver:(5)	(0.05%)
Portfolio turnover rate	0.23%
Tortoise Auction Rate Senior Notes (000's)	$110,000
Per common share amount of borrowings outstanding at end of period	$ 8.67
Per common share amount of preferred shares outstanding at end of period	$ 2.76
Per common share amount of net assets, excluding borrowings and preferred shares, at end of period	$ 36.97
Asset coverage, per $1,000 of principal amount of auction rate senior notes	
Series A	$ 4,263
Series B	$ 4,263
Asset coverage ratio of auction rate senior notes(6)	426%

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(1) Commencement of Operations.

(2) Information presented relates to a share of common stock outstanding for the entire period.

(3) Amount is less than $0.01 per share.

(4) Not Annualized. Total investment return is calculated assuming a purchase of common stock at the market price on the first day and a sale at the current market price on the last day of the period reported. The calculation also assumes reinvestment of dividends at actual prices pursuant to the Company's dividend investment plan. Total investment return does not reflect brokerage commissions.

(5) Annualized.

(6) Represents value of total assets less all liabilities and indebtedness not represented by Senior Notes at the end of the period divided by Senior Notes outstanding at the end of the period.

The following table sets forth information about the Company's outstanding senior securities as of October 31, 2004:

TITLE OF SECURITY	TOTAL PRINCIPAL AMOUNT/LIQUIDATION PREFERENCE OUTSTANDING	ASSET COVERAGE PER $1,000 OF PRINCIPAL AMOUNT	ASSET COVERAGE PER SHARE ($25,000 LIQUIDATION PREFERENCE)	AV FAI PER DENO OR P AM
Tortoise Notes....................				
Series A.......................	$60,000,000	$4,263		$2
Series B.......................	$50,000,000	$4,263		$2
Money Market Cumulative Preferred				
Shares (1,400 MMP shares).......	$35,000,000		$80,856	$2

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* Fair value of the Notes and MMP Shares approximates the principal amount and liquidation preference, respectively, because interest and dividend rates payable on the Notes and MMP Shares are determined at auctions and fluctuate with changes in prevailing market interest rates.

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MARKET AND NET ASSET VALUE INFORMATION

The Company's currently outstanding shares of common stock are, and the Common Shares offered by this prospectus, subject to notice of issuance, will be, listed on the NYSE. Shares of the Company's common stock commenced trading on the NYSE on February 25, 2004.

The Company's common stock has a limited trading history and has traded both at a premium and at a discount in relation to net asset value. Although the Company's shares recently have been trading at a premium above net asset value, there can be no assurance that this will continue after the offering or that the shares will not again trade at a discount. The continued development of alternatives to the Company as a vehicle for investment in a portfolio of energy infrastructure MLPs, including other publicly traded investment companies and private funds, may reduce or eliminate any tendency of the shares to trade at a premium in the future. Shares of closed-end investment companies frequently trade at a discount from net asset value. See "Risks -- Market Discount Risk."

The following table sets forth for each of the periods indicated the high and low closing market prices for shares of the Company on the NYSE, the net asset value per share and the premium or discount to net asset value per share at which the Company's shares were trading. Net asset value is generally determined on the last business day of each calendar month. See "Net Asset Value" for information as to the determination of the Company's net asset value.

	MARKET PRICE(3)			PREMIUM/ (DISCOUNT) T NET ASSET VALUE(2)	
MONTH ENDED	HIGH	LOW	NET ASSET VALUE(1)	HIGH	LOW
March 31, 2004	$26.00	$24.95	$23.77	9.4%	5.0
April 30, 2004	25.00	23.10	23.83	4.9%	-3.1
May 31, 2004	24.20	21.99	22.84	6.0%	-3.7
June 30, 2004	24.00	22.45	22.67	5.9%	-1.0
July 31, 2004	24.19	22.74	23.25	4.0%	-2.2
August 31, 2004	25.06	23.86	24.19	3.6%	-1.4
September 30, 2004	26.60	24.98	24.38	9.1%	2.5
October 31, 2004	26.60	24.65	25.30	5.1%	-2.6
November 30, 2004	27.70	25.39	25.54	8.5%	-0.6

Source: Bloomberg Financial and Fund Accounting Records.

(1) Based on the net asset value calculated on the close of business on the last business day of each prior calendar month.

(2) Calculated based on the information presented.

(3) Based on high and low closing market price for the respective month.

The last reported sale price, net asset value per share and percentage premium to net asset value per share of the common stock on December 14, 2004 were $27.53, $26.34 and 4.5%, respectively. As of October 31, 2004, the Company had 12,684,154 shares of common stock outstanding and net assets of the Company were $323,966,194.

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USE OF PROCEEDS

As of October 31, 2004, the Company had invested 99.6% of its total assets. The net proceeds of the offering of Common Shares will be approximately $46,144,961 after payment of the underwriting discounts and commissions and estimated offering costs borne by the Company. The Company will invest the net proceeds of the offering in accordance with the Company's investment objective and policies as described under "Investment Objective and Principal Investment Strategies" as soon as practicable. It is presently anticipated that the Company will be able to invest the net proceeds of this offering in securities of energy infrastructure companies that meet the Company's investment objective and policies within approximately three months after the completion of the offering. Whether the Company can meet this timeframe depends to a significant degree on the availability of direct placement opportunities. Pending such investment, it is anticipated that the proceeds will be invested in securities issued by the U.S. government or its agencies or instrumentalities or in high quality, short-term or long-term debt obligations. A delay in the anticipated use of proceeds could lower returns and lower the Company's distribution for the outstanding shares of common stock and the Common Shares offered hereby.

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CAPITALIZATION

The following table sets forth the capitalization of the Company as of October 31, 2004, and as adjusted to give effect to the issuance of the Common Shares offered hereby. As indicated below, common stockholders will bear the offering costs associated with this offering.

	ACTUAL	AS ADJUSTED
	(UNAUDITED)	
LONG-TERM DEBT:		
Tortoise Notes, denominations of $25,000 or any multiple thereof*................................	$110,000,000	$110,000,000
PREFERRED STOCK OUTSTANDING:		
MMP Shares, $.001 par value per share, $25,000 stated value per share at liquidation; 10,000,000 shares authorized/1,400 shares issued*....................	$ 35,000,000	$ 35,000,000
COMMON STOCKHOLDERS' EQUITY:		
Common Stock, $.001 par value per share; 100,000,000 shares authorized; 12,684,154 shares outstanding and 14,439,181 shares outstanding as adjusted, respectively*....................................	$ 12,684	$ 14,439
Additional paid-in capital...........................	$294,154,142	$340,297,347**
Accumulated net investment loss, net of deferred tax benefit..	(54,682)	(54,682)
Accumulated net realized loss from investments, net of deferred tax benefit..............................	(88,778)	(88,778)
Net unrealized appreciation of investments and interest rate swap agreements, net of deferred tax expense...	29,942,828	29,942,828
Net assets applicable to common stock.................	$323,966,194	$370,111,154

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* None of these outstanding shares/notes are held by or for the account of the Company.

** As adjusted, additional paid-in capital reflects the proceeds of the issuance of Common Shares ($47,999,988) less $.001 par value per share of common stock ($1,755), less the underwriting commissions ($1,755,027) and less the estimated offering costs borne by the Company ($100,000) related to the issuance of Common Shares in the amount of $0.06 per share of common stock.

THE COMPANY

The Company is a nondiversified, closed-end management investment company registered under the 1940 Act which began operations in February 2004. The Company was organized as a Maryland corporation on October 30, 2003, pursuant to a charter (the "Charter") governed by the laws of the State of Maryland. On February 27, 2004, the Company issued an aggregate of 11,000,000 shares of common stock, par value $0.001 per share, in an initial public offering. On March 23, 2004 and April 8, 2004, the Company issued an additional 1,100,000 shares of common stock and 500,000 shares common stock, respectively, in connection with the partial exercises by the underwriters of their over-allotment option. The net proceeds of the initial public offering and subsequent exercises of the over-allotment option of common stock was approximately $300,000,000 after the payment of offering expenses. On July 15, 2004, the Company issued $110,000,000 aggregate principal amount of Tortoise Notes. On September 16, 2004, the Company issued 1,400 MMP Shares, liquidation preference $25,000 per share ($35,000,000 in the aggregate). The Company's common stock is listed on the NYSE under the symbol "TYG."

The following provides information about the Company's outstanding securities as of October 31, 2004:

TITLE OF CLASS	AMOUNT AUTHORIZED	AMOUNT HELD BY THE COMPANY OR FOR ITS ACCOUNT	AMOUNT OUTSTANDING
Common Stock..	100,000,000	0	12,684,154
Tortoise Notes......................................			
Series A..	$ 60,000,000	0	$60,000,000
Series B..	$ 50,000,000	0	$50,000,000
Preferred Stock (MMP Shares)........................	10,000,000	0	1,400

The Company declared distributions to holders of common stock in May, August and November 2004 in the amounts of $0.20, $0.34 and $0.43 per share, respectively. The Company expects that a significant portion of these distributions will be treated as a return of capital to stockholders for tax purposes.

INVESTMENT OBJECTIVE

The Company's investment objective is to seek a high level of total return with an emphasis on current distributions paid to stockholders. For purposes of the Company's investment objective, total return includes capital appreciation of, and all distributions received from, securities in which the Company invests regardless of the tax character of the distributions. The Company seeks to provide its stockholders with an efficient vehicle to invest in a portfolio of MLPs. Similar to the tax characterization of cash distributions made by MLPs to its unit holders, the Company believes that its stockholders will have relatively high levels of the deferred taxable income associated with cash distributions made by the Company to stockholders.

ENERGY INFRASTRUCTURE INDUSTRY

The Company concentrates its investments in the energy infrastructure sector. The Company pursues its objective by investing principally in a portfolio of equity securities issued by MLPs. MLP common units historically have generated higher average total returns than domestic common stock (as measured by the S&P 500) and fixed income securities. A more detailed description of investment policies and restrictions and more detailed information about portfolio investments are contained in the statement of additional information.

Energy Infrastructure Companies. For purposes of the Company's policy of investing 90% of total assets in securities of energy infrastructure companies, an energy infrastructure company is one that derives at least 50% of its revenues from "Qualifying Income" under Section 7704 of the Internal Revenue Code or one that derives at least 50% of its revenues from the provision of services directly related to the generation of

Qualifying Income. Qualifying Income is defined as any income and/or gains from the exploration, development, mining or production, processing, refining, transportation (including pipelines transporting natural gas, oil or products thereof), or the marketing or delivery of any mineral or natural resource (including fertilizer, geothermal energy, and timber).

Energy infrastructure companies (other than most pipeline MLPs) do not operate as "public utilities" or "local distribution companies," and are therefore not subject to rate regulation by state or federal utility commissions. However, energy infrastructure companies may be subject to greater competitive factors than utility companies, including competitive pricing in the absence of regulated tariff rates, which could cause a reduction in revenue and which could adversely affect profitability. Most pipeline MLPs are subject to government regulation concerning the construction, pricing and operation of pipelines. Pipeline MLPs are able to set prices (rates or tariffs) to cover operating costs, depreciation and taxes, and provide a return on investment. These rates are monitored by the Federal Energy Regulatory Commission (FERC) which seeks to ensure that consumers receive adequate and reliable supplies of energy at the lowest possible price while providing energy suppliers and transporters a just and reasonable return on capital investment and the opportunity to adjust to changing market conditions.

Master Limited Partnerships. Under normal circumstances, the Company invests at least 70% of its total assets in equity securities of MLPs that derive at least 90% of their income from energy infrastructure operations and are organized as partnerships, thereby eliminating income tax at the entity level. The MLP has two classes of partners, the general partner, and the limited partners. The general partner is usually a major energy company, investment fund or the direct management of the MLP. The general partner normally controls the MLP through a 2% equity interest plus units that are subordinated to the common (publicly traded) units for at least the first five years of the partnership's existence and then only converting to common if certain financial tests are met.

As a motivation for the general partner to successfully manage the MLP and increase cash flows, the terms of most MLPs typically provide that the general partner receives a larger portion of the net income as distributions reach higher target levels. As cash flow grows, the general partner receives a greater interest in the incremental income compared to the interest of limited partners. The general partner's incentive compensation typically increases up to 50% of incremental income. Nevertheless, the aggregate amount distributed to limited partners will increase as MLP distributions reach higher target levels. Given this incentive structure, the general partner has an incentive to streamline operations and undertake acquisitions and growth projects in order to increase distributions to all partners.

Energy infrastructure MLPs in which the Company invests can generally be classified in the following categories:

Pipeline MLPs are common carrier transporters of natural gas, natural gas liquids (primarily propane, ethane, butane and natural gasoline), crude oil or refined petroleum products (gasoline, diesel fuel and jet fuel). Pipeline MLPs also may operate ancillary businesses such as storage and marketing of such products. Revenue is derived from capacity and transportation fees. Historically, pipeline output has been less exposed to cyclical economic forces due to its low cost structure and government-regulated nature. In addition, pipeline MLPs do not have direct commodity price exposure because they do not own the product being shipped.

Processing MLPs are gatherers and processors of natural gas as well as providers of transportation, fractionation and storage of natural gas liquids ("NGLs"). Revenue is derived from providing services to natural gas producers, which require treatment or processing before their natural gas commodity can be marketed to utilities and other end user markets. Revenue for the processor is fee based, although it is not uncommon to have some participation in the prices of the natural gas and NGL commodities for a portion of revenue.

Propane MLPs are distributors of propane to homeowners for space and water heating. Revenue is derived from the resale of the commodity on a margin over wholesale cost. The ability to maintain margin is a key to profitability. Propane serves approximately 3% of the household energy needs in the United

States, largely for homes beyond the geographic reach of natural gas distribution pipelines. Approximately 70% of annual cash flow is earned during the winter heating season (October through March). Accordingly, volumes are weather dependent, but have utility type functions similar to electricity and natural gas.

Coal MLPs own, lease and manage coal reserves. Revenue is derived from production and sale of coal, or from royalty payments related to leases to coal producers. Electricity generation is the primary use of coal in the United States. Demand for electricity and supply of alternative fuels to generators are the primary drivers of coal demand. Coal MLPs are subject to operating and production risks, such as: the MLP or a lessee meeting necessary production volumes; federal, state and local laws and regulations which may limit the ability to produce coal; the MLPs' ability to manage production costs and pay mining reclamation costs; and the effect on demand that the Clean Air Act standards have on coal-end users.

Although the Company also may invest in equity and debt securities of energy infrastructure companies that are organized and/or taxed as corporations, it is likely that any such investments will be in debt securities because the equity dividends from such corporations typically do not meet the Company's investment objective. The Company also may invest in securities of general partners or other affiliates of MLPs and private companies operating energy infrastructure assets.

INVESTMENT PROCESS

Under normal circumstances, the Company invests at least 90% of its total assets (including assets obtained through leverage) in securities of energy infrastructure companies. The Adviser seeks to invest in securities that offer a combination of quality, growth and yield intended to result in superior total returns over the long run. The Adviser's securities selection process includes a comparison of quantitative, qualitative, and relative value factors. Although the Adviser uses research provided by broker-dealers and investment firms, primary emphasis is placed on proprietary analysis and valuation models conducted and maintained by the Adviser's in-house investment analysts. To determine whether a company meets its criteria, the Adviser generally looks for a strong record of distribution growth, a solid ratio of debt to equity and coverage ratio with respect to distributions to unit holders, and a proven track record, incentive structure and management team. All of the public energy infrastructure companies in which the Company invests have a market capitalization greater than $100 million.

INVESTMENT POLICIES

The Company seeks to achieve its investment objective by investing primarily in securities of MLPs that the Adviser believes offer attractive distribution rates and capital appreciation potential. The Company also may invest in other securities set forth below if the Adviser expects to achieve the Company's objective with such investments.

The Company's policy of investing at least 90% of its total assets (including assets obtained through leverage) in securities of energy infrastructure companies is nonfundamental and may be changed by the Board of Directors without stockholder approval, provided that stockholders receive at least 60 days' prior written notice of any change.

The Company has adopted the following additional nonfundamental policies:

- Under normal circumstances, the Company invests at least 70% and up to 100% of total assets in equity securities issued by MLPs. Equity units currently consist of common units, convertible subordinated units, and pay-in-kind units.

- The Company may invest up to 30% of total assets in restricted securities, primarily through direct placements. Subject to this policy, the Company may invest without limitation in illiquid securities. The types of restricted securities that the Company may purchase include MLP convertible subordinated units, unregistered MLP common units and securities of private companies (i.e., non-MLPs).

Investments in private companies that do not have any publicly traded shares or units are limited to 5% of total assets.

- The Company may invest up to 25% of total assets in debt securities of energy infrastructure companies, including certain securities rated below investment grade ("junk bonds"). Below investment grade debt securities will be rated at least B3 by Moody's and at least B- by S&P at the time of purchase, or comparably rated by another statistical rating organization or if unrated, determined to be of comparable quality by the Adviser.

- The Company will not invest more than 10% of total assets in any single issuer.

- The Company will not engage in short sales.

Unless otherwise stated, all investment restrictions apply at the time of purchase and the Company will not be required to reduce a position due solely to market value fluctuations.

INVESTMENT SECURITIES

The types of securities in which the Company may invest include, but are not limited to, the following:

Equity Securities of MLPs. Consistent with its investment objective, the Company may invest up to 100% of its total assets in equity securities issued by energy infrastructure MLPs, including common units, convertible subordinated units and I-Shares. The table below summarizes the features of these securities, and a further discussion of these securities follows:

	COMMON UNITS	CONVERTIBLE SUBORDINATED UNITS	I-SHARES
VOTING RIGHTS........	Limited to certain significant decisions; no annual election of directors	Same as common units	No direct MLP voting rights
DIVIDEND PRIORITY....	First right to minimum quarterly distribution ("MQD") specified in Partnership Agreement; arrearage rights	Second right to MQD; no arrearage rights	Equal in amount and priority to common units but paid in additional I-Shares at current market value of I-Shares
DIVIDEND RATE........	Minimum set in Partnership Agreement; participate pro rata with subordinated units after both MQDs are met	Equal in amount to common units; participate pro rata with common units above the MQD	Equal in amount to common units
TRADING.............	Listed on NYSE, AMEX and NASDAQ National Market	Not publicly traded	Listed on NYSE

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	COMMON UNITS	CONVERTIBLE SUBORDINATED UNITS	I-SHARES
TAX TREATMENT........	Ordinary income to the extent of taxable income allocated to holder; tax-free return of capital thereafter to extent of holder's basis; remainder as capital gain	Same as common units	Full distribution treated as return of capital; since distribution is in shares, total basis is not reduced

TYPE OF INVESTOR.....	Retail; creates UBTI for tax-exempt investor; not qualifying income for regulated investment companies	Same as common units	Institutional; does not create UBTI; qualifying income for regulated investment companies
LIQUIDITY PRIORITY...	Intended to receive return of all capital first	Second right to return of capital; pro rata with common units thereafter	Same as common units (indirect right through I-share issuer)
CONVERSION RIGHTS....	None	One-to-one ratio into common units	None

MLP Common Units. MLP common units represent an equity ownership interest in a partnership, providing limited voting rights and entitling the holder to a share of the company's success through distributions and/or capital appreciation. Unlike stockholders of a corporation, common unit holders do not elect directors annually and generally have the right to vote only on certain significant events, such as mergers, a sale of substantially all of the assets, removal of the general partner or material amendments to the partnership agreement. MLPs are required by their partnership agreements to distribute a large percentage of their current operating earnings. Common unit holders generally have first right to a MQD prior to distributions to the convertible subordinated unit holders or the general partner (including incentive distributions). Common unit holders typically have arrearage rights if the MQD is not met. In the event of liquidation, MLP common unit holders have first rights to the partnership's remaining assets after bondholders, other debt holders, and preferred unit holders have been paid in full. MLP common units trade on a national securities exchange or over-the-counter.

MLP Convertible Subordinated Units. MLP convertible subordinated units are typically issued by MLPs to founders, corporate general partners of MLPs, entities that sell assets to the MLP, and institutional investors. The purpose of the convertible subordinated units is to increase the likelihood that during the subordination period there will be available cash to be distributed to common unit holders. The Company expects to purchase subordinated units in direct placements from such persons. Convertible subordinated units generally are not entitled to distributions until holders of common units have received specified MQD, plus any arrearages, and may receive less in distributions upon liquidation. Convertible subordinated unit holders generally are entitled to MQD prior to the payment of incentive distributions to the general partner, but are not entitled to arrearage rights. Therefore, they generally entail greater risk than MLP common units. They are generally convertible automatically into the senior common units of the same issuer at a one-to-one ratio upon the passage of time or the satisfaction of certain financial tests. These units do not trade on a national exchange or over-the-counter, and there is no active market for convertible subordinated units. The value of a convertible security is a function of its worth if converted into the underlying common units. Convertible subordinated units generally have similar voting rights as MLP common units.

MLP I-Shares. I-Shares represent an indirect investment in MLP I-units. I-units are equity securities issued to affiliates of MLPs, typically a limited liability company, that owns an interest in and manages the MLP. The issuer has management rights but is not entitled to incentive distributions. The I-Share issuer's assets consist exclusively of MLP I-units. Distributions by MLPs to I-unit holders are made in the form of additional I-units, generally equal in amount to the cash received by common unit holders of MLPs. Distributions to I-Share holders are made in the form of additional I-Shares, generally equal in amount to the

I-units received by the I-Share issuer. The issuer of the I-Share is taxed as a corporation, however, the MLP does not allocate income or loss to the I-Share issuer. Accordingly, investors receive a Form 1099, are not allocated their proportionate share of income of the MLPs and are not subject to state filing obligations.

Debt Securities. The Company may invest up to 25% of its assets in debt securities of energy infrastructure companies, including securities rated below investment grade. The Company's debt securities may have fixed or variable principal payments and all types of interest rate and dividend payment and reset terms, including fixed rate, adjustable rate, zero coupon, contingent, deferred, payment in kind and auction rate features. To the extent that the Company invests in below investment grade debt securities, such securities will be rated, at the time of investment, at least B- by S&P or B3 by Moody's or a comparable rating by at least one other rating agency or, if unrated, determined by the Adviser to be of comparable quality. If a security satisfies the Company's minimum rating criteria at the time of purchase and is subsequently downgraded below such rating, the Company will not be required to dispose of such security. If a downgrade occurs, the Adviser will consider what action, including the sale of such security, is in the best interest of the Company and its stockholders.

Because the risk of default is higher for below investment grade securities than investment grade securities, the Adviser's research and credit analysis is an especially important part of managing securities of this type. The Adviser will attempt to identify those issuers of below investment grade securities whose financial condition the Adviser believes are adequate to meet future obligations or have improved or are expected to improve in the future. The Adviser's analysis focuses on relative values based on such factors as interest or dividend coverage, asset coverage, earnings prospects and the experience and managerial strength of the issuer.

Restricted Securities. The Company may invest up to 30% of total assets in restricted securities, primarily through direct placements. An issuer may be willing to offer the purchaser more attractive features with respect to securities issued in direct placements because it has avoided the expense and delay involved in a public offering of securities. Adverse conditions in the public securities markets may also preclude a public offering of securities. MLP convertible subordinated units are typically purchased from affiliates of the issuer or other existing holders of convertible units rather than directly from the issuer.

Securities obtained by means of direct placements are less liquid than securities traded in the open market because of statutory and contractual restrictions on resale. Such securities are, therefore, unlike securities that are traded in the open market, which can be expected to be sold immediately if the market is adequate. This lack of liquidity creates special risks for the Company. However, the Company could sell such securities in privately negotiated transactions with a limited number of purchasers or in public offerings under the 1933 Act. MLP convertible subordinated units also convert to publicly traded common units upon the passage of time and/or satisfaction of certain financial tests.

Defensive and Temporary Investments. Under adverse market or economic conditions or pending investment of offering or leverage proceeds, the Company may invest up to 100% of its total assets in securities issued or guaranteed by the U.S. government or its instrumentalities or agencies, short-term debt securities, certificates of deposit, bankers' acceptances and other bank obligations, commercial paper rated in the highest category by a rating agency or other fixed income securities deemed by the Adviser to be consistent with a defensive posture, or may hold cash. The Adviser also may invest in such instruments to meet working capital needs including, but not limited to, for collateral in connection with certain investment techniques, to hold a reserve pending payment of distributions, and to facilitate the payment of expenses and settlement of trades. The yield on such securities may be lower than the returns on MLPs or yields on lower rated fixed income securities. To the extent the Company uses this strategy, it may not achieve its investment objective.

CONFLICTS OF INTEREST

Conflicts of interest may arise from the fact that the Adviser and its affiliates carry on substantial investment activities for other clients, in which the Company has no interest. The Adviser or its affiliates may have financial incentives to favor certain of such accounts over the Company. Any of their proprietary accounts and other customer accounts may compete with the Company for specific trades. The Adviser or its

affiliates may give advice and recommend securities to, or buy or sell securities for the Company which advice or securities may differ from advice given to, or securities recommended or bought or sold for, other accounts and customers, even though their investment objectives may be the same as, or similar to, those of the Company.

The Adviser evaluates a variety of factors in determining whether a particular investment opportunity or strategy is appropriate and feasible for the relevant account at a particular time, including, but not limited to, the following: (i) the nature of the investment opportunity taken in the context of the other investments at the time; (ii) the liquidity of the investment relative to the needs of the particular entity or account; (iii) the availability of the opportunity (i.e., size of obtainable position); (iv) the transaction costs involved; and (v) the investment or regulatory limitations applicable to the particular entity or account. Because these considerations may differ when applied to the Company and relevant accounts under management in the context of any particular investment opportunity, the investment activities of the Company, on the one hand, and other managed accounts, on the other hand, may differ considerably from time to time. In addition, the fees and expenses of the Company differ from those of the other managed accounts. Accordingly, stockholders should be aware that the future performance of the Company and other accounts of the Adviser may vary.

Situations may occur when the Company could be disadvantaged because of the investment activities conducted by the Adviser and its affiliates for its other accounts. Such situations may be based on, among other things, the following: (i) legal or internal restrictions on the combined size of positions that may be taken for the Company or the other accounts, thereby limiting the size of the Company's position; or (ii) the difficulty of liquidating an investment for the Company or the other accounts where the market cannot absorb the sale of the combined position. The Company's investment opportunities may be limited by affiliations of the Adviser or its affiliates with energy infrastructure companies.

Under the 1940 Act, the Company and its affiliates may be precluded from co-investing in negotiated private placements of securities. The Company may apply to the SEC for exemptive relief to permit the Company and its affiliates to make such investments. Unless and until the Company obtains an exemptive order, the Company will not co-invest with its affiliates in negotiated private placement transactions.

The Adviser and its principals, officers, employees, and affiliates may buy and sell securities or other investments for their own accounts and may have actual or potential conflicts of interest with respect to investments made on behalf of the Company. As a result of differing trading and investment strategies or constraints, positions may be taken by principals, officers, employees, and affiliates of the Adviser that are the same as, different from, or made at a different time than positions taken for the Company.

PORTFOLIO TURNOVER

The Company's annual portfolio turnover rate may vary greatly from year to year. Although the Company cannot accurately predict its annual portfolio turnover rate, it is not expected to exceed 30% under normal circumstances. From the commencement of operations through October 31, 2004, the Company's actual portfolio turnover rate was less than 1%. However, portfolio turnover rate is not considered a limiting factor in the execution of investment decisions for the Company. A higher turnover rate results in correspondingly greater brokerage commissions and other transactional expenses that are borne by the Company. High portfolio turnover may result in the Company's recognition of gains that will increase the Company's tax liability and thereby lower the after-tax distributions of the Company. In addition, high portfolio turnover may increase the Company's current and accumulated earnings profits, resulting in a greater portion of the Company's distributions being treated as taxable dividends for federal income tax purposes. See "Tax Matters."

LEVERAGE

The Company may borrow money, issue preferred stock, or issue other senior securities to the extent permitted by the 1940 Act. These practices are known as leverage. The Company has Tortoise Notes and MMP Shares outstanding in an aggregate principal amount and liquidation preference representing 29.5% of

26

total assets as of October 31, 2004. The Company generally will not use leverage unless it believes that leverage will serve the best interests of its stockholders. The principal, although not exclusive, factor used in making this determination is whether the potential return is likely to exceed the cost of leverage. The Company also may borrow up to an additional 5% of its total assets (not including the amount so borrowed) for temporary purposes, including the settlement and clearance of securities transactions, which otherwise might require untimely dispositions of portfolio holdings.

Under the 1940 Act, the Company is not permitted to incur indebtedness constituting senior securities unless immediately thereafter the Company has total assets (including the proceeds of the indebtedness) at least equal to 300% of the amount of the indebtedness. Stated another way, the Company may not borrow for investment purposes more than 33 1/3% of its total assets, including the amount borrowed. The Company also must maintain this 300% "asset coverage" for as long as the indebtedness is outstanding. The 1940 Act provides that the Company may not declare any cash dividend or other distribution on its shares, or purchase any of its shares of capital stock (through tender offers or otherwise), unless it would satisfy this 300% asset coverage after deducting the amount of the dividend, other distribution or share purchase price, as the case may be. If the asset coverage for indebtedness declines to less than 300% as a result of market fluctuations or otherwise, the Company may be required to sell a portion of its investments when it may be disadvantageous to do so. Under the 1940 Act, the Company may only issue one class of senior securities representing indebtedness. So long as Tortoise Notes are outstanding, additional senior securities representing indebtedness must rank on a parity with Tortoise Notes.

Under the 1940 Act, the Company is not permitted to issue preferred stock unless immediately after such issuance the total assets are at least 200% of the liquidation value of the outstanding preferred stock. Stated another way, the Company may not issue preferred stock that has an aggregate liquidation value of more than 50% of its total assets (less liabilities and indebtedness), including the amount leveraged. In addition, the Company is not permitted to declare any cash dividend or other distribution on its common stock unless, at the time of such declaration, the total assets less liabilities and indebtedness (determined after deducting the amount of such dividend or distribution) is at least 200% of such liquidation value. The Company may, as a result of market conditions or otherwise, be required to purchase or redeem MMP shares, or sell a portion of its investments when it may be disadvantageous to do so, in order maintain asset coverage for MMP Shares or any other preferred stock of at least 200%. Common stockholders would bear the costs of an additional preferred stock offering which would include offering expenses and the ongoing payment of dividends. Under the 1940 Act, the Company may only issue one class of senior securities representing equity. So long as MMP Shares are outstanding, additional senior equity securities must rank on a parity with MMP Shares.

The Company may, but is not required to, hedge general interest rate exposure arising from its use of leverage by entering into interest rate transactions. Interest rate transactions are hedging transactions such as interest rate swaps and the purchase of interest rate caps and floors. Interest rate swaps involve the exchange by the Company with another party of their respective commitments to pay or receive interest (e.g., an exchange of floating rate payments for fixed payments). The purchase of an interest rate cap entitles the purchaser, to the extent that a specified index exceeds a predetermined interest rate, to receive payments of interest on a notional principal amount from the party selling such interest rate cap. The purchase of an interest rate floor entitles the purchaser, to the extent that a specified index falls below a predetermined interest rate, to receive payments of interest on a notional principal amount from the party selling such interest rate floor. The Company uses interest rate transactions solely for the purpose of hedging its leveraged capital structure. The use of interest rate transactions is a highly specialized activity that involves investment techniques and risks different from those associated with ordinary portfolio security transactions.

The Company has entered into interest rate swap transactions that are intended to hedge the Company's interest payment obligations under the Tortoise Notes against material increases in interest rates through mid-July 2007. The Company's dividend payment obligations under the MMP Shares remain unhedged as of the date of this prospectus. See "Risks -- Hedging Strategy Risk."

EFFECTS OF LEVERAGE

On July 15, 2004, the Company issued Tortoise Notes (Series A) in an aggregate principal amount of $60,000,000 and Tortoise Notes (Series B) in an aggregate principal amount of $50,000,000. The aggregate principal amount of Tortoise Notes represented 22.4% of total assets as of October 31, 2004. Asset coverage with respect to Tortoise Notes was 426% as of that date. The interest rate payable by the Company on both series of Tortoise Notes varies based on auctions normally held every twenty-eight (28) days. As of October 31, 2004, the current interest rate payable on Tortoise Notes Series A and Series B was 2.19% and 2.20%, respectively. However, the Company has entered into interest rate swap agreements to protect itself from increasing interest expense on Tortoise Notes resulting from increasing short-term interest rates. Under the terms of outstanding swap agreements as of October 31,t style="font-family:inherit;font-size:10pt;">Net in

$
(1,083

)

$
7

$
(4,609
)

$
3,594

Net income (loss) per share:

Basic
$
(0.06
)

$
0.00

$
(0.29
)

$
0.27

Diluted
$
(0.06
)

$
0.00

$
(0.29
)

$

0.25

Weighted average shares outstanding:

Basic
17,905

13,465

15,787

13,417

Diluted
17,905

14,335

15,787

14,370

(1) Includes:

Additional amortization of non-cancelable prepaid royalty

$
103

$
—

$
321

$
5

Stock-based compensation
34

17

93

41

Amortization of acquired developed technology
—

—

—

1,050

(2) Includes stock-based compensation
214

120

624

309

(3) Includes stock-based compensation
260

225

771

500

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended September 30, 2011	2010
Cash flows from operating activities:		
Net income (loss)	$(4,609)	$3,594
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,800	3,328
Gain on sale of patents	(1,600)	—
Stock-based compensation	1,488	850
Reversal of uncertain tax positions	(967)	(5,957)
Gain on sale of marketable securities	(264)	(660)
Deferred income tax expense	69	—
Other non-cash tax expense (benefit)	26	(27)
Amortization of acquired developed technology	—	1,050
Other	89	162
Changes in operating assets and liabilities:		
Accounts receivable, net	130	300
Inventories, net	175	692
Prepaid expenses and other current and long-term assets, net	808	1,024
Accounts payable	787	(1,797)
Accrued current and long-term liabilities	(167)	373
Income taxes payable	195	123
Net cash provided by (used in) operating activities	(40)	3,055
Cash flows from investing activities:		
Proceeds from sales and maturities of marketable securities	12,961	12,150
Purchases of property and equipment	(2,017)	(1,171)
Proceeds from sale of patents	1,600	—
Purchases of marketable securities	—	(13,567)
Purchases of other assets	—	(290)
Proceeds from sales of property and equipment	—	5
Net cash provided by (used in) investing activities	12,544	(2,873)
Cash flows from financing activities:		
Repurchase of debentures currently payable	(15,779)	—
Net proceeds from equity offering	8,327	—
Payments on line of credit	(3,000)	—
Payments on asset financings	(2,219)	(1,794)
Proceeds from issuances of common stock	312	193
Net cash used in financing activities	(12,359)	(1,601)
Net change in cash and cash equivalents	145	(1,419)
Cash and cash equivalents, beginning of period	16,872	17,797
Cash and cash equivalents, end of period	$17,017	$16,378

See accompanying notes to condensed consolidated financial statements.

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

NOTE 1: BASIS OF PRESENTATION

Nature of Business

We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications and hold 114 patents related to the visual display of digital image data. Our solutions enable manufacturers of digital display and projection devices, such as large-screen flat panel televisions and digital front projectors, to manufacture their products with a consistently high level of video quality, regardless of the content's source or format. Our core technology leverages unique proprietary techniques for intelligently processing video signals from a variety of sources to ensure that all resulting images are optimized. Additionally, our products help our customers reduce costs and differentiate their display and projection devices, an important factor in industries that experience rapid innovation. Pixelworks was founded in 1997 and is incorporated under the laws of the state of Oregon.

Condensed Consolidated Financial Statements

These condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted pursuant to such regulations, although we believe that the disclosures provided are adequate to prevent the information presented from being misleading.

The financial information included herein for the three and nine month periods ended September 30, 2011 and 2010 is unaudited; however, such information reflects all adjustments, consisting of normal recurring adjustments, that are, in the opinion of management, necessary for a fair presentation of the financial position, results of operations and cash flows of the Company for these interim periods. The financial information as of December 31, 2010 is derived from our audited consolidated financial statements and notes thereto for the fiscal year ended December 31, 2010, included in Item 8 of our Annual Report on Form 10-K, filed with the SEC on March 9, 2011, and should be read in conjunction with such consolidated financial statements.

The results of operations for the three and nine month periods ended September 30, 2011 are not necessarily indicative of the results expected for the entire fiscal year ending December 31, 2011.

Recent Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820)-Fair Value Measurement ("ASU 2011-04"), to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. ASU 2011-04 changes certain fair value measurement principles and enhances the disclosure requirements. The provisions of this new guidance are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The guidance is not expected to have a material impact on our consolidated financial statements.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, Comprehensive Income (Topic 220)-Presentation of Comprehensive Income ("ASU 2011-05"), to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. The provisions of this new guidance require retrospective application and are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The guidance will change the presentation of our consolidated financial statements but will not impact our financial position or results of operations.

Reclassifications

Certain reclassifications have been made to the 2010 condensed consolidated financial statements and notes to conform to the 2011 presentation.

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Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and judgments that affect amounts reported in the financial statements and accompanying notes. Our significant estimates and judgments include those related to product returns, warranty obligations, bad debts, inventories, property and equipment, impairment of long-lived assets, amortization of prepaid royalties, valuation of share-based payments, income taxes, litigation and other contingencies. The actual results experienced could differ materially from our estimates.

NOTE 2: BALANCE SHEET COMPONENTS

Accounts Receivable, Net

Accounts receivable are recorded at invoiced amount and do not bear interest when recorded or accrue interest when past due. Accounts receivable are stated net of an allowance for doubtful accounts, which is maintained for estimated losses that may result from the inability of our customers to make required payments. Accounts receivable consists of the following:

	September 30, 2011	December 31, 2010
Accounts receivable, gross	$4,750	$4,886
Less: allowance for doubtful accounts	(393)	(399)
Accounts receivable, net	$4,357	$4,487

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

	Nine Months Ended September 30,	
	2011	2010
Balance at beginning of period	$399	$428
Additions charged (reductions credited)	(6)	8
Balance at end of period	$393	$436

Inventories, Net

Inventories consist of finished goods and work-in-process, and are stated at the lower of standard cost (which approximates actual cost on a first-in, first-out basis) or market (net realizable value), net of a reserve for slow-moving and obsolete items.

Inventories consist of the following:

	September 30, 2011	December 31, 2010
Finished goods	$2,475	$2,961
Work-in-process	3,078	3,232
Total	5,553	6,193
Less: reserve for slow-moving and obsolete items	(870)	(1,335)
Inventories, net	$4,683	$4,858

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The following is the change in our reserve for slow-moving and obsolete items:

	Nine Months Ended September 30,	
	2011	2010
Balance at beginning of period	$1,335	$2,140
New provision	356	476
Sales of previously reserved inventory	(56)	(84)
Net provision for obsolete inventory	300	392
Final scrap of previously reserved inventory	(765)	(564)
Balance at end of period	$870	$1,968

Based upon our forecast and backlog, we do not currently expect to be able to sell or otherwise use the reserved inventory we have on hand at September 30, 2011. However, it is possible that a customer will decide in the future to purchase a portion of the reserved inventory.

We recorded lower of cost or market write-downs of $0 and $771 for the nine months ended September 30, 2011 and 2010, respectively.

Property and Equipment, Net

Property and equipment consists of the following:

	September 30, 2011	December 31, 2010
Gross carrying amount	$23,107	$20,406
Less: accumulated depreciation and amortization	(15,522)	(14,576)
Property and equipment, net	$7,585	$5,830

Accrued Liabilities and Current Portion of Long-Term Liabilities

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

	September 30, 2011	December 31, 2010
Accrued payroll and related liabilities	$2,759	$2,365
Current portion of accrued liabilities for asset financings	2,053	2,601
Accrued commissions and royalties	1,383	1,139
Accrued interest payable	469	358
Reserve for warranty returns	390	723
Accrued costs related to restructuring	80	172
Other	1,411	1,625
	$8,545	$8,983

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

	Nine Months Ended September 30,	
	2011	2010
Reserve for warranty returns:		
Balance at beginning of period	$723	$304
Provision (benefit)	(139)	688
Charge-offs	(194)	(445)
Balance at end of period	$390	$547

Long-Term Liabilities, Net of Current Portion

Long-term liabilities, net of current portion, consist of the following:

	September 30, 2011	December 31, 2010
Accrued liabilities for asset financings	$2,099	$1,314
Deferred rent	163	302
Payroll and related liabilities	150	165
Accrued costs related to restructuring	61	119
Other	107	161
	$2,580	$2,061

Short-Term Line of Credit

On December 21, 2010, we entered into a Loan and Security Agreement (the "Revolving Loan Agreement") with Silicon Valley Bank (the "Bank"). The Revolving Loan Agreement provides for a secured working capital-based revolving line of credit (the "Revolving Line") in an aggregate amount of up to the lesser of (i) $10,000, or (ii) 80% of eligible domestic accounts receivable and certain foreign accounts receivable. In addition, the Revolving Loan Agreement provides for non-formula advances of up to $10,000 which may be made solely during the last five business days of any fiscal month or quarter and which must be repaid by the Company on or before the fifth business day after the applicable fiscal month or quarter end. Due to their repayment terms, non-formula advances do not provide the Company with usable liquidity.

The Revolving Loan Agreement contains customary affirmative and negative covenants as well as customary events of default. The occurrence of an event of default could result in the acceleration of the Company's obligations under the Revolving Loan Agreement and an increase to the applicable interest rate, and would permit the Bank to exercise remedies with respect to its security interest. As of September 30, 2011, we were in compliance with all of the terms of the Revolving Loan Agreement.
As of September 30, 2011, we had no outstanding borrowings under the Revolving Line. As of December 31, 2010, short-term borrowings outstanding under the Revolving Line were non-formula advances in the aggregate of $3,000, which were repaid within required terms.

Debentures

In 2004, we issued $150,000 of 1.75% convertible subordinated debentures (the "debentures") due 2024. Between 2006 and 2009, we repurchased and retired $134,221 principal amount of the debentures. On April 13, 2011, we announced an offer to repurchase all of the remaining outstanding debentures, as required under the terms of the indenture governing the debentures. In connection with the offer, we filed a Tender Offer Statement on Schedule TO on that day, including as an exhibit, a notice to holders of the debentures specifying the terms, conditions and procedures of our offer to repurchase. The remaining $15,779 principal amount of the debentures were properly tendered to us and were redeemed for cash at par value on May 16, 2011.

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NOTE 3: MARKETABLE SECURITIES AND FAIR VALUE MEASUREMENTS

As of September 30, 2011 we had no short- or long-term marketable securities. As of December 31, 2010, short- and long-term marketable securities, classified as available-for-sale, consisted of the following:

	Cost	Unrealized Gain (Loss)	Fair Value
Short-term marketable securities:			
US government agencies debt securities	$5,513	$3	$5,516
Commercial paper	5,747	—	5,747
Corporate debt security	1,104	(1)	1,103
Total	$12,364	$2	$12,366
Long-term marketable securities:			
Equity securities	$348	$255	$603

Unrealized holding gains and losses are recorded in accumulated other comprehensive income, a component of shareholders' equity, in the condensed consolidated balance sheets. During the nine months ended September 30, 2011, we sold the remaining portion of our long-term equity investment. We determined the cost of the securities sold using specific identification. Net unrealized holding gains of $255 on available-for-sale securities were reclassified out of accumulated other comprehensive income for the nine month period ended September 30, 2011.

Fair Value Measurements

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

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

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

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

The following table presents information about our assets measured at fair value on a recurring basis in the condensed consolidated balance sheets as of September 30, 2011 and December 31, 2010:

	Level 1	Level 2	Level 3	Total
As of September 30, 2011:				
Money market funds	$9,191	$—	$—	$9,191
As of December 31, 2010:				
Money market funds	$10,933	$—	$—	$10,933
Certificates of deposit	200	—	—	200
US government agencies debt securities	—	5,516	—	5,516
Commercial paper	—	6,947	—	6,947
Corporate debt security	—	1,605	—	1,605
Long-term marketable securities	603	—	—	603
Total	$11,736	$14,068	$—	$25,804

We have excluded $3,000 previously included in money market funds as of December 31, 2010, as the amount represents cash not subject to fair value reporting requirements.

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

NOTE 4: RESTRUCTURINGS

All actions under our prior restructuring plans were completed in the second quarter of 2009; however, due to decreases in estimated future sublease income and related professional fees, lease termination costs of $94 were recorded in the first quarter of 2010.

As of September 30, 2011, accrued lease termination costs of $141 are included in current and non-current accrued liabilities in the condensed consolidated balance sheets and will be paid in cash over the remaining lease terms of approximately two years.

NOTE 5: INCOME TAXES

The benefit for income taxes recorded for the third quarter of 2011 and 2010 was primarily due to a benefit of $636 and $673, respectively, for the reversal of previously recorded tax contingencies due to the expiration of applicable statutes of limitation, partially offset by current and deferred tax expense for our profitable cost-plus foreign entities and accruals for tax contingencies in foreign jurisdictions.

The benefit for income taxes recorded for the first nine months of 2011 and 2010 was primarily due to a benefit of $967 and $5,957, respectively, for the reversal of previously recorded tax contingencies due to the expiration of the applicable statutes of limitation, partially offset by current and deferred tax expense for our profitable cost-plus foreign entities and accruals for tax contingencies in foreign jurisdictions.

As of September 30, 2011, we continued to provide a full valuation allowance against essentially all of our U.S. and Canadian net deferred tax assets as we do not believe that it is more likely than not that we will realize a benefit from those assets. We have not recorded a valuation allowance against our other foreign net deferred tax assets as we believe that it is more likely than not that we will realize a benefit from those assets.

As of September 30, 2011 and December 31, 2010, the amount of our uncertain tax positions was a liability of $2,870 and $3,574, respectively. A number of years may elapse before an uncertain tax position is resolved by settlement or statute of limitation. Settlement of any particular position could require the use of cash. If the uncertain tax positions we have accrued for are sustained by the taxing authorities in our favor, the reduction of the liability will reduce our effective tax rate. We reasonably expect reductions in the liability for unrecognized tax benefits and interest and penalties of approximately $1,416 within the next twelve months due to the expiration of statutes of limitation in foreign jurisdictions. We recognize interest and penalties related to uncertain tax positions in income tax expense in our consolidated statements of operations.

NOTE 6: INTEREST EXPENSE AND OTHER, NET

Interest expense and other, consists of the following:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Interest expense	$(90)	$(125)	$(378)	$(372)

Amortization of debt issuance costs	—	(19)	(31)	(55)
Interest income	1	17	14	49
Total interest expense and other, net	$(89)	$(127)	$(395)	$(378)

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NOTE 7: COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) is as follows:

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Net income (loss)	$(1,083)	$7	$(4,609)	$3,594
Reclassification of unrealized gain upon sale of available-for-sale securities	—	(469)	(255)	(409)
Unrealized gain (loss) on available-for-sale investments	—	(218)	(2)	205
Tax effect of unrealized gain (loss) on available-for-sale investments	—	102	26	(27)
Total comprehensive income (loss)	$(1,083)	$(578)	$(4,840)	$3,363

NOTE 8: EARNINGS PER SHARE

Basic earnings per share amounts are computed based on the weighted average number of common shares outstanding. Diluted weighted average shares outstanding include the weighted average number of common shares outstanding plus potentially dilutive common shares outstanding during the period.

Potentially dilutive common shares from employee equity incentive plans are determined by applying the treasury stock method to the assumed exercise of outstanding stock options, the assumed vesting of outstanding restricted stock awards and units, and the assumed issuance of common stock under the employee stock purchase plan. Potentially dilutive common shares issuable upon conversion of our convertible subordinated debentures were computed using the if-converted-method.

The following schedule reconciles the computation of basic net income (loss) per share and diluted net income (loss) per share (in thousands, except per share data):

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Net income (loss) used in basic net income (loss) per share	$(1,083)	$7	$(4,609)	$3,594
Basic weighted average shares outstanding	17,905	13,465	15,787	13,417
Dilutive effect of employee equity incentive plans	—	870	—	953
Diluted weighted average shares outstanding	17,905	14,335	15,787	14,370
Net income (loss) per common share:				
Basic	$(0.06)	$0.00	$(0.29)	$0.27
Diluted	$(0.06)	$0.00	$(0.29)	$0.25

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

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010

Employee equity incentive plans	3,798	1,834	3,715	1,608
Conversion of debentures	—	216	—	216

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NOTE 9: SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental disclosure of cash flow information is as follows:

	Nine Months Ended September 30, 2011	2010
Cash paid during the period for:		
Interest	$234	$237
Income taxes	472	111
Non-cash investing and financing activities:		
Acquisitions of property and equipment and other assets under extended payment terms	$2,457	$4,210

NOTE 10: SHAREHOLDERS' EQUITY

In May 2011, we sold 4,197,500 shares of common stock in an underwritten registered offering at a price to the public of $2.24 per share. Net proceeds to the Company, after deducting underwriting discounts, commissions, and other expenses, were approximately $8,327.

NOTE 11: SEGMENT INFORMATION

We have identified a single operating segment: the design and development of integrated circuits for use in electronic display devices. A majority of our assets are located in the United States.

Geographic Information

Revenue by geographic region, attributed to countries based on the domicile of the end customer, is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Japan	$12,024	$12,014	$32,090	$34,695
Taiwan	2,939	2,747	7,883	10,044
China	687	165	1,787	945
Europe	541	884	1,879	2,553
Korea	306	648	1,319	2,093
United States	410	635	1,177	2,394
Other	484	934	1,646	2,660
	$17,391	$18,027	$47,781	$55,384

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Significant Customers

The percentage of revenue attributable to our distributors, top five end customers, and individual distributors or end customers that represented more than 10% of revenue in at least one of the periods presented, is as follows:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2011		2010		2011		2010	
Distributors:								
All distributors	75	%	65	%	69	%	59	%
Distributor A	58	%	49	%	52	%	42	%
End customers: (1)								
Top five end customers	55	%	59	%	55	%	58	%
End customer A	16	%	12	%	13	%	12	%
End customer B	12	%	11	%	10	%	11	%
End customer C	11	%	18	%	15	%	20	%
End customer D	7	%	10	%	7	%	6	%

(1) End customers include customers who purchase directly from us, as well as customers who purchase our products indirectly through distributors.

The following accounts represented 10% or more of total accounts receivable in at least one of the periods presented:

	September 30, 2011		December 31, 2010	
Account A	38	%	45	%
Account B	14	%	25	%
Account C	11	%	6	%

NOTE 12: RISKS AND UNCERTAINTIES

Concentration of Suppliers

We do not own or operate a semiconductor fabrication facility and do not have the resources to manufacture our products internally. We rely on four third-party foundries to produce all of our wafers and three assembly and test vendors for completion of finished products. We do not have any long-term agreements with any of these suppliers. In light of these dependencies, it is reasonably possible that failure to perform by one of these suppliers could have a severe impact on our results of operations. Additionally, the concentration of these vendors within the People's Republic of China and Taiwan increases our risk of supply disruption due to natural disasters, economic instability, political unrest or other regional disturbances.

Risk of Technological Change

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

Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk consist of cash equivalents and accounts receivable. We limit our exposure to credit risk associated with cash equivalent balances by holding our funds in highly liquid money market accounts. We limit our exposure to credit risk associated with accounts receivable by carefully evaluating creditworthiness before offering terms to customers.

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NOTE 13: COMMITMENTS AND CONTINGENCIES

Indemnifications
Certain of our agreements include indemnification provisions for claims from third-parties relating to our intellectual property. It is not possible for us to predict the maximum potential amount of future payments or indemnification costs under these or similar agreements due to the conditional nature of our obligations and the unique facts and circumstances involved in each particular agreement. We have not made any payments under these agreements in the past, and as of September 30, 2011, we have not incurred any material liabilities arising from these indemnification obligations. In the future, however, such obligations could impact our results of operations.

Legal Proceedings
We are subject to legal matters that arise from time to time in the ordinary course of our business. Although we currently believe that resolving such matters, individually or in the aggregate, will not have a material adverse effect on our financial position, our results of operations, or our cash flows, these matters are subject to inherent uncertainties and our view of these matters may change in the future.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Forward-looking Statements
This Management's Discussion and Analysis of Financial Condition and Results of Operations contains "forward-looking statements" that are based on current expectations, estimates, beliefs, assumptions and projections about our business. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates" and variations words and similar expressions are intended to identify such forward-looking statements. Such forward-looking statements include the disclosure contained under the caption "Results of Operations—Business Outlook" below. These statements are not guarantees of future performance and involve certain risks and uncertainties that are difficult to predict and which may cause actual outcomes and results to differ materially from what is expressed or forecasted in such forward-looking statements. A detailed discussion of risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements is included in Part II, Item 1A of this Quarterly Report on Form 10-Q. These forward-looking statements speak only as of the date on which they are made, and we do not undertake any obligation to update any forward-looking statement to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q. If we do update or correct one or more forward-looking statements, you should not conclude that we will make additional updates or corrections with respect thereto or with respect to other forward-looking statements. Except where the context otherwise requires, in this Quarterly Report on Form 10-Q, the "Company," "Pixelworks," "we," "us" and "our" refer to Pixelworks, Inc., an Oregon corporation, and its wholly-owned subsidiaries.

Overview
We are an innovative designer, developer and marketer of video and pixel processing semiconductors and software for high-end digital video applications and hold 114 patents related to the visual display of digital image data. Our solutions enable manufacturers of digital display and projection devices, such as large-screen flat panel televisions and digital front projectors, to manufacture their products with a consistently high level of video quality, regardless of the content's source or format. Our core technology leverages unique proprietary techniques for intelligently processing video signals from a variety of sources to ensure that all resulting images are optimized. Additionally, our products help our customers reduce costs and differentiate their display and projection devices, an important factor in industries that experience rapid innovation. Pixelworks was founded in 1997 and is incorporated under the laws of the state of Oregon.

Results of Operations

Revenue, net

Net revenue for the three month periods ended September 30, 2011 and 2010, was as follows (dollars in thousands):

	Three Months Ended September 30,		2011 v. 2010	
	2011	2010	$ Change	% Change
Revenue, net	$17,391	$18,027	$(636)	(4)%

Net revenue decreased $0.6 million, or 4%, from the third quarter of 2010 to the third quarter of 2011. The decrease was primarily attributable to a 22% decrease in average selling price (“ASP”), partially offset by a 23% increase in units sold.

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The increase in units sold was attributable to increased sales into the advanced television market of our MotionEngine® co-processor integrated circuits ("ICs") as sales associated with recent design wins ramped in volume at top-tier advanced television market customers. This increase was partially offset by a decrease in sales of end-of-life products we acquired in conjunction with our June 2005 acquisition of Equator Technologies, Inc. The decrease in ASP was primarily due to a greater proportion of unit sales of our MotionEngine® advanced video co-processor ICs, which have a lower price point than our other product lines. The decrease in ASP was also attributable to reduced pricing on our earlier generation digital projector products and changes in the mix of digital projector product sales.

Net revenue for the nine month periods ended September 30, 2011 and 2010, was as follows (dollars in thousands):

	Nine Months Ended September 30,		2011 v. 2010	
	2011	2010	$ Change	% Change
Revenue, net	$47,781	$55,384	$(7,603)	(14)%

Net revenue decreased $7.6 million, or 14% from the first nine months of 2010 to the first nine months of 2011. The decrease was primarily attributable to a 19% decrease in ASP, partially offset by a 7% increase in units sold.

The increase in units sold was attributable to increased sales into the advanced television market of our MotionEngine® co-processor ICs as sales associated with recent design wins ramped in volume at top-tier advanced television market customers. This increase was partially offset by a decrease in digital projector product sales which was primarily due to an inventory correction during the first half of 2011. The decrease in ASP was primarily due to a greater proportion of unit sales of our MotionEngine® advanced video co-processor ICs, which have a lower price point than our other product lines. The decrease in ASP was also attributable to reduced pricing on our earlier generation digital projector products and changes in the mix of digital projector product sales.

Cost of revenue and gross profit

Cost of revenue and gross profit for the three month periods ended September 30, 2011 and 2010, was as follows (dollars in thousands):

	Three months ended September 30,			
	2011	% of revenue	2010	% of revenue
Direct product costs and related overhead [1]	$8,800	51%	$9,403	52%
Inventory charges [2]	(2)	0	313	2
Amortization of acquired developed technology	—	0	—	0
Other cost of revenue [3]	137	1	17	0
Total cost of revenue	$8,935	51%	$9,733	54%
Gross profit	$8,456	49%	$8,294	46%

[1] Includes purchased materials, assembly, test, labor, employee benefits, warranty expense and royalties.
[2] Includes the net provision for inventory reserves and lower of cost or market write-downs.
[3] Includes stock based compensation and additional amortization of a non-cancelable prepaid royalty.

Cost of revenue decreased to 51% of total revenue in the third quarter of 2011, down from 54% of total revenue in the third quarter of 2010. The percentage decrease resulted primarily from a decrease in inventory charges as we transitioned our customers to our next generation of MotionEngine® co-processor IC products. The decrease is also partially due to a reduction in direct product costs as a percentage of revenue due to improvements in our manufacturing processes and an increased benefit from scrap disposal, partially offset by customer transition to our new digital projector products and MotionEngine® co-processor IC products, which have higher material costs than earlier generation products.

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Cost of revenue and gross profit for the nine month periods ended September 30, 2011 and 2010, was as follows (dollars in thousands):

	Nine months ended September 30,					
	2011	% of revenue		2010	% of revenue	
Direct product costs and related overhead [1]	$24,620	52	%	$27,528	50	%
Inventory charges [2]	300	1		1,163	2	
Amortization of acquired developed technology	—	0		1,050	2	
Other cost of revenue [3]	414	1		46	0	
Total cost of revenue	$25,334	53	%	$29,787	54	%
Gross profit	$22,447	47	%	$25,597	46	%

1 Includes purchased materials, assembly, test, labor, employee benefits, warranty expense and royalties.
2 Includes the net provision for inventory reserves and lower of cost or market write-downs.
3 Includes stock based compensation and additional amortization of a non-cancelable prepaid royalty.

Cost of revenue decreased to 53% of total revenue in the first nine months of 2011, down from 54% of total revenue in the first nine months of 2010. The percentage decrease resulted primarily from reduced inventory charges as we transitioned our customers to our next generation of MotionEngine® co-processor IC products as well as the elimination of amortization expense for acquired developed technology assets that were fully amortized as of the second quarter of 2010. These decreases were partially offset by an increase in direct product costs as a percentage of revenue due to customer transition to our new digital projector products and MotionEngine® co-processor IC products, which have higher material costs than earlier generation products, partially offset by improvements in our manufacturing processes and an increased benefit from scrap disposal.

Research and development

Research and development expense includes compensation and related costs for personnel, development-related expenses including non-recurring engineering and fees for outside services, depreciation and amortization, expensed equipment, facilities and information technology expense allocations and travel and related expenses.

Research and development expense for the three month periods ended September 30, 2011 and 2010, was as follows (dollars in thousands):

	Three Months Ended September 30,		2011 v. 2010		
	2011	2010	$ Change	% Change	
Research and development	$5,982	$5,612	$370	7	%

Research and development expense increased $0.4 million, or 7%, from the third quarter of 2010 to the third quarter of 2011. The increase is primarily attributable to an increase of $0.4 million in compensation expense due to annual merit salary increases at the beginning of the third quarter of 2011.

Research and development expense for the nine month periods ended September 30, 2011 and 2010, was as follows (dollars in thousands):

	Nine Months Ended September 30,		2011 v. 2010		
	2011	2010	$ Change	% Change	
Research and development	$17,531	$16,505	$1,026	6	%

Research and development expense increased $1.0 million, or 6%, from the first nine months of 2010 to the first nine months of 2011. The increase is primarily attributable to the following:

- Compensation expense increased $0.8 million as a result of annual merit salary increases at the beginning of the third

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quarter of 2011 and increased headcount during the 2011 period compared to the 2010 period;

- Depreciation and amortization expense increased $0.7 million due to intellectual property and engineering software tool additions; and
- Non-recurring engineering and outside services expense decreased $0.4 million due to the timing of development activities.

Selling, general and administrative

Selling, general and administrative expense includes compensation and related costs for personnel, sales commissions, allocations for facilities and information technology expenses, travel, outside services and other general expenses incurred in our sales, marketing, customer support, management, legal and other professional and administrative support functions.

Selling, general and administrative expense for the three and nine month periods ended September 30, 2011 and 2010, was as follows (dollars in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2011	2010	% Change	2011	2010	% Change
Selling, general and administrative	$3,641	$3,685	(1)%	$11,132	$11,435	(3)%

Selling, general and administrative expense decreased slightly from the third quarter of 2010 to the third quarter of 2011, and decreased $0.3 million or 3%, from the first nine months of 2010 to the first nine months of 2011. The decrease in the 2011 periods compared to the 2010 periods is due primarily to non-recurring legal expenses incurred during 2010 and a general decrease in several expense categories. These decreases were partially offset by an increase in compensation expense due to annual merit salary increases at the beginning of the third quarter of 2011.

Restructuring

All actions under our prior restructuring plans were completed in the second quarter of 2009; however, due to decreases in estimated future sublease income and related professional fees, lease termination costs of $0.1 million were recorded in the first quarter of 2010. As of September 30, 2011, accrued lease termination costs of $0.1 million are included in current and non-current accrued liabilities in the condensed consolidated balance sheets and will be paid in cash over the remaining lease terms of approximately two years.

Other income (expense), net

Net other income (expense) for the three and nine month periods ended September 30, 2011 and 2010, was as follows (dollars in thousands):

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2011	2010	$ Change	2011	2010	$ Change
Interest expense and other, net [1]	$(89)	$(127)	$38	$(395)	$(378)	$(17)
Gain on sale of marketable securities [2]	—	316	(316)	264	660	(396)
Gain on sale of patents [3]	—	—	—	1,600	—	1,600
Total other income (expense), net	$(89)	$189	$(278)	$1,469	$282	$1,187

1 Interest expense and other, net consists of interest expense, interest income and amortization of debt issuance costs. The decrease from the third quarter of 2010 to the third quarter of 2011 is due primarily to a decrease in interest expense and amortization of debt issuance costs attributable to the repayment of our convertible subordinated debentures (the "debentures") in the second quarter of 2011. The increase from the first nine months of 2010 to the first nine months of 2011 is due to an increase in interest under other contractual agreements offset by a decrease in interest expense and debt amortization costs due to the repayment of our debentures.

2 Realized gains on the sale of available-for-sale marketable securities.

3

In the first quarter of 2011, we sold certain patents and related rights and materials for proceeds and a net gain of $1.6 million. All of the patents were originally obtained by us during our June 2005 acquisition of Equator Technologies, Inc., and the underlying technologies pertain to markets that we no longer pursue.

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Provision (benefit) for income taxes

The benefit for income taxes recorded for the third quarter of 2011 and 2010 was primarily due to a benefit of $0.6 million and $0.7 million, respectively, for the reversal of previously recorded tax contingencies due to the expiration of applicable statutes of limitation, partially offset by current and deferred tax expense for our profitable cost-plus foreign entities and accruals for tax contingencies in foreign jurisdictions.

The benefit for income taxes recorded for the first nine months of 2011 and 2010 was primarily due to a benefit of $1.0 million and $5.9 million, respectively, for the reversal of previously recorded tax contingencies due to the expiration of the applicable statutes of limitation, partially offset by current and deferred tax expense for our profitable cost-plus foreign entities and accruals for tax contingencies in foreign jurisdictions.

Business Outlook

On October 20, 2011, we provided an outlook for the fourth quarter of 2011 in our earnings release, which was furnished on a current report on Form 8-K. The outlook provided the following anticipated financial results prepared in accordance with U.S. generally accepted accounting principles:

- Fourth quarter revenue of $17 million to $18 million;
- Gross profit margin of approximately 46% to 48%; and
- Operating expenses of $9.5 million to $10.5 million.

Liquidity and Capital Resources

Cash and short- and long-term marketable securities

Our cash and cash equivalents and short- and long-term marketable securities were as follows (dollars in thousands):

	September 30, 2011	December 31, 2010	$ Change	% Change
Cash and cash equivalents	$17,017	$16,872	$145	1 %
Short-term marketable securities	—	12,366	(12,366)	(100)
Long-term marketable securities	—	603	(603)	(100)
Total cash and marketable securities	$17,017	$29,841	$(12,824)	(43)%

Total cash and marketable securities decreased $12.8 million from December 31, 2010 to September 30, 2011. The net decrease in the first nine months of 2011 resulted primarily from $15.8 million used to repurchase our outstanding debentures, $4.2 million in payments on property and equipment and other asset financing and $3.0 million used to repay the outstanding balance on our line of credit. These decreases were partially offset by $8.3 million in net proceeds from our equity offering and $1.6 million proceeds from the sale of patents.

As of September 30, 2011, cash equivalents consisted of $9.2 million in U.S. denominated money market funds. Although we do not hold short- or long-term investments as of September 30, 2011, our investment policy requires that our portfolio maintains a weighted average maturity of less than 12 months. Additionally, no maturities can extend beyond 24 months and concentrations with individual securities are limited. Investments must be rated at least A-1 / P-1 by Standard & Poor’s / Moody’s, and our investment policy is reviewed at least annually by our Audit Committee.

Although cash balances held at our foreign subsidiaries would be subject to U.S. taxes if repatriated, we have sufficient U.S. net operating losses to eliminate the liability associated with any such repatriation and foreign taxes due upon repatriation would not be significant.

Accounts receivable, net

Accounts receivable, net decreased to $4.4 million as of September 30, 2011 from $4.5 million as of December 31, 2010. The average number of days sales outstanding decreased to 23 days as of September 30, 2011 from 29 days as of December 31, 2010. The decrease in days sales outstanding was primarily due to an increase in customer payments received in advance of payment terms.

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Inventories, net

Inventories, net decreased to $4.7 million as of September 30, 2011 from $4.9 million as of December 31, 2010. Inventory turnover increased to 7.5 as of September 30, 2011 from 5.8 as of December 31, 2010, primarily due to lower average inventory balances and increased cost of goods sold, associated with increased revenue for the third quarter of 2011 compared to the fourth quarter of 2010. Inventory turnover is calculated based on annualized operating results and average inventory balances for the respective quarters.

Capital resources

Equity offering

In May 2011, we sold 4,197,500 shares of common stock in an underwritten registered offering at a price to the public of $2.24 per share. Net proceeds to the Company, after deducting underwriting discounts, commissions, and other expenses, were approximately $8.3 million.

Short-term line of credit

On December 21, 2010, we entered into a Loan and Security Agreement (the "Revolving Loan Agreement") with Silicon Valley Bank (the "Bank"). The Revolving Loan Agreement provides for a secured working capital-based revolving line of credit (the "Revolving Line") in an aggregate amount of up to the lesser of (i) $10.0 million, or (ii) 80% of eligible domestic accounts receivable and certain foreign accounts receivable. In addition, the Revolving Loan Agreement provides for non-formula advances of up to $10.0 million which may be made solely during the last five business days of any fiscal month or quarter and which must be repaid by the Company on or before the fifth business day after the applicable fiscal month or quarter end. Due to their repayment terms, non-formula advances do not provide the Company with usable liquidity.

The Revolving Loan Agreement contains customary affirmative and negative covenants as well as customary events of default. The occurrence of an event of default could result in the acceleration of the Company's obligations under the Revolving Loan Agreement and an increase to the applicable interest rate, and would permit the Bank to exercise remedies with respect to its security interest. As of September 30, 2011, we were in compliance with all of the terms of the Revolving Loan Agreement.

As of September 30, 2011, we had no outstanding borrowings under the Revolving Line. As of December 31, 2010, short-term borrowings outstanding under the Revolving Line were non-formula advances in the aggregate of $3.0 million which were repaid within required terms.

Debentures

In 2004, we issued $150.0 million of 1.75% convertible subordinated debentures due 2024. Between 2006 and 2009, we repurchased and retired $134.2 million principal amount of the debentures. On April 13, 2011, we announced an offer to repurchase all of the remaining outstanding debentures, as required under the terms of the indenture governing the debentures. In connection with the offer, we filed a Tender Offer Statement on Schedule TO on that day, including as an exhibit, a notice to holders of the debentures specifying the terms, conditions and procedures of our offer to repurchase. The remaining $15.8 million principal amount of the debentures were properly tendered to us and were redeemed for cash at par value on May 16, 2011.

Liquidity

While total cash and marketable securities decreased $12.8 million during the first nine months of 2011, primarily due to the payment of $18.8 million to repurchase our outstanding debentures and repay our line of credit, our working capital increased by $5.9 million over the same period. As of September 30, 2011, we have no short- or long-term debt and our cash and cash equivalents balance of $17.0 million is highly liquid. We anticipate that our existing working capital, as well as funds available under our Revolving Line, will be adequate to fund our operating, investing and financing needs for the next twelve months. If necessary, management will pursue financing arrangements including the issuance of debt or equity securities or will reduce expenditures, in order to meet the Company's cash requirements. There is no assurance that, if required, we will be able to raise additional capital or reduce discretionary spending to provide the required liquidity which, in turn, may have an adverse effect on our results of operations and financial position.

From time to time, we may evaluate acquisitions of businesses, products or technologies that complement our business. Any further transactions, if consummated, may consume a material portion of our working capital or require additional financing activities, including the issuance of equity securities that may result in dilution to existing shareholders.

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Contractual Payment Obligations

Our contractual obligations for 2011 and beyond are included in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, filed with the Securities and Exchange Commission on August 5, 2011. Our obligations for 2011 and beyond have not changed materially as of September 30, 2011.

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, results of operations, liquidity, capital expenditures or capital resources.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Interest Rate Risk

As of September 30, 2011, all of our invested funds were held in highly liquid money market accounts with yields approaching zero, accordingly, we do not have significant exposure to changes in interest rates.

Exchange Rate Risk

All of our sales and inventory purchases are denominated in U.S. dollars and, as a result, we have relatively little exposure to foreign currency exchange risk with respect to our sales or cost of goods sold. We have employees located in offices in Japan, Taiwan, Korea and the People's Republic of China and as such, a portion of our operating expenses as well as foreign income taxes payable 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 analyze our exposure to foreign currency fluctuations and may engage in financial hedging techniques in the future to attempt to minimize the effect of these potential fluctuations; however, foreign currency exchange rate fluctuations may adversely affect our financial results in the future.

Item 4. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

Based on management's evaluation (with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO")), as of the end of the period covered by this report, our CEO and CFO have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act")) are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes to our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including the CEO and CFO, does not expect that our Disclosure Controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of the effectiveness of controls to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings.
For a discussion of legal proceedings, see “Note 13: Commitments and Contingencies” in the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q.

Item 1A. Risk Factors.
Investing in our shares of common stock involves a high degree of risk, and investors should carefully consider the risks described below before making an investment decision. If any of the following risks occur, the market price of our shares of common stock could decline and investors could lose all or part of their investment. Additional risks that we currently believe are immaterial may also impair our business operations. In assessing these risks, investors should also refer to the other information contained or incorporated by reference in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2010, including our consolidated financial statements and related notes, and our other filings made from time to time with the Securities and Exchange Commission.
Company Specific Risks
Our product strategy, which is targeted at markets demanding superior video and image quality, may not lead to new design wins or significantly increased revenue in a timely manner or at all, which could materially adversely affect our results of operations and limit our ability to grow.
We have adopted a product strategy that focuses on our core competencies in pixel processing and delivering high levels of video and image quality. With this strategy, we continue to make further investments in the development of our ImageProcessor architecture for the digital projector market, with particular focus on adding increased performance and functionality. For the advanced television market, our strategy focuses on implementing our intellectual property (“IP”) to improve the video performance of our customers’ image processors through the use of our MotionEngine® advanced video co-processor integrated circuits (“ICs”). This strategy is designed to address the needs of the large-screen, high-resolution, high-quality segment of the television market. Although our product strategy is developed to take advantage of market trends, such markets may not develop or may take longer to develop than we expect. We cannot assure you that the products we are developing will adequately address the demands of our target customers, or that we will be able to produce our new products at costs that enable us to price these products competitively.
Even if our product strategy is properly targeted, we cannot assure you that the products we are developing will lead to a significant increase in revenue from new design wins. To achieve design wins, we must design and deliver cost-effective, innovative and integrated semiconductors that overcome the significant costs associated with qualifying a new supplier and which make developers reluctant to change component sources. Additionally, potential developers may be less likely or unwilling to select our products due to concerns over our financial strength. Further, design wins do not necessarily result in developers ordering large volumes of our products. Developers can choose at any time to discontinue using our products in their designs or product development efforts. A design win is not a binding commitment by a developer to purchase our products, but rather a decision by a developer to use our products in its design process. Even if our products are chosen to be incorporated into a developer’s products, we may still not realize significant revenue from the developer if its products are not commercially successful or it chooses to qualify, or incorporate the products, of a second source. Additionally, even if our product strategy is successful at achieving design wins and increasing our revenue, we may continue to incur operating losses due to the significant research and development costs that are required to develop competitive products for the advanced television market.
We may fail to retain or attract the specialized technical and management personnel required to successfully operate our business.
Our success depends on the continued services of our executive officers and other key management, engineering, and sales and marketing personnel and on our ability to continue to attract, retain and motivate qualified personnel. Competition for skilled engineers and management personnel is intense within our industry, and we may not be successful in hiring and retaining qualified individuals. The loss of, or inability to hire, key personnel could limit our

ability to develop new products and adapt existing products to our customers' requirements, and may result in lost sales and a diversion of management resources. We have experienced, and may continue to experience difficulty and increased compensation expense, in order to hire and retain qualified engineering personnel in our Shanghai design center.

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The May 16, 2011, repurchase of our convertible debentures consumed a significant portion of our cash balances and we may be unable to successfully implement new products or enhancements to our current products, or we may need to implement future restructuring plans, which could adversely affect our future sales and financial condition.

The repurchase of the debentures required a significant portion of our available cash. The reduction of our financial resources could limit our ability to execute our product strategy or may require the need to implement future restructuring plans, particularly if we are unable to generate cash from operations or obtain additional sources of financing. Any future restructuring actions may slow our development of new or enhanced products by limiting our research and development and engineering activities. If we are unable to successfully introduce new or enhanced products, our sales and financial condition will be adversely affected.

We may not be able to borrow funds under our credit facility or secure future financing.

In December 2010, we entered into a Loan and Security Agreement with Silicon Valley Bank to provide for a secured, working capital-based, revolving line of credit. We view this line of credit as a source of available liquidity to fund fluctuations in our working capital requirements. For example, if we experience an increase in order activity from our customers, our cash balance may decrease due to the need to purchase inventories to fulfill those orders. If this occurs, we may need to draw on this facility in order to maintain our liquidity.

This facility contains various conditions, covenants and representations with which we must be in compliance in order to borrow funds. We cannot assure you that we will be in compliance with these conditions, covenants and representations in the future when we may need to borrow funds under this facility. In addition, this facility expires on December 21, 2012, after which time we may need to secure new financing to continue funding fluctuations in our working capital requirements. We cannot assure you that we will be able to secure new financing, or financing on terms that are acceptable to us.

Dependence on a limited number of sole-source, third-party manufacturers for our products exposes us to shortages based on low manufacturing yield, errors in manufacturing, uncontrollable lead-times for manufacturing, capacity allocation, price increases with little notice, volatile inventory levels and delays in product delivery, which could result in delays in satisfying customer demand, increased costs and loss of revenue.

We do not own or operate a semiconductor fabrication facility and do not have the resources to manufacture our products internally. We rely on four third-party foundries to produce all of our wafers and three assembly and test vendors for completion of finished products. The wafers used in any one of our products are fabricated by only one foundry. Sole sourcing each product increases our dependence on our suppliers.

We have limited control over delivery schedules, quality assurance, manufacturing yields, potential errors in manufacturing and production costs. We do not have long-term supply contracts with our third-party manufacturers, so they are not obligated to supply us with products for any specific period of time, quantity or price, except as may be provided in a particular purchase order. Our suppliers can increase the prices of the products we purchase from them with little notice, which may cause us to increase the prices to our customers and harm our competitiveness. Because our requirements represent only a small portion of the total production capacity of our contract manufacturers, they could reallocate capacity to other customers even during periods of high demand for our products, as they have done in the past. We expect this may occur again in the future.

Establishing a relationship with a new contract manufacturer in the event of delays or increased prices would be costly and burdensome. The lead time to make such a change would be at least nine months, and the estimated time for us to adapt a product’s design to a particular contract manufacturer’s process is at least four months. Additionally, we have, and may continue to choose new foundries to manufacture our wafers which may require us to modify our design methodology flow for the process technology and intellectual property cores of the new foundry. If we have to qualify a new foundry or packaging, assembly and testing supplier for any of our products or if we are unable to obtain our products from our contract manufacturers on schedule, at costs that are acceptable to us, or at all, we could incur significant delays in shipping products, our ability to satisfy customer demand could be harmed, our revenue from the sale of products may be lost or delayed and our customer relationships and ability to obtain future design wins could be damaged.

If we are not profitable in the future, we may be unable to continue our operations.

We have incurred operating losses since 2004. If and when we achieve profitability depends upon a number of factors, including our ability to develop and market innovative products, accurately estimate inventory needs, contract effectively for manufacturing capacity and maintain sufficient funds to finance our activities. We cannot assure you that we will ever achieve profitability. If we are not profitable in the future, we may be unable to continue our operations.

The concentration of our employees, manufacturers and customers in Japan, the People's Republic of China ("PRC"), Korea, Taiwan and Singapore increases our risk that a natural disaster, or a work stoppage, or economic or political instability in the region could have a material adverse effect on our business, financial condition or results of operations.

Most of our current manufacturers and customers are located in the PRC, Japan, Korea, Taiwan or Singapore. In addition, a majority of our employees are located in this region. Disruptions from natural disasters, health epidemics and political, social and economic instability may affect the region and would have a negative impact on our results of operations. In addition, the economy of the PRC differs from the economies of many countries in respects such as structure, government involvement, level of development, growth rate, capital reinvestment, allocation of resources, self-sufficiency, rate of inflation, foreign currency flows and balance of payments position, among others. We cannot be assured that the PRC's economic policies will be consistent or effective. Our results of operations and financial position may be harmed by changes in the PRC's political, economic or social conditions.

In addition, the risk of natural disasters in the Pacific Rim region, such as the March 2011 earthquake and tsunami in Japan, is significant due to the proximity of major earthquake fault lines in the area. Although we are not currently experiencing adverse effects to our business from the March 2011 earthquake and tsunami in Japan, common consequences of earthquakes include power outages and disruption or impairment of production capacity. Other natural disasters or events such as political unrest, labor strikes or work stoppages in countries where our manufacturers and customers are located, would likely result in the disruption of our manufacturers' and customers' operations. Any disruption resulting from these types of events could cause significant delays in shipments of our products until we are able to shift our manufacturing from the affected contractor to another third-party vendor. There can be no assurance that alternative capacity could be obtained on favorable terms, or in a timely manner, if at all.

Because of our long product development process and sales cycles, we may incur substantial costs before we earn associated revenue and ultimately may not sell as many units of our products as we originally anticipated.

We develop products based on anticipated market and customer requirements and incur substantial product development expenditures, which can include the payment of large up-front, third-party license fees and royalties, prior to generating associated revenue. Our work under these projects is technically challenging and places considerable demands on our limited resources, particularly on our most senior engineering talent. Because the development of our products incorporates not only our complex and evolving technology but also our customers' specific requirements, a lengthy sales process is often required before potential customers begin the technical evaluation of our products. Our customers typically perform numerous tests and extensively evaluate our products before incorporating them into their systems. The time required for testing, evaluation and design of our products into a customer's system can take up to nine months or more. It can take an additional nine months or longer before a customer commences volume shipments of systems that incorporate our products.

Because of the lengthy development and sales cycles, we will experience delays between the time we incur expenditures for research and development, sales and marketing and inventory and the time we generate revenue, if any, from these expenditures. Additionally, if actual sales volumes for a particular product are substantially less than originally anticipated, we may experience large write-offs of capitalized license fees, software development tools, product masks, inventories or other capitalized or deferred product-related costs, or increased amortization of non-cancelable prepaid royalties, any of which would negatively affect our operating results. For example, our provisions for obsolete inventory and lower of cost or market write-downs were $1.6 million and $1.2 million in 2010 and 2009, respectively and $0.3 million for the nine months ended September 30, 2011.

We may be unable to successfully manage any future growth, including the integration of any future acquisition or equity investment, which could disrupt our business and severely harm our financial condition.

We may determine that it is beneficial to increase our capacity to develop new and enhanced products in the future. If we fail to effectively manage internal growth, our operating expenses may increase more rapidly than our revenue, adversely affecting our financial condition and results of operations. To manage any future growth effectively in a rapidly evolving market, we must be able to maintain and improve our operational and financial systems, train and manage our employee base and attract and retain qualified personnel with relevant experience. We must also manage multiple relationships with customers, business partners, contract manufacturers, suppliers and other third parties. We could spend substantial amounts of time and money in connection with expansion efforts for which we may not realize any profit. Our systems, procedures, controls or financial resources may not be adequate to support our operations and we may not be able to grow quickly enough to exploit potential market opportunities.

In addition, we may not be able to successfully integrate the businesses, products, technologies or personnel of any entity that we might acquire in the future, and any failure to do so could disrupt our business and seriously harm our financial condition.

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A significant amount of our revenue comes from a limited number of customers and distributors, exposing us to increased credit risk and subjecting our cash flow to the risk that any of our customers or distributors could decrease or cancel its orders.

The display manufacturing market is highly concentrated and we are, and will continue to be, dependent on a limited number of customers and distributors for a substantial portion of our revenue. Sales to our top distributor represented 52%, 44% and 35% of revenue for the nine month period ended September 30, 2011 and the years ended December 31, 2010 and 2009, respectively. Revenue attributable to our top five end customers represented 55%, 58% and 56% of revenue for the nine month period ended September 30, 2011 and the years ended December 31, 2010 and 2009, respectively. As of September 30, 2011 and 2010, we had three accounts that each represented 10% or more of accounts receivable. All of the orders included in our backlog are cancelable. A reduction, delay or cancellation of orders from one or more of our significant customers, or a decision by one or more of our significant customers to select products manufactured by a competitor or to use its own internally-developed semiconductors, would significantly impact our revenue. Further, the concentration of our accounts receivable with a limited number of customers increases our credit risk. The failure of these customers to pay their balances, or any customer to pay future outstanding balances, would result in an operating expense and reduce our cash flows.

Our dependence on selling to distributors and integrators increases the complexity of managing our supply chain and may result in excess inventory or inventory shortages.

Selling to distributors and original equipment manufacturers ("OEMs") that build display devices based on specifications provided by branded suppliers, also referred to as integrators, reduces our ability to forecast sales accurately and increases the complexity of our business. Our sales are made on the basis of customer purchase orders rather than long-term purchase commitments. Our distributors, integrators and customers may cancel or defer purchase orders at any time but we must order wafer inventory from our contract manufacturers three to four months in advance.

The estimates we use for our advance orders from contract manufacturers are based, in part, on reports of inventory levels and production forecasts from our distributors and integrators, which act as intermediaries between us and the companies using our products. This process requires us to make numerous assumptions concerning demand and to rely on the accuracy of the reports and forecasts of our distributors and integrators, each of which may introduce error into our estimates of inventory requirements. Our failure to manage this challenge could result in excess inventory or inventory shortages that could materially impact our operating results or limit the ability of companies using our semiconductors to deliver their products. For example, we overestimated demand for certain of our products which led to significant charges for obsolete inventory in 2010, 2009 and 2008. On the other hand, if we underestimate demand, we would forego revenue opportunities, lose market share and damage our customer relationships.

International sales account for almost all of our revenue, and if we do not successfully address the risks associated with international sales and operations, our revenue and expenses could be adversely affected.

Sales outside the U.S. accounted for approximately 98%, 96% and 97% of revenue for the nine month period ended September 30, 2011 and the years ended December 31, 2010 and 2009, respectively. We anticipate that sales outside the U.S. will continue to account for a substantial portion of our revenue in future periods. In addition, customers who incorporate our products into their products sell a substantial portion of their products outside of the U.S., and all of our products are manufactured outside of the U.S. We are, therefore, subject to many international risks, including, but not limited to:

- difficulties in managing international distributors and manufacturers due to varying time zones, languages and business customs;
- compliance with U.S. laws affecting operations outside of the U.S., such as the Foreign Corrupt Practices Act;
- foreign currency exchange fluctuations in the currencies of Japan, the PRC, Taiwan or Korea;
- reduced or limited protection of our IP, particularly in software, which is more prone to design piracy;
- difficulties in collecting outstanding accounts receivable balances;
- changes in tax laws and the interpretation of those laws;
- difficulties regarding timing and availability of export and import licenses;

- political and economic instability, particularly in the PRC, Japan, Taiwan, or Korea;
- difficulties in maintaining sales representatives outside of the U.S. that are knowledgeable about our industry and products;
- changes in the regulatory environment in the PRC, Japan, Taiwan and Korea that may significantly impact purchases of our products by our customers;

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- outbreaks of health epidemics in the PRC or other parts of Asia;
- imposition of new tariffs, quotas, trade barriers and similar trade restrictions on our sales; and
- greater vulnerability to infrastructure and labor disruptions than established markets.

All of these factors could result in increased costs or decreased revenues, and could materially affect our product sales, financial condition and results of operations.

Additionally, we have employees located in offices in Japan, Taiwan, Korea and the PRC and as such, a portion of our operating expenses as well as foreign income taxes payable 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 analyze our exposure to foreign currency fluctuations and may engage in financial hedging techniques in the future to attempt to minimize the effect of these potential fluctuations; however, foreign currency exchange rate fluctuations may adversely affect our financial results in the future.

Continued compliance with regulatory and accounting requirements will be challenging and will require significant resources.

We spend a significant amount of management time and external resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including evolving Securities and Exchange Commission rules and regulations, NASDAQ Global Market rules, the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Sarbanes-Oxley Act of 2002 which requires management’s annual review and evaluation of internal control over financial reporting. Failure to comply with these laws and rules could lead to investigation by regulatory authorities, de-listing from the NASDAQ Global Market, or penalties imposed on us. If we are unable to maintain an effective system of internal controls, our shareholders could lose confidence in the accuracy and completeness of our financial reports which in turn could cause our stock price to decline.

Our net operating loss carryforwards may be limited or they may expire before utilization.

As of December 31, 2010, we had federal, state and foreign net operating loss carryforwards of approximately $173.1 million, $73.5 million and $0.4 million, respectively, which expire between 2011 and 2027. These net operating loss carryforwards may be used to offset future taxable income and thereby reduce our U.S. federal income taxes otherwise payable. Section 382 of the Internal Revenue Code of 1986, as amended (the “Code”), imposes an annual limit on the ability of a corporation that undergoes an “ownership change” to use its net operating loss carry forwards to reduce its tax liability. In the event of certain changes in our shareholder base, we may at some point in the future experience an “ownership change” as defined in Section 382 of the Code. Accordingly, our use of the net operating loss carryforwards may be limited by the annual limitations described in Section 382 of the Code. In addition, all or a portion of these net operating loss carryforwards may expire unutilized.

Our effective income tax rate is subject to unanticipated changes in, or different interpretations of tax rules and regulations and forecasting our effective income tax rate is complex and subject to uncertainty.

As a global company, we are subject to taxation by a number of taxing authorities and as such, our tax rates vary among the jurisdictions in which we operate. Unanticipated changes in our tax rates could affect our future results of operations. Our effective tax rates could be adversely affected by changes in the mix of earnings in countries with differing statutory tax rates, changes in tax laws or the interpretation of tax laws either in the United States or abroad, or by changes in the valuation of our deferred tax assets and liabilities. The ultimate outcomes of any future tax audits are uncertain, and we can give no assurance as to whether an adverse result from one or more of them would have a material effect on our operating results and financial position.

The computation of income tax expense is complex as it is based on the laws of numerous tax jurisdictions and requires significant judgment on the application of complicated rules governing accounting for tax provisions under U.S. generally accepted accounting principles. Income tax expense for interim quarters is based on our forecasted tax rate for the year, which includes forward looking financial projections, including the expectations of profit and loss by jurisdiction, and contains numerous assumptions. For these reasons, our tax rate may be materially different than our forecast.

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Company Risks Related to the Semiconductor Industry and Our Markets

Our highly integrated products and high-speed mixed signal products are difficult to manufacture without defects and the existence of defects could result in increased costs, delays in the availability of our products, reduced sales of products or claims against us.

The manufacture of semiconductors is a complex process and it is often difficult for semiconductor foundries to produce semiconductors free of defects. Because many of our products are more highly integrated than other semiconductors and incorporate mixed signal analog and digital signal processing, multi-chip modules and embedded memory technology, they are even more difficult to produce without defects. Defective products can be caused by design or manufacturing difficulties. Therefore, identifying quality problems can occur only by analyzing and testing our semiconductors in a system after they have been manufactured. The difficulty in identifying defects is compounded because the process technology is unique to each of the multiple semiconductor foundries we contract with to manufacture our products. Despite testing by both our customers and us, errors or performance problems may be found in existing or new semiconductors.

Failure to achieve defect-free products may result in increased costs and delays in the availability of our products. Additionally, customers could seek damages from us for their losses and shipments of defective products may harm our reputation with our customers. We have experienced field failures of our semiconductors in certain customer applications that required us to institute additional testing. As a result of these field failures, we have incurred warranty costs due to customers returning potentially affected products and have experienced reductions in revenues due to delays in production. Our customers have also experienced delays in receiving product shipments from us that resulted in the loss of revenue and profits. In 2010, for example, we incurred higher than expected yield losses due to defective third party IP incorporated into certain of our products, which resulted in higher direct material cost and a temporary inability to meet our customer's requested demand. Although we were able to resolve the issue without incurring material losses and have implemented additional processes to control this type of risk, similar issues may occur again in the future. Additionally, shipments of defective products could cause us to lose customers or to incur significant replacement costs, either of which would harm our business.

The development of new products is extremely complex and we may be unable to develop our new products in a timely manner and without defects, errors or bugs, or at all, which would result in a failure to obtain new design wins and/or maintain our current revenue levels.

The development of semiconductors is a complex process and many of our products are highly integrated and incorporate mixed analog and digital signal processing, multichip modules and embedded memory technology, further complicating the development process. In addition to the inherent difficulty of designing complex ICs, product development delays may result from:

- difficulties in hiring and retaining necessary technical personnel;
- difficulties with contract manufacturers;
- difficulties in reallocating engineering resources and overcoming resource limitations;
- changes to product specifications and customer requirements;
- changes to market or competitive product requirements; and
- unanticipated engineering complexities.

Even if we are able to meet our customers' design windows, the highly complex products we provide to our customers may contain defects, errors and bugs when they are first introduced. We have in the past and may in the future experience these defects, errors and bugs. In addition, if any of our products do contain defects, errors or bugs when first introduced, we may be unable to correct the problems at an acceptable cost or at all. Consequently, our reputation may be damaged and customers may be reluctant to buy our products, which could harm our ability to retain existing customers and to attract new customers. In addition, any defects, errors or bugs could interrupt or delay sales of our new products to our customers. If we are not successful in development of new products, our financial results will be adversely affected.

We use a customer-owned tooling process for manufacturing most of our products which exposes us to the possibility of poor yields and unacceptably high product costs.

We build most of our products on a customer-owned tooling basis, also known in the semiconductor industry as COT, whereby we directly contract the manufacture of our products, including wafer production, assembly and test. As a result, we are subject to increased risks arising from wafer manufacturing yields and risks associated with coordination of the manufacturing, assembly and testing process. Poor product yields result in higher product costs, which could make our products less competitive if we increase our prices to compensate for our higher costs, or could result in lower gross profit margins if we do not increase our prices.

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Intense competition in our markets may reduce sales of our products, reduce our market share, decrease our gross profit and result in large losses.

We compete with specialized and diversified electronics and semiconductor companies that offer display processors or scaling components. Some of these include CSR plc, i-Chips Technologies Inc., Intersil Corporation, MediaTek Inc., MStar Semiconductor, Novatech Co., Ltd.Inc., Realtek Semiconductor Corp., Renesas Electronics America, Sigma Designs, Inc., Silicon Image, Inc., STMicroelectronics N.V., Sunplus Technology Co., Ltd., Trident Microsystems, Inc. and other companies. Potential and current competitors may include diversified semiconductor manufacturers and the semiconductor divisions or affiliates of some of our customers, including LG Electronics, Inc., Matsushita Electric Industrial Co., Ltd., Mitsubishi Digital Electronics America, Inc., NEC Corporation, NVIDIA Corporation, Samsung Electronics Co., Ltd., SANYO Electric Co., Ltd., Seiko Epson Corporation, Sharp Electronics Corporation, Sony Corporation, Texas Instruments Incorporated and Toshiba America, Inc. In addition, start-up companies may seek to compete in our markets.

Many of our competitors have longer operating histories and greater resources to support development and marketing efforts than we do. Some of our competitors operate their own fabrication facilities. These competitors may be able to react more quickly and devote more resources to efforts that compete directly with our own. Our current or potential customers have developed, and may continue to develop, their own proprietary technologies and become our competitors. Increased competition from both competitors and our customers' internal development efforts could harm our business, financial condition and results of operations by, for example, increasing pressure on our profit margin or causing us to lose sales opportunities. In 2010 and 2011, for example, frame rate conversion technology similar to that used in our line of MotionEngine® advanced video co-processors continued to be integrated into the system-on-chip ("SoC") products of our competitors, particularly in lower refresh rate television products. We cannot assure you that we can compete successfully against current or potential competitors.

If we are not able to respond to the rapid technological changes and evolving industry standards in the markets in which we compete, or seek to compete, our products may become less desirable or obsolete.

The markets in which we compete or seek to compete are subject to rapid technological change and miniaturization capabilities, frequent new product introductions, changing customer requirements for new products and features and evolving industry standards. The introduction of new technologies and emergence of new industry standards could render our products less desirable or obsolete, which could harm our business and significantly decrease our revenue. Examples of changing industry standards include the growing use of broadband to deliver video content, increased display resolution and size, faster screen refresh rates, video capability such as high definition and 3D, the proliferation of new display devices and the drive to network display devices together. Our products are incorporated into our customers' products, which have different parts and specifications and utilize multiple protocols that allow them to be compatible with specific computers, video standards and other devices. If our customers' products are not compatible with these protocols and standards, consumers will return, or not purchase, these products and the markets for our customers' products could be significantly reduced. Additionally, if the technology used by our customers becomes less competitive due to cost, customer preferences or other factors relative to alternative technologies, sales of our products could decline.

Shortages of materials used in the manufacturing of our products and other key components of our customers' products may increase our costs, impair our ability to ship our products on time and delay our ability to sell our products.

From time to time, shortages of components and materials that are critical to the manufacture of our products and our customers' products may occur. Such critical components and materials include semiconductor wafers and packages, double data rate memory die, display components, analog-to-digital converters, digital receivers, video decoders and voltage regulators. If material shortages occur, we may incur additional costs or be unable to ship our products to our customers in a timely fashion, both of which could harm our business and adversely affect our results of operations. Our contract manufacturers may be required to source these components from alternate vendors, which would require us to re-qualify our parts with customers, which could cause delays in shipments. Our customers are also currently evaluating whether material shortages will decrease their ability to produce and ship their products. Although these risks have not materially adversely affected our business, financial condition or results of operations to date we cannot assure you that such risks will not do so in the future.

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Our developed software may be incompatible with industry standards and challenging and costly to implement, which could slow product development or cause us to lose customers and design wins.

We provide our customers with software development tools and with software that provides basic functionality for our ICs and enables enhanced connectivity of our customers' products. Software development is a complex process and we are dependent on software development languages and operating systems from vendors that may limit our ability to design software in a timely manner. Also, as software tools and interfaces change rapidly, new software languages introduced to the market may be incompatible with our existing systems and tools, requiring significant engineering efforts to migrate our existing systems in order to be compatible with those new languages. Software development disruptions could slow our product development or cause us to lose customers and design wins. The integration of software with our products adds complexity, may extend our internal development programs and could impact our customers' development schedules. This complexity requires increased coordination between hardware and software development schedules and increases our operating expenses without a corresponding increase in product revenue. This additional level of complexity lengthens the sales cycle and may result in customers selecting competitive products requiring less software integration.

The competitiveness and viability of our products could be harmed if necessary licenses of third-party technology are not available to us on terms that are acceptable to us or at all.

We license technology from independent third parties that is incorporated into our products or product enhancements. Future products or product enhancements may require additional third-party licenses that may not be available to us on terms that are acceptable to us or at all. In addition, in the event of a change in control of one of our licensors, it may become difficult to maintain access to its licensed technology. If we are unable to obtain or maintain any third-party license required to develop new products and product enhancements, we may have to obtain substitute technology with lower quality or performance standards, or at greater cost, either of which could seriously harm the competitiveness of our products.

Our limited ability to protect our IP and proprietary rights could harm our competitive position by allowing our competitors to access our proprietary technology and to introduce similar products.

Our ability to compete effectively with other companies will depend, in part, on our ability to maintain the proprietary nature of our technology, including our semiconductor designs and software code. We provide the computer programming code for our software to customers in connection with their product development efforts, thereby increasing the risk that customers will misappropriate our proprietary software. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to help protect our proprietary technologies. We hold 114 patents and have 25 patent applications pending for protection of our significant technologies. Competitors in both the U.S. and foreign countries, many of whom have substantially greater resources than we do, may apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell our products, or they may develop similar technology independently or design around our patents. Effective patent, copyright, trademark and trade secret protection may be unavailable or limited in foreign countries.

We cannot assure you that the degree of protection offered by patent or trade secret laws will be sufficient. Furthermore, we cannot assure you that any patents will be issued as a result of any pending applications or that any claims allowed under issued patents will be sufficiently broad to protect our technology. In addition, it is possible that existing or future patents may be invalidated, diluted, circumvented, challenged or licensed to others.

Others may bring infringement actions against us that could be time consuming and expensive to defend.

We may become subject to claims involving patents or other IP rights. IP claims could subject us to significant liability for damages and invalidate our proprietary rights. In addition, IP claims may be brought against customers that incorporate our products in the design of their own products. These claims, regardless of their success or merit and regardless of whether we are named as defendants in a lawsuit, would likely be time consuming and expensive to resolve and would divert the time and attention of management and technical personnel. Additionally, certain of our customer agreements include indemnification provisions for claims from third-parties related to our IP. Any IP litigation or claims also could force us to do one or more of the following:

- stop selling products using technology that contains the allegedly infringing IP;
- attempt to obtain a license to the relevant IP, which may not be available on terms that are acceptable to us or at all;

- attempt to redesign those products that contain the allegedly infringing IP; or
- pay damages for past infringement claims that are determined to be valid or which are arrived at in settlement of such litigation or threatened litigation.

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If we are forced to take any of the foregoing actions, we may incur significant additional costs or be unable to manufacture and sell our products, which could seriously harm our business. In addition, we may not be able to develop, license or acquire non-infringing technology under reasonable terms. These developments could result in an inability to compete for customers or otherwise adversely affect our results of operations.

We are dependent on manufacturers of our semiconductor products not only to respond to changes in technology and industry standards but also to continue the manufacturing processes on which we rely.

To respond effectively to changes in technology and industry standards, we are dependent on our foundries to implement advanced semiconductor technologies and our operations could be adversely affected if those technologies are unavailable, delayed or inefficiently implemented. In order to increase performance and functionality and reduce the size of our products, we are continuously developing new products using advanced technologies that further miniaturize semiconductors and we are dependent on our foundries to develop and provide access to the advanced processes that enable such miniaturization. We cannot be certain that future advanced manufacturing processes will be implemented without difficulties, delays or increased expenses. Our business, financial condition and results of operations could be materially adversely affected if advanced manufacturing processes are unavailable to us, substantially delayed or inefficiently implemented.

Creating the capacity for new technological changes may cause manufacturers to discontinue older manufacturing processes in favor of newer ones. We must then either retire the affected part or port (develop) a new version of the part that can be manufactured with a newer process technology. In the event that a manufacturing process is discontinued, our current suppliers may be unwilling or unable to manufacture our current products. We may not be able to place last time buy orders for the old technology or find alternate manufacturers of our products to allow us to continue to produce products with the older technology while we expend the significant costs for research and development and time to migrate to new, more advanced processes. For example, we utilize 0.18um and 0.15um standard logic processes, which may only be available for the next five to seven years. Additionally, a portion of our products use 0.11um technology for memory die, which is being phased out in favor of 65nm technology node (memory die) to increase yields and decrease cost. Because of this transition, our customers must re-qualify the affected parts.

Our products are characterized by average selling prices that decline over relatively short periods of time, which will negatively affect our financial results unless we are able to reduce our product costs or introduce new products with higher average selling prices.

Average selling prices for our products decline over relatively short periods of time, while many of our product costs are fixed. When our average selling prices decline, our gross profit declines unless we are able to sell more units or reduce the cost to manufacture our products. We have experienced declines in our average selling prices and expect that we will continue to experience them in the future, although we cannot predict when they may occur or how severe they will be. Our financial results will suffer if we are unable to offset any reductions in our average selling prices by increasing our sales volumes, reducing our costs, adding new features to our existing products or developing new or enhanced products in a timely manner with higher selling prices or gross profits.

The cyclical nature of the semiconductor industry may lead to significant variances in the demand for our products and could harm our operations.

In the past, the semiconductor industry has been characterized by significant downturns and wide fluctuations in supply and demand. Also, the industry has experienced significant fluctuations in anticipation of changes in general economic conditions, including economic conditions in Asia, Europe and North America. The cyclical nature of the semiconductor industry has also led to significant variances in product demand and production capacity. We have experienced, and may continue to experience, periodic fluctuations in our financial results because of changes in industry-wide conditions.

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Environmental laws and regulations have caused us to incur, and may again cause us to incur, significant expenditures to comply with applicable laws and regulations, and we may be assessed considerable penalties for noncompliance.

We are subject to numerous environmental laws and regulations. Compliance with current or future environmental laws and regulations could require us to incur substantial expenses which could harm our business, financial condition and results of operations. We have worked, and will continue to work, with our suppliers and customers to ensure that our products are compliant with enacted laws and regulations. Failure by us or our contract manufacturers to comply with such legislation could result in customers refusing to purchase our products and could subject us to significant monetary penalties in connection with a violation, either of which would have a material adverse effect on our business, financial condition and results of operations. Current environmental laws and regulations could become more stringent over time, imposing even greater compliance costs and increasing risks and penalties associated with violations, which could seriously harm our business, financial condition and results of operations. There can be no assurance that violations of environmental laws or regulations will not occur in the future as a result of our inability to obtain permits, human error, equipment failure or other causes.

Other Risks

The continued adverse global economic environment and volatility in global credit and financial markets could materially and adversely affect our business and results of operations.

Slow economic activity, increased unemployment, decreased business and consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns have contributed to and continue to contribute to a challenging economic environment. This environment has led to reduced spending in the markets in which we compete and made it difficult for our customers, our vendors and us to accurately forecast and plan future business activities. Furthermore, the constraints in the capital and credit markets may limit the ability of our customers to meet their liquidity needs, which could result in an impairment of their ability to make timely payments to us and to reduce their demand for our products, adversely impacting our results of operations and cash flows.

Future sales of our equity could result in significant dilution to our existing shareholders and depress the market price of our common stock.

We may need to seek additional capital from time to time. If this financing is obtained through the issuance of equity securities, debt convertible into equity securities, options or warrants to acquire equity securities or similar instruments or securities, our existing shareholders will experience dilution in their ownership percentage upon the issuance, conversion or exercise of such securities and such dilution could be significant. For example, in May 2011, we issued 4.2 million shares of our common stock in an underwritten registered offering. Further, new equity securities issued by us could have rights, preferences or privileges senior to those of our common stock.

In addition, any such issuance by us or sales of our securities by our security holders, or the perception that such issuances or sales could occur, could negatively impact the market price of our securities. For example, we have a number of institutional shareholders that own significant blocks of our common stock. If one or more of these shareholders were to sell large portions of their holdings in a relatively short time, for liquidity or other reasons, the prevailing market price of our common stock could be negatively affected. This could result in further potential dilution to our existing shareholders and the impairment of our ability to raise capital through the sale of equity, debt or other securities.

The price of our common stock has and may continue to fluctuate substantially.

Our stock price and the stock prices of technology companies similar to Pixelworks have been highly volatile. The price of our common stock may decline and the value of your investment may be reduced regardless of our performance.

The trading volume of our common stock each day is relatively low. As a result, our shareholders may be unable to sell significant quantities of common stock in the public trading markets without a significant reduction in the price of our common shares. Additionally, market fluctuations, as well as general economic and political conditions, including recessions, interest rate changes or international currency fluctuations, may negatively impact the market price of our common stock. Other factors that could negatively impact our stock price include:

- actual or anticipated fluctuations in our operating results;
- changes in expectations as to our future financial performance;

- changes in financial estimates of securities analysts;
- announcements by us or our competitors of technological innovations, design wins, contracts, standards, acquisitions or divestitures;
- the operating and stock price performance of other comparable companies;

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- issuances or proposed issuances of equity, debt or other securities by us, or sales of securities by our security holders; and
- changes in market valuations of other technology companies.

Any inability or perceived inability of investors to realize a gain on an investment in our common stock could have an adverse effect on our business, financial condition and results of operations by potentially limiting our ability to retain our customers, to attract and retain qualified employees and to raise capital.

We may be unable to maintain compliance with NASDAQ Marketplace Rules which could cause our common stock to be delisted from the NASDAQ Global Market. This could result in the lack of a market for our common stock, cause a decrease in the value of our common stock, and adversely affect our business, financial condition and results of operations.

On June 4, 2008, we effected a one-for-three reverse split of our common stock. We effected the reverse split to regain compliance with NASDAQ Marketplace Rules, particularly the minimum $1.00 per share requirement for continued inclusion on the NASDAQ Global Market. The per share price of our common stock has fluctuated significantly and was below $1.00 as recently as May 6, 2009. We cannot guarantee that it will remain at or above $1.00 per share and if the price again drops below $1.00 per share, the stock could become subject to delisting again, and we may seek shareholder approval for an additional reverse split. A second reverse split could produce adverse effects and may not result in a long-term or permanent increase in the price of our common stock. In addition to the minimum $1.00 per share requirement, NASDAQ Global Market also requires satisfaction of one of the following in addition to certain other requirements: (i) a minimum of $50.0 million in total asset value and $50.0 million in revenues (in the latest fiscal year or in two of the last three fiscal years), (ii) a minimum of $50.0 million in market value of listed securities, or (iii) a minimum of $10.0 million in stockholders' equity. As of September 30, 2011, we had a total asset value of less than $50.0 million and as recently as December 31, 2008, our shareholders' equity was below $10.0 million. In the future, we may be unable to meet these continued listing requirements and our stock could become subject to delisting.

If our common stock is delisted, trading of the stock will most likely take place on an over-the-counter market established for unlisted securities. An investor is likely to find it less convenient to sell, or to obtain accurate quotations in seeking to buy, our common stock on an over-the-counter market, and many investors may not buy or sell our common stock due to difficulty in accessing over-the-counter markets, or due to policies preventing them from trading in securities not listed on a national exchange or other reasons. For these reasons and others, delisting would adversely affect the liquidity, trading volume and price of our common stock, causing the value of an investment in us to decrease and having an adverse effect on our business, financial condition and results of operations by limiting our ability to attract and retain qualified executives and employees and limiting our ability to raise capital.

The anti-takeover provisions of Oregon law and in our articles of incorporation could adversely affect the rights of the holders of our common stock, including by preventing a sale or takeover of us at a price or prices favorable to the holders of our common stock.

Provisions of our articles of incorporation and bylaws and provisions of Oregon law may have the effect of delaying or preventing a merger or acquisition of us, making a merger or acquisition of us less desirable to a potential acquirer or preventing a change in our management, even if our shareholders consider the merger, acquisition or change in management favorable or if doing so would benefit our shareholders. In addition, these provisions could limit the price that investors would be willing to pay in the future for shares of our common stock. The following are examples of such provisions in our articles of incorporation or bylaws:

- our board of directors is authorized, without prior shareholder approval, to change the size of the board (our articles of incorporation provide that if the board is increased to eight or more members, the board will be divided into three classes serving staggered terms, which would make it more difficult for a group of shareholders to quickly change the composition of our board);
- our board of directors is authorized, without prior shareholder approval, to create and issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us or to effect a change of control, commonly referred to as "blank check" preferred stock;
-

members of our board of directors can be removed only for cause and at a meeting of shareholders called expressly for that purpose, by the vote of 75 percent of the votes then entitled to be cast for the election of directors; and

- our board of directors may alter our bylaws without obtaining shareholder approval; and shareholders are required to provide advance notice for nominations for election to the board of directors or for proposing matters to be acted upon at a shareholder meeting.

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Item 6. Exhibits.

31.1	Certification of Chief Executive Officer.
31.2	Certification of Chief Financial Officer.
32.1*	Certification of Chief Executive Officer.
32.2*	Certification of Chief Financial Officer.

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* Exhibits 32.1 and 32.2 are being furnished and shall not be deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or otherwise subject to the liability of that section, nor shall such exhibits be deemed to be incorporated by reference in any registration statement or other document filed under the Securities Act of 1933, as amended, or the Exchange Act, except as otherwise stated in such filing.

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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.

PIXELWORKS, INC.

Dated: November 4, 2011

/s/ Steven L. Moore
Steven L. Moore
Vice President, Chief Financial Officer, Secretary and Treasurer

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